**Capital Market and Portfolio Management**

**NMIMS Centre for Distance and Online Education (NCDOE)**

**Internal Assignment Applicable for April 2025 Examination**

**Q1. Mr. A is looking to invest some of his savings for the future. He has two options: stocks and bonds. He decides to visit his friend Mr. B, who is an experienced investor, to ask for some advice. Mr. B said "Think of stocks like owning a piece of a company. When you buy stocks, you're actually buying a small share of that company. But bonds are like loans you give to companies or governments. When you buy a bond, you're lending them money, and they promise to pay you back with interest over a set period. From investment adviser’s point of view how will you differentiate stock & bond?**

**Answer:**

**Introduction:**

Investing in stocks and bonds are two fundamental approaches to wealth creation, each carrying distinct characteristics, risks, and returns. Stocks represent ownership in a company, offering investors a share in its profits and potential growth. When an individual buys stocks, they become a shareholder, benefiting from capital appreciation and dividends. However, stock prices fluctuate due to market conditions, making them a riskier investment.

Bonds, on the other hand, function as debt instruments where investors lend money to corporations or governments in exchange for periodic interest payments and repayment of the principal amount at maturity. Bonds are generally considered safer than stocks, providing stable income with lower risk, though returns are often modest.

From an investment adviser's perspective, stocks suit those seeking high returns and long-term growth, whereas bonds are ideal for risk-averse investors prioritizing capital preservation and steady income. A balanced portfolio often includes both to optimize risk and returns.

**This is partially solved sample answer**

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**Q2. John, a new investor, is interested in putting his money into mutual funds but is worried about the risk. Suppose you are investing in mutual fund from several years, as a friend explain the different types of mutual funds that can help John in diversifying risk.**

**Answer:**

**Introduction:**

Mutual funds are an excellent way to invest while managing risk through diversification. As a friend with years of experience, I’d explain to John that mutual funds pool money from multiple investors and invest in a mix of stocks, bonds, or other assets, reducing the impact of individual market fluctuations.

There are various types of mutual funds to suit different risk levels. Equity funds offer high returns but come with greater risk, while debt funds provide stable income with lower risk. Balanced or hybrid funds combine both for moderate risk and steady growth. Index funds track market performance passively, and sector funds focus on specific industries. By selecting the right mix, John can build a well-diversified portfolio to balance risk and reward.

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**Q3a. Alpha takes in to an account the volatility of an asset & compares its risk adjusted performance to an already established benchmark index. If portfolio return is 30%, the risk-free rate is 8%, beta is 1.1, and the benchmark index return is 20% calculate alpha.**

**Answer:**

**Introduction:**

Alpha measures an investment's performance relative to a benchmark index, adjusting for risk. It indicates whether a portfolio has outperformed or underperformed the market after considering its risk level. A positive alpha suggests the portfolio has generated excess returns, while a negative alpha indicates underperformance.

Alpha is calculated using the formula:

$$α=Portfolio Return-[Risk-Free Rate+β(Benchmark Return-Risk-Free Rate)]$$

Using the given values, we can determine the portfolio’s alpha.

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**b. Arbitrage pricing theory helps investors to determine whether an asset is undervalued or overvalued. On the basis of this information investors can decide invest or not to invest. Arbitrage Pricing Theory is based on some assumption describe few of them.**

**Answer:**

**Introduction:**

Arbitrage Pricing Theory (APT) is a financial model that helps investors assess whether an asset is fairly priced by considering multiple macroeconomic factors affecting returns. Unlike the Capital Asset Pricing Model (CAPM), APT assumes that asset prices are influenced by various systematic risks rather than just market risk.

Key assumptions include:

* Asset returns are driven by multiple risk factors.
* No arbitrage opportunities exist in equilibrium.
* Investors prefer higher returns for higher risk.
* Markets are competitive, and securities are correctly priced based on risk exposure.

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