Informed Decision Making (Shares) : Various Analysis Before Investment In Shares

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I. Analysis of anticipated risk and return from the point of customer: The objective of investment must be clearly decided before an investment decision is taken. It is on the basis of the objectives that as investor decide upon the type of share to be purchased. The objectives of portfolio are normally expressed in terms of risk and return. As already mentioned, risk and return have direct relationship – higher the return that one wishes to have from the investment portfolio, higher could be the risk that one has to take. Small caps generally have high level of anticipated risk and high level of anticipated returns, mid cap stocks generally heave mid size anticipated risk and medium returns and finally large caps have lower level of risk and comparatively moderate anticipated returns.

II. Economy Analysis: Economic analysis is a study of the economy that's part of fundamental analysis, which is a method investors use to make long-term investment decisions. Economic analysis examines whether economic conditions are favorable for a company's success. It involves looking at broad economic indicators, such as: GDP growth, Inflation rates, Unemployment rates, Interest rates, and Government fiscal policies.

Analysts also consider how economic activities affect corporate profits, investors, and share prices. They may make assumptions about future economic conditions, such as interest rates, inflation, and economic growth. However, these conditions are always changing and may not turn out as expected. **This analysis help us to decide as to in which country we should invest.**

III. Industry Analysis: After deciding the objectives of investment portfolio in terms of risk and returns have been specified, one of the first decisions that an investor faces is to identify the industries which have a high growth potential. Approaches suggested in this regard are :

1. **Statistical analysis of past performance** : A statistical analysis of the immediately past performance of the share price indices of the various industries and changes therein related to the general price index of shares of all industries should be made. The Reserve Bank of India publishes index number of security prices every month in it's bulletin which may be take to represent the behavior of share prices

of the various industries in the last few years. The relative changes in the price index of each industry as compared with the changes with the average price index of the of the shares of all industries would show those industries which are having a higher growth potential in the past few years. **It may be noted that an industry may not remain a growth industry for all time**. The analysis of share price indices over a number of years will enable the investor to identify the industries which are rated high by the market at the time of analysis. **Thus one shall know how to make an assessment of the various characteristics of the industries to finalize a list of industries in which he can spread his investment**.

Steps involved in industry analysis: As it has been discussed an appraisal of the particular industry's prospects is essential, since the basic profitability of any company depends upon the economic prospects of the industry to which it belongs. The following factors may in particular be kept in mind while assessing the factors relating to an industry:

1. Demand /supply pattern for the industry's products and it's growth potential: The most important aspect is to see the likely demand of the products of the industry and the gap between demand and supply. Ideally future demand and supply of the industry can be known by deducing next 10 years demand / supply forecast made by various agencies – Niti Aayog, Chamber of Coomerec and institutions like NCAER etc.
   Besides one should appreciate the fact of stages in product life cycle – introduction, development, rapid growth, maturity or saturation and decline.

2. Profitability: The cost structure of the industry as related to it's sale price is an important consideration. It is obvious that profitability in an industry is a vital consideration for the investor, since profit is both a measure of performance as well as a source of earning for him. He may analyze the profitability ratios, specially ROI, GP and NP ratio of existing companies in the industry.

3. Particular characteristics of the industry: Each industry has it's own characteristics, which must be studied in depth in order to understand their impact on the working of the industry. Industries with a fast changing technology they may encounter technological obsoleesence. Similarly, many other industrie are characterized by high rate of profit and losses alternate year and facing seasonal fluctuation cycles.

4. Labour management relations in the industry: The state of labour –management relationship in the particular industry also has a great deal of influence on the future profitability of the industry. Whetherthe industry under analysis has been maintaining a cordial relationship between labour and management.

III. Company Analysis: To select a company for investment purposes is the last one in the chain of decisions. Before selecting a company for investment a number of qualitative factors have to be seen. Relevant information must be collected and analyzed properly analyzed. It must be emphasized that past performance and information is relevant only to the extent indicates the future trends. **Hence the investor has to visualize the performance of the company in future by analyzing it's past performance.**

1. Size and Ranking: A rough idea regarding the size and ranking of the company within the economy, in general and the industry in particular would help the investor in assessing the risk associated with the company. For this purpose net capital employed, the net profit, ROI and the Sales figures of the company under consideration may be compared with similar data similar data of other companies in the same industry group. It is also useful to assess position of technical know how, research and development activity and price leadership.

2. Growth Record: the growth in sales, net income, net capital employed and earning per share of the company in the past few years should be examined. **Most important growth indicators are (a). P/E Ratio, (b). % growth of earning per annum and (c). % growth rate of net block**.

The **P/E ratio** is again the most important indicator for the investor among all three. It shows the number of times the earning per share are covered by the market price of the share. By comparison of this ratio pertaining to different companies the investment manager can have an idea about the image of the company and can determine whether the share is under-priced or over-priced. It is one of the most important factors on the basis of which the investor takes a decision to purchase the share. This is because it relates the market price of the shares and **the earning per share (EPS).**

Earning per share (EPS) can not be sole basis to decide about growth prospects but still it is one of them

The **percentage growth rate of Net Block** shows how the company has been developing it's capacity level. Dynamic company keeps on investing and diversifying it's business.

3. Management Analysis: This is an intangible factor. Yet it has a very important bearing on the values of the shares. Quality of management, the confidence that investor has in a particular business house, it's policies vis-à-vis its relationship with the investors, dividend and financial performance record of other companies in the same group.

The management. They are responsible for the future of the company and have the power to make decisions and formulate policies that impact the business. Under good management, a company can do wonders. But under bad management, even a strong company can fall apart. So it makes sense to study the management; find out – how experienced they are, how their decisions have contributed to the company's growth, and so on.

Attend or listen to recordings of earnings calls and shareholder meetings to understand how management communicates its vision and handles tough questions.

Research how the management team has handled past crises or significant challenges. Successful navigation through difficult times can be a positive indicator of strong leadership.

Look into the company's corporate governance policies. A transparent and accountable governance structure often reflects a well-managed company. This information is typically available in the annual report or corporate governance section of the company's website.

By understanding the management's experience and past decision-making, you may better assess the company's potential. Evaluating how they communicate, handle crises, and follow corporate governance practices can provide valuable insights into the company's leadership quality.

4. Financial Analysis : An analysis of company's financial statements for the past few years would help the investment manager in understanding the **financial solvency and liquidity, the efficiency with which the funds are used, the profitability, the operating efficiency and financial & operating leverage.** These are some of the important parameters to be considered before investment. Previous 10 years EPS, P/E, Yield, Book Value & intrinsic value of the share may be calculated. Other ratios to measure profitability, operating efficiency and turnover efficiency should be calculated. Calculation of Financial Solvency and Liquidity may also support in informed decision making.

Pattern of existing stock holding: An analysis of existing stock holding of the company would also be relevant. This would show the stake of various parties in the company. Shares of a company are held by not only retail investors but also promoters, domestic and foreign institutional investors, mutual funds, employees and so on. A change in the holdings of such stakeholders reveals their outlook on the company. For instance:

Promoters: As key personnel, promoters of a company have great control over its affairs, directly or indirectly. They have high stakes in the company. Therefore, a decreasing promoter holding trend may be a red flag as it can indicate that promoters themselves are not positive about the prospects of the company.

Institutional and mutual fund holdings: These stakeholders transact stock in bulk. Therefore, a change in their holdings also indicates their outlook for the stock. If you see high buying activity in stock, the big investors are probably positive about the company's growth. The opposite is also true.

Example of importance of Share holding pattern: Life Insurance Corporation and other financial institutions had a substantial holding when the bank was nationalized. The residual company proposed a scheme whereby those shareholders, who wish to opt out, could receive a certain amount as compensation in cash. It was only at the instance and the bargaining strength of institutional investors that the compensation offered to the shareholders, who wishes to opt out of the company was raised considerably.

5. Marketability of the Shares: Another important consideration for an investor is the marketability of the shares of the company. Mere listing of a share on the stock exchange does not automatically means that the share can be sold or purchased at will. There may be many shares which remain inactive for a long periods with no transaction being effected.

6. Latest Information of the company: News and developments can significantly impact a company's stock price. Positive news, such as a successful product launch or an increase in market share, might boost the stock price. Conversely, negative news, like a regulatory fine or a decline in sales, might cause the stock price to drop.

   By keeping track of the latest news, you can better understand how these events might affect the companies you are interested in. This understanding can help you make more informed investment decisions.

7. You need to analyse how the stock you want to invest in has performed compared to its peers. It is crucial to compare similar stocks—meaning you should compare a small-cap stock with other small-cap stocks, not with large-cap stocks. Here are some questions you can answer to make an effective comparison:

   Return Analysis Over Specific Timeframes

   How much returns has the stock generated over specific timelines, such as 1 year, 5 years, and 10 years? By looking at these time periods, you can see if the stock has consistently delivered strong returns or if it has been more volatile compared to its peers.

   Competitive Edge

   Does the company have a competitive edge over its peers? This could include unique products, innovative technology, strong brand loyalty, or significant market share. A competitive edge may indicate the company's ability to maintain and grow its market position.

   Upcoming Projects

   What are the company's upcoming projects, and how will these projects make the company better than its peers? Understanding the company's future initiatives can provide insights into its growth potential and strategic direction.

   Price-to-Earnings (PE) Ratio

   What is the PE ratio of the company compared to its peers? The PE ratio can help you determine if the stock is overvalued or undervalued relative to its peers, providing a sense of market expectations for future growth.

   Dividend Analysis

   What has been the company's dividend per share, dividend yield, and dividend growth rate compared to its peers? If dividends are important to you, comparing these metrics can show you which companies offer better returns in terms of dividends.

8. **Momentum Analysis.** Technical traders usually want to identify strong, up trending stocks for potential buys and weak down trending stocks for shorts. One way to find them is to use moving averages, which are trend-following indicators that smooth out day-to-day price movements to show a stock's general direction over time. Moving averages can also act as support and resistance levels. **Support** is an area on the chart where downward trends seem to find a floor as buying pressure overcomes selling pressure. **Resistance** is often a price area where the upward trends start to fizzle as selling pressure overcomes buying pressure.

   ▪ **A simple moving average** is calculated by averaging a stock's closing prices over a defined period. Many traders use 20 days as a starting point, but you can use different periods according to your trading style.

- A momentum trader going long might ask, is a stock trading above its 20-day moving average? Has its 20-day moving average broken above its 50-day moving average? A trader looking to short a stock might search for one trading below its 20-day moving average and has a 20-day moving average below its 50-day moving average. You might narrow the list further by looking for stocks that trade at least 200,000 shares per day.

9. Scanning charts: After compiling a list of candidates, it's time to look for those with good entry points. Two common entry strategies are either to look for breakouts in the direction of the trend—for example, stocks experiencing a sharp upward movement in price—or to look for pullbacks, which are short-term moves in the opposite direction of the longer-term trend. For breakouts on longs, an entry point could be the first or second new high after the stock has traded sideways for a few days. For breakouts on shorts, an entry point could be the first or second new low after a few days of sideways movement. With the pullback strategy, you may want to see the stock correct for a few days in the direction opposite the trend. You might then consider buying into that short-term weakness on the longs or selling into that short-term strength on the shorts.

Fundamental Analysis Vs. Technical Analysis:

In trading, investing, and finance, two approaches help investors analyze markets and securities: fundamental and technical analysis. Each helps evaluate investment opportunities, and many traders blend both for a more comprehensive view. Fundamental analysis focuses on the quality of an asset, while technical analysis looks at market trends as an indicator of value.

Fundamental analysis is used in finance to evaluate the **intrinsic value, the real worth, of a security** or whole sectors and markets. For a company stock, fundamental analysis is used to scrutinize income statements, balance sheets, and cash flow statements. Fundamental analysis is generally for those looking for long-term value. **Technical analysis** evaluates financial assets, such as stocks, currencies, or commodities, by reviewing the historical price and volume data. Unlike fundamental analysis, which focuses on the intrinsic value of an asset, technical analysis examines the volume and price of shares over time.

Intrinsic Value for Share Brokers: *It is the real value of share calculated by the investor and it may not be equal to the Book Value of share.* Intrinsic value, also known as real value, is the estimated or calculated value of a stock, company, currency, or product. It's a theoretical concept that's based on both qualitative and quantitative factors, and it may or may not be the same as the current market price.