PORTFOLIO SELECTION

GALGOTIAS UNIVERSITY

Portfolio Management
Security Analysis
Portfolio Analysis
Portfolio Selection
Portfolio Revision
Portfolio Evaluation

Portfolio

A portfolio is a grouping of financial assets such as stocks, bonds, cash equivalents as well as their mutual, exchange –traded and closed-fund counterparts.

His choice depends upon the risk-return characteristics of individual securities.

Building a Portfolio

Step-1 : Use the Markowitz portfolio selection model to identify optimal combinations.

Step-2 : Consider borrowing and lending possibilities.

Step-3 : choose the final portfolio based on your preferences for return relative to risk

PORTFOLIO SELECTION

Goal: finding the optimal portfolio

OPTIMAL PORTFOLIO: Portfolio that provides the highest return and lowest risk.

Method of portfolio selection: Markowitz model.

Portfolio Selection

The proper goal of portfolio construction would be to generate a portfolio that provides the highest return and the lowest risk is called **Optimal portfolio.**

➢The process of finding the optimal portfolio is described as **Portfolio selection**

Efficient Set of Portfolio

The concept of efficient portfolio, let us consider various combinations of securities and designated them as portfolio 1 to n.

The risk of these portfolios may be estimated by measuring the standard deviation of portfolio returns.

Portfolio no	Expected return	Standard deviation
1	5.6	4.5
2	7.8	5.8
3	9.2	7.6
4	10.5	8.1
5	11.7	8.1
6	12.4	9.3
7	13.5	9.5
8	13.5	11.3
9	15.7	12.7
10	16.8	12.9

Compare 4 & 5 which have same standard deviation

Higher return?? Pf no.5 gives higher expected return which is more efficient portfolio.

Pf no	Expected Return	Standard Deviation
1	5.6	4.5
2	7.8	5.8
3	9.2	7.6
4	10.5	8.1
5	11.7	8.1
6	12.4	9.3
7	13.5	9.5

Compare 7 & 8 which have same Expected return

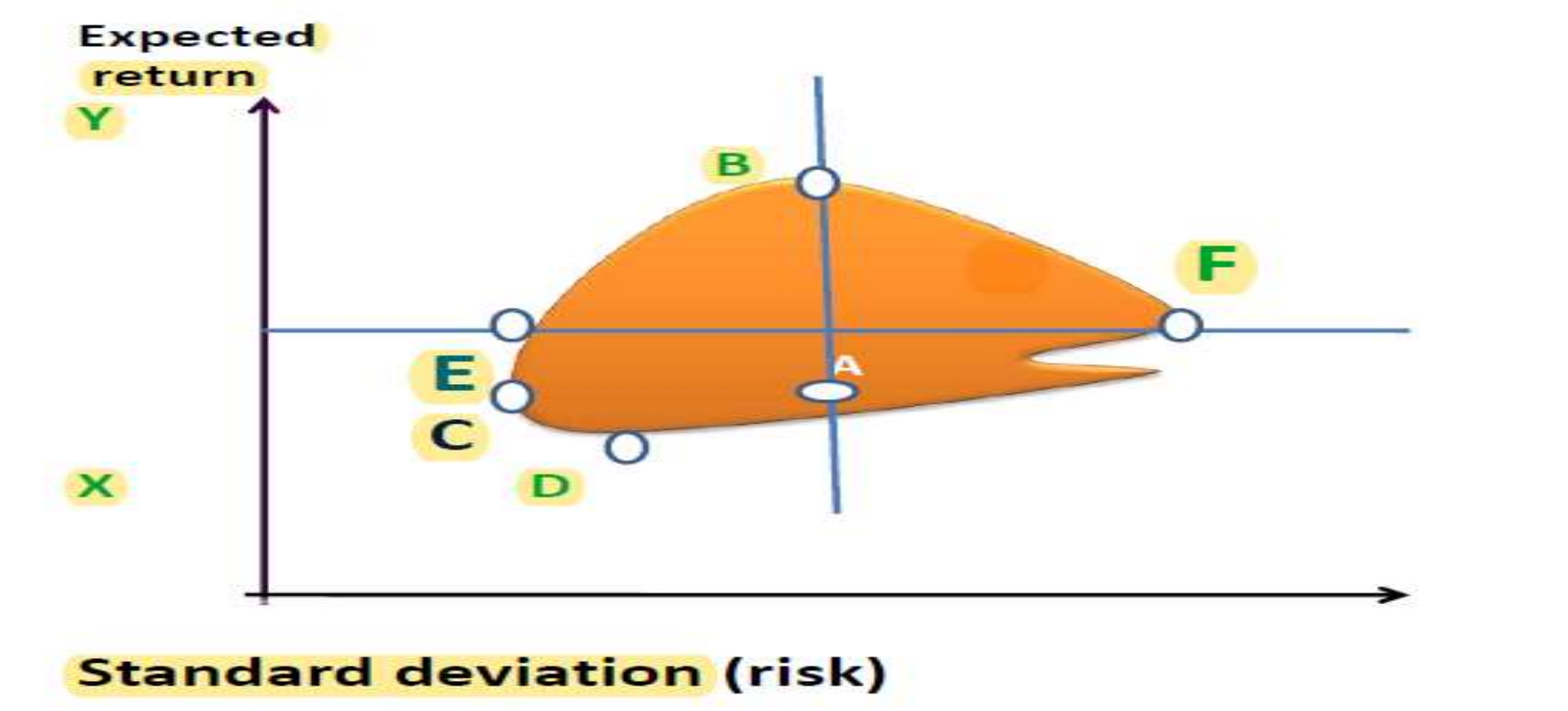
Lower standard deviation?? Pf no.7 which is more efficient portfolio

Pf no	Expected Return	Standard Deviation
1	5.6	4.5
2	7.8	5.8
3	9.2	7.6
4	10.5	8.1
5	11.7	8.1
6	12.4	9.3
7	13.5	9.5

CRITERIA: EFFICIENT PROTFOLIO

Given 2 portfolio with the same expected return, the investor would prefer the one with the lower risk.

Given 2 portfolio with the same risk, the investor would prefer the one with the higher expected return



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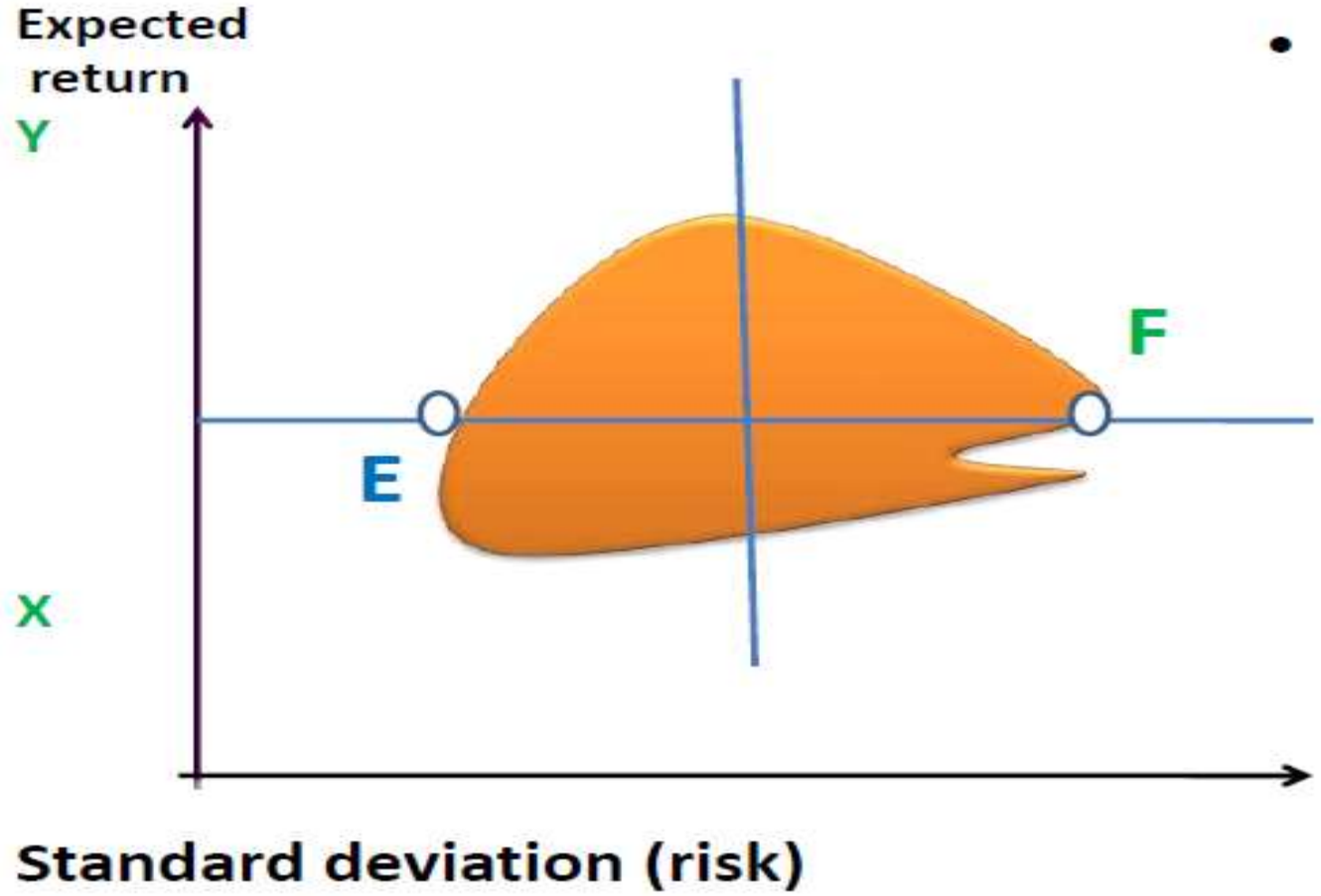
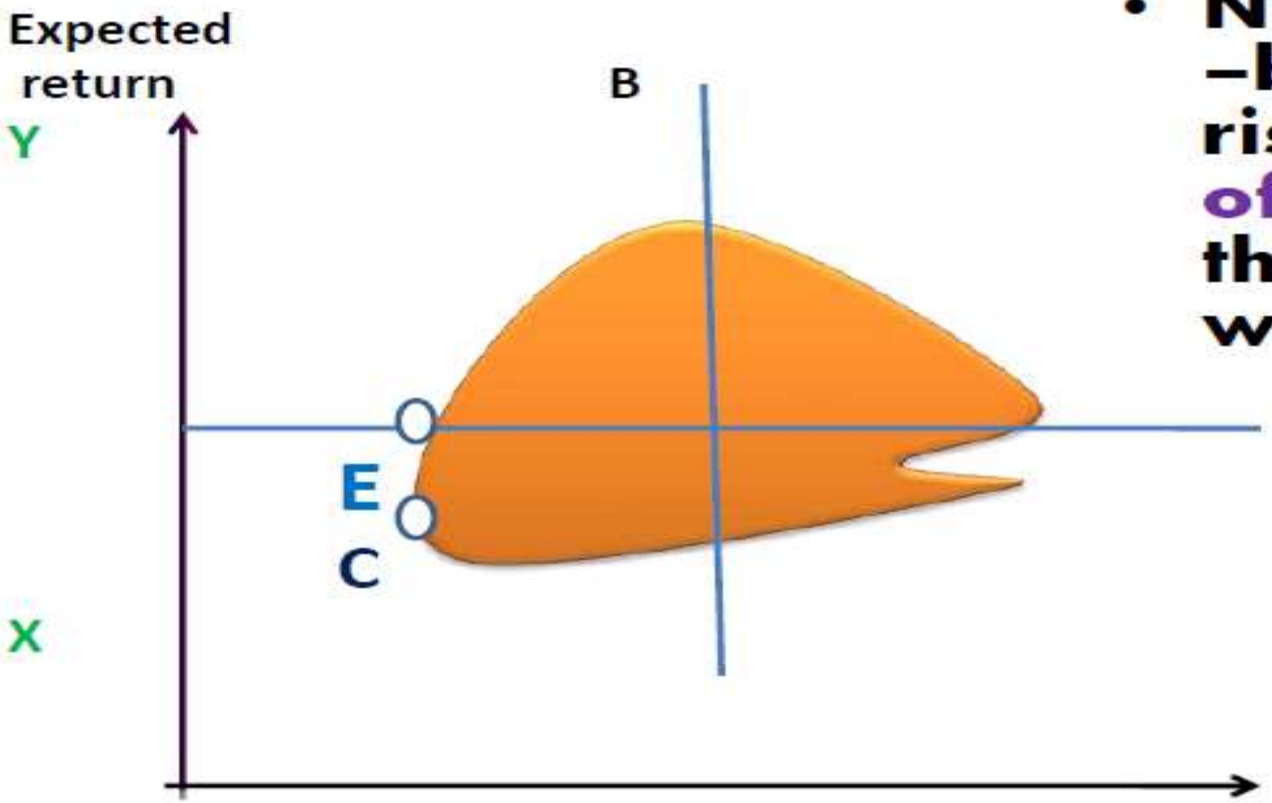
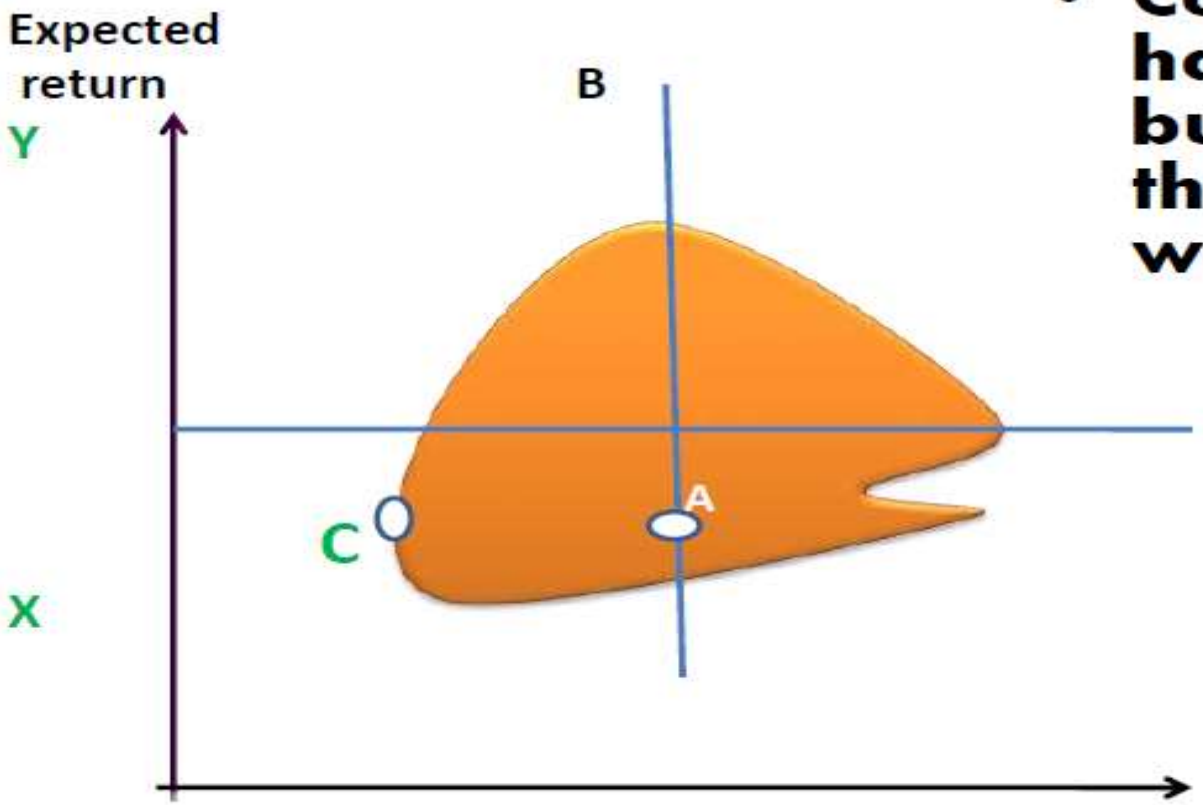


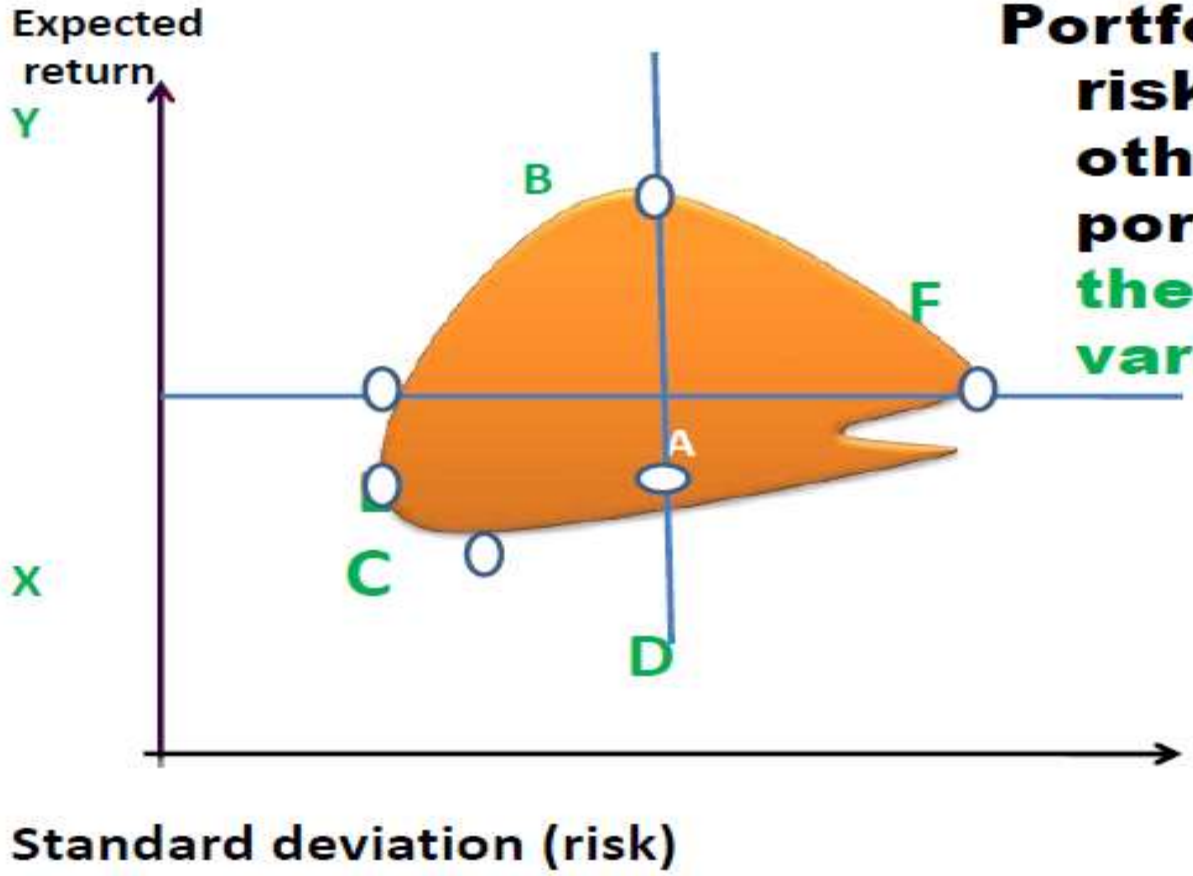
- Consider E & F – both have same return but E has less risk then portfolio E would be preferred



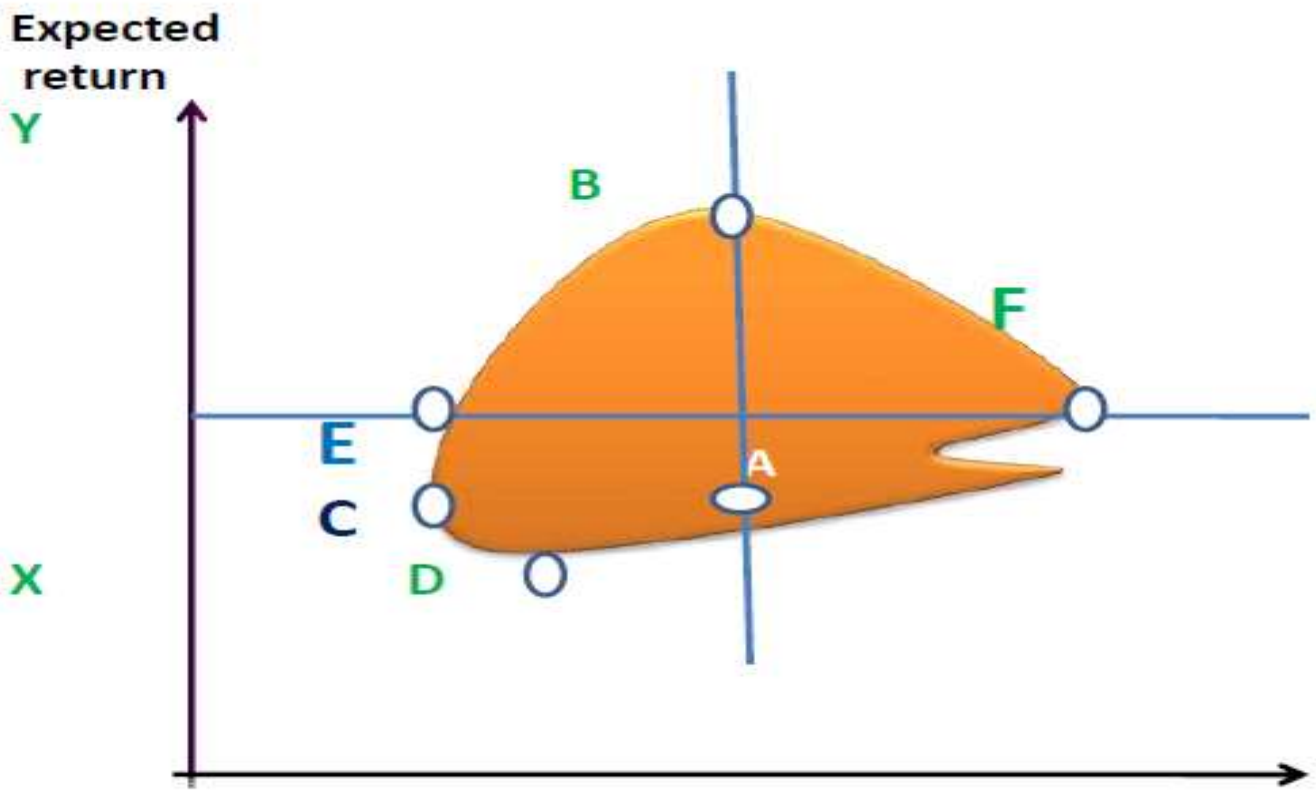
- Now consider C & E –both have same risk but portfolio E offer more return then portfolio E would preferred.



- Consider C& A – both have same return but C has less risk then portfolio C would be preferred



Portfolio C has the lowes risk compared to all other portfolios. Here portfolio C represents the global minimum variance portfolio.



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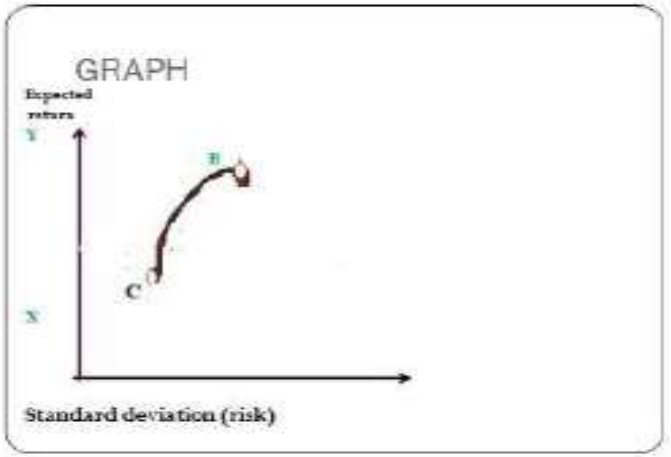

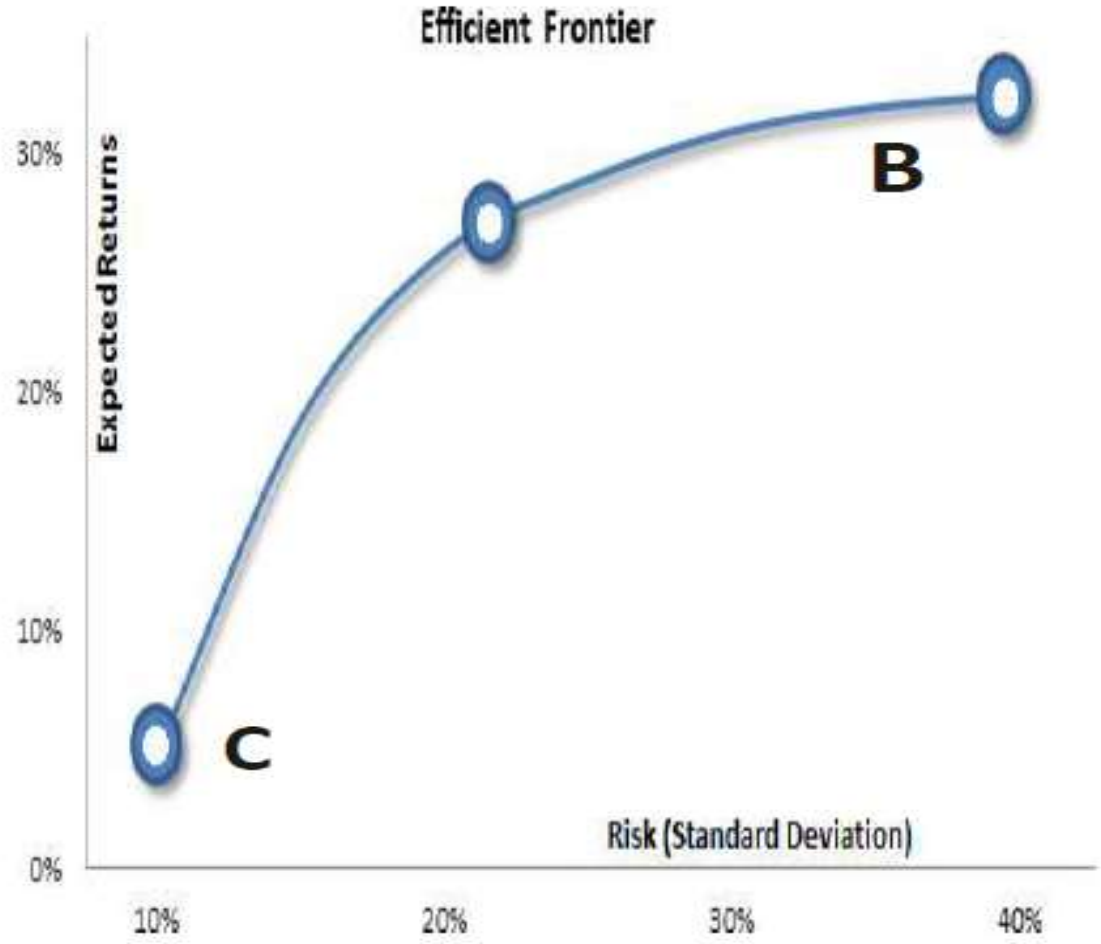

- It contain all the efficient portfolio.
- Lying between the global minimum variance portfolio (risk) & the maximum return.

References

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2. Dalton, John M. : How the stock Market work, Prentice Hall, New Delhi.
3. Gupta, L.C: Stock Exchange Trade in India; Society for capital Market Research and Development, Delhi;