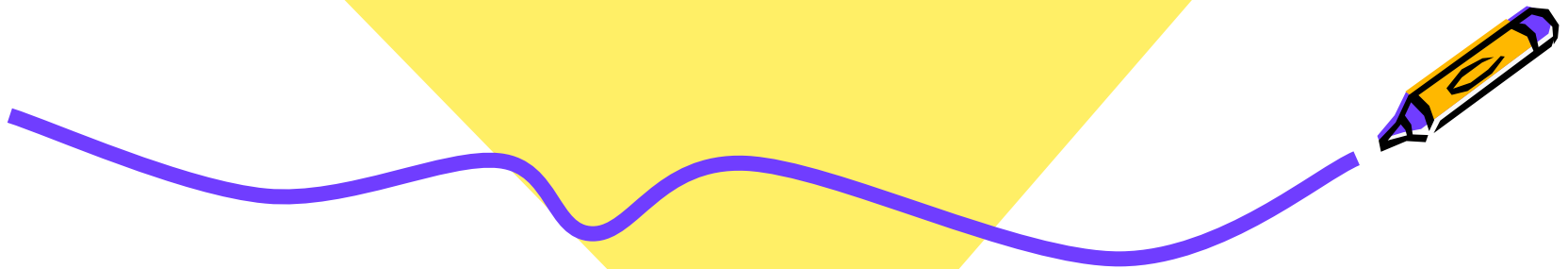




Introduction to Investments (Chapter 1)

B 661



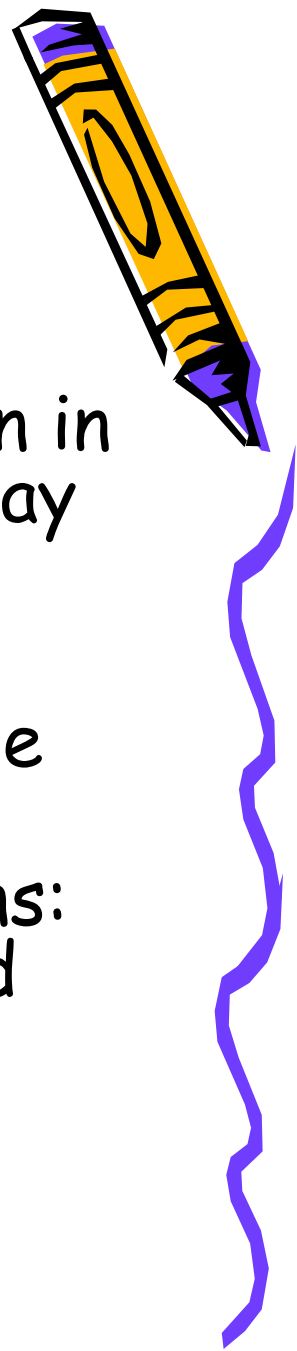
Meaning of Investments



- Commitment of money that is expected to generate additional money
- Current commitment of dollars for a period of time to desire future payments that will compensate the investor for
 - The time the funds are committed
 - The expected rate of inflation, and
 - The uncertainty of the future payments
- The investor can be an individual, a government, and/or a corporation

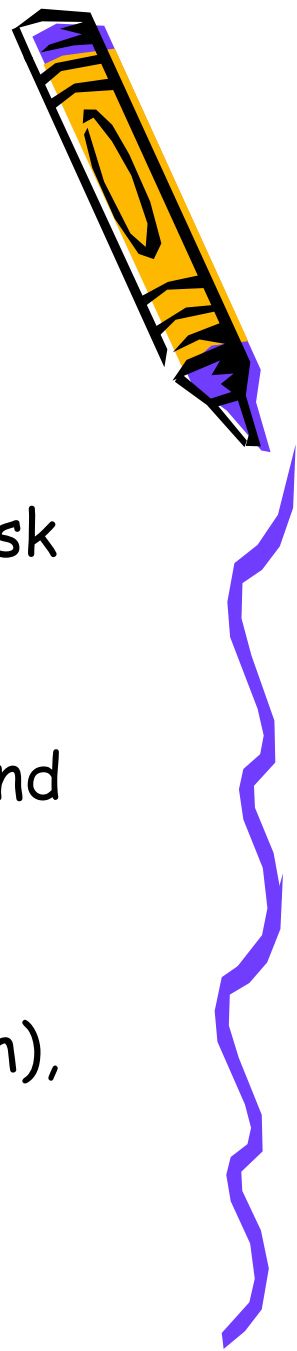


Why do individuals invest?



- To achieve a higher level of consumption in the future by forgoing consumption today
- To improve our welfare in the future
- Investments help us achieve tradeoff between current consumption and future consumption
- Basic element of all investment decisions: trade-off between expected return and risk





Why Study Investments?

- The Personal Aspects
 - To earn better returns in relation to the risk we assume when we invest
 - Knowledge of investments help investors understand the relationship between risk and return
- Investment as a Profession
 - To become a licensed broker (series 7 exam), to become CFA/CFP/CMA, knowledge of investments is needed



Investment Decisions



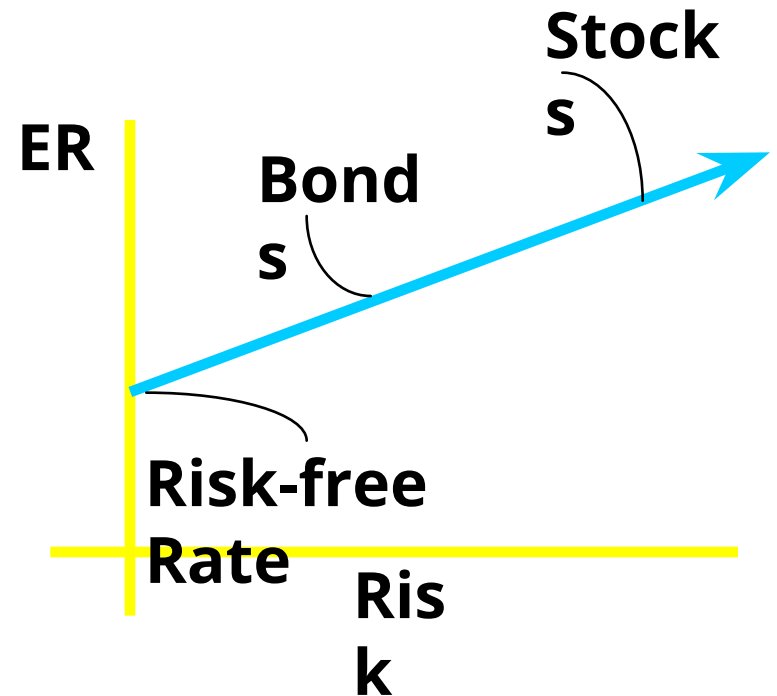
- Underlying investment decisions: the tradeoff between expected return and risk
 - Expected return is not usually the same as realized return
- Risk: the possibility that the realized return will be different than the expected return



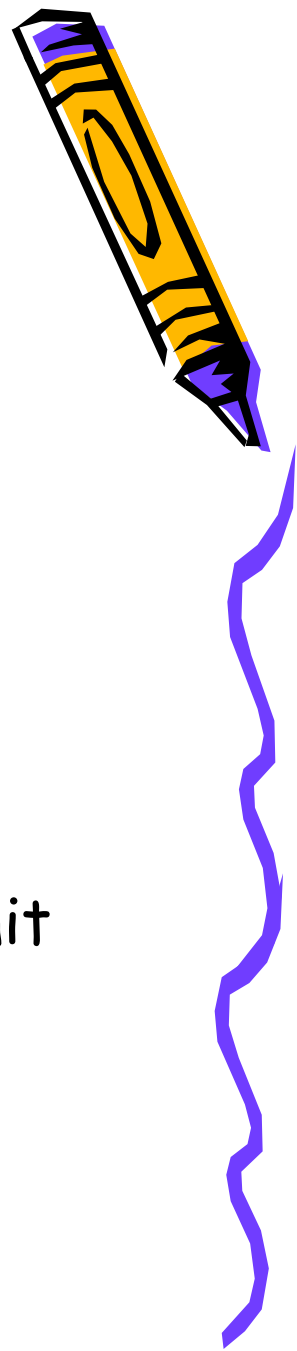
The Tradeoff Between ER and Risk



- Investors manage risk at a cost - lower expected returns (ER)
- Any level of expected return and risk can be attained



The Investment Decision Process



- Two-step process:
 - Security analysis and valuation
 - Necessary to understand security characteristics
 - Portfolio management
 - Selected securities viewed as a single unit
 - How efficient are financial markets in processing new information?
 - How and when should it be revised?
 - How should portfolio performance be measured?



Factors Affecting the Process



- Uncertainty in *ex post* returns dominates decision process
 - Future unknown and must be estimated
- Foreign financial assets: opportunity to enhance return or reduce risk
- Quick adjustments needed to a changing environment
- The Internet and investment opportunities
- Institutional investors important



Sources of Risk

- Interest Rate Risk
- Purchasing Power Risk
- Bull-Bear Market Risk
- Default Risk
- Liquidity Risk
- Callability Risk
- Convertibility Risk
- Political Risk

