

Introduction to Investments

Introduction to Investments – Study Notes

1. What Is an Investment?

- **Definition:** Allocation of money (or other resources) to an asset with the expectation of generating a future return.
- **Key objectives:**
 1. **Capital growth** – increase in the value of the original amount.
 2. **Income generation** – regular cash flow (e.g., dividends, interest).
 3. **Preservation of purchasing power** – beating inflation.

2. Core Investment Concepts

Concept	Meaning	Why It Matters
Risk	Probability that actual returns differ from expected returns.	Higher risk ? potential for higher reward, but also larger losses.
Return	Profit earned on an investment (absolute or %).	Measures success; used to compare alternatives.
Time Horizon	Length of time an investor expects to hold an asset.	Influences risk tolerance and asset selection.
Liquidity	Ease of converting an asset to cash without loss of value.	Determines how quickly funds can be accessed.
Diversification	Spreading capital across different assets/markets.	Reduces unsystematic (asset-specific) risk.
Asset Allocation	Strategic division of a portfolio among major asset classes (e.g., equities, bonds, cash, real estate).	Primary driver of long-term portfolio performance.

3. Major Asset Classes

Asset Class	Typical Characteristics	Common Instruments
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Equities (Stocks)	Ownership stake; high potential growth; higher volatility.	Common shares, preferred shares, ADRs, ETFs.
Fixed Income (Bonds)	Debt securities; regular interest payments; lower volatility than stocks.	Government bonds, corporate bonds, municipal bonds, bond funds.
Cash & Cash Equivalents	Very low risk; minimal return; high liquidity.	Money market funds, Treasury bills, certificates of deposit.
Real Estate	Tangible property; income via rent; potential for appreciation.	Direct property, REITs, real estate mutual funds.
Alternative Investments	Diverse, often less correlated with traditional markets.	Commodities, hedge funds, private equity, venture capital, cryptocurrencies.

4. Risk-Return Spectrum

1. **Cash & Cash Equivalents** – lowest risk, lowest return.
2. **High-Quality Bonds** – modest risk, modest return.
3. **Diversified Equity Portfolios** – moderate-high risk, higher return.
4. **Sector-Specific or Emerging-Market Equities** – high risk, high return potential.
5. **Alternative & Illiquid Assets** – variable risk, often higher return but with limited liquidity.

Visual tip: Imagine a diagonal line on a graph where the X-axis is risk and the Y-axis is expected return; most assets fall near this “efficient frontier.”

5. The Investment Process

1. **Set Goals** – define purpose (retirement, education, wealth accumulation), amount needed, and time horizon.
2. **Assess Risk Tolerance** – consider age, income stability, financial obligations, and psychological comfort with volatility.
3. **Develop Asset Allocation** – choose a mix of asset classes aligned with goals and tolerance.
4. **Select Specific Investments** – pick individual securities, mutual funds, ETFs, or other vehicles that fit the allocation.
5. **Implement the Portfolio** – execute trades, consider transaction costs and tax implications.

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6. **Monitor