**Capital Market and Portfolio Management**

**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? (10 Marks)**

**Ans 1.**

**Introduction**

Investing is an essential part of financial planning, and understanding different investment options is crucial for making informed decisions. Among the various investment avenues, stocks and bonds are two of the most common financial instruments used by investors to grow wealth. While both serve as vehicles for investment, they differ fundamentally in terms of ownership, risk, returns, and overall purpose. Stocks represent equity ownership in a company, offering the potential for high returns along with higher risks. On the other hand, bonds are fixed-income securities that act as loans to governments or corporations, providing stable and predictable returns. From an investment

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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. (10 Marks)**

**Ans 2.**

**Introduction**

Mutual funds have become one of the most popular investment options for individuals seeking diversification, professional management, and long-term wealth creation. For new investors like John, mutual funds provide an opportunity to invest in a diversified portfolio without requiring extensive market knowledge. However, concerns about risk are common, and understanding different types of mutual funds can help mitigate these fears. Mutual funds cater to various investment objectives, risk tolerances, and time horizons, making them suitable for a wide range of

**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. (5 Marks)**

#### **Ans 3a.**

#### **Introduction**

Alpha is a crucial metric in portfolio management that measures an investment’s excess return relative to a benchmark index. It accounts for the volatility of an asset and evaluates its risk-adjusted performance. A positive alpha indicates that the investment has outperformed the market, whereas a negative alpha suggests underperformance. Investors and fund managers use alpha to assess the effectiveness of their investment strategies. In this case, we will calculate alpha using the given

**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. (5 Marks)**

**Ans 3b.**

#### **Introduction**

Arbitrage Pricing Theory (APT) is an advanced asset pricing model that helps investors determine whether an asset is undervalued or overvalued based on various economic factors. Unlike the Capital Asset Pricing Model (CAPM), APT considers multiple macroeconomic variables affecting stock prices. The theory assumes that asset returns can be explained by a linear relationship with multiple risk factors. By identifying mispriced securities, investors can exploit arbitrage o