Understanding Investments

Chapter 1
To understand the investments field as currently practiced

To help you make investment decisions that will enhance your economic welfare

To create realistic expectations about the outcome of investment decisions
Investments Defined

- Investments is the study of the process of committing funds to one or more assets
  - Emphasis on holding financial assets and marketable securities
  - Concepts also apply to real assets
  - Foreign financial assets should not be ignored
Why Study Investments?

- Most individuals make investment decisions sometime
  - Need sound framework for managing and increasing wealth

- Essential part of a career in the field
  - Security analyst, portfolio manager, registered representative, Certified Financial Planner, Chartered Financial Analyst
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
Chapter 1

End