

Study Notes for NISM-Series-XXI-A: Portfolio Management Services (PMS) Distributors Certification Examination

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Examination Details

Total Questions	100 X 1 Marks
Total Marks	100
Type	Multiple Choice
Pass Score	60% = 60 marks
Duration	2 Hours
Negative marks	-0.10

Chapterwise Weightages

Chapters	Chapter Name	Proposed Weightages
1	Investments	7
2	Introduction to securities markets	5
3	Investing in stocks	10
4	Investing in fixed income securities	5
5	Derivatives	5
6	Collective Investment Vehicles	5
7	Role of portfolio managers	10
8	Operational aspects of portfolio managers	13
9	Portfolio management process	15
10	Performance measurement and evaluation of portfolio managers	10
11	Taxation	5
12	Regulatory, governance and ethical aspects of portfolio managers	10

NISM-Series-XXI-A: Portfolio Management Services (PMS) Distributors Certification Examination

CHAPTER 1: INVESTMENTS

Investment Definition: Investment involves committing funds to assets with the expectation of generating income or capital appreciation over time.

Savings vs. Investment: Savings are idle funds kept for future use, while investments are deployed to generate returns, often involving risk.

Investment vs. Speculation: Investment focuses on long-term wealth creation with calculated risks, whereas speculation seeks short-term gains based on price fluctuations.

Speculation Characteristics: Speculation often involves higher risk, lacks fundamental analysis, and is driven by market sentiment or conjectures.

Investment Objectives: Key objectives include capital preservation, income generation, and capital appreciation, tailored to investor needs.

Capital Preservation: Aims to minimize erosion of the principal amount, suitable for risk-averse investors.

Income Generation: Focuses on generating regular income through dividends or interest, often prioritized by retirees.

Capital Appreciation: Targets long-term growth in investment value, typically through equities or growth-oriented assets.

Risk-Return Tradeoff: Higher expected returns are associated with higher risks, varying by investor risk appetite.

Risk-Free Rate: The return on investments with no default risk, such as government securities, forms the baseline for return expectations.

Pure Rate of Interest: Represents the cost of deferring current consumption for future returns, excluding risk and inflation.

Inflation Adjustment: Returns must account for inflation to maintain purchasing power over time.

Risk Premium: Additional return demanded by investors for bearing uncertainty in future payments.

Systematic Risk: Market-wide risks affecting all investments, such as economic downturns, cannot be diversified away.

Unsystematic Risk: Specific to individual assets or companies, can be reduced through diversification.

Financial Risk: Arises from market fluctuations, leverage, or poor financial management of the issuer.

Business Risk: Stems from operational challenges or competitive pressures affecting a company's profitability.

Political Risk: Results from changes in government policies, regulations, or political instability impacting investments.

Equity Investments: Involve ownership in companies, offering potential for capital gains and dividends but with higher volatility.

Fixed Income Securities: Provide regular interest payments and principal repayment, with lower risk than equities.

Real Estate Investments: Offer tangible assets with potential for rental income and capital appreciation, but require significant capital.

Commodities: Include hard (e.g., gold) and soft (e.g., agricultural products) assets, driven by global supply and demand.

Derivatives: Financial contracts deriving value from underlying assets, used for hedging or speculation.

Structured Products: Complex instruments combining derivatives and securities, suitable for sophisticated investors.

Mutual Funds: Pooled investment vehicles offering diversification and professional management.

Portfolio Management Services (PMS): Customized investment solutions for high-net-worth individuals, managed by professionals.

Alternative Investment Funds (AIFs): Include private equity, hedge funds, and venture capital, with higher risk and return potential.

Diversification Benefits: Spreading investments across asset classes reduces overall portfolio risk.

Liquidity Needs: Investments should align with the investor's need for quick access to funds.

Investment Horizon: The time period an investor plans to hold an investment influences asset selection.

Risk Appetite: Varies by individual, affecting the choice between conservative and aggressive investments.

Capital Market Expectations: Forecasts of asset class returns guide investment decisions.

Tax Considerations: Tax implications influence net returns and investment choices.

Investment Vehicles: Regulated options like mutual funds, PMS, and AIFs offer professional management for a fee.

Life-Cycle Savings Pattern: Household savings fluctuate based on income and consumption needs over time.

Equity Risk: Driven by market volatility and company-specific factors, impacting stock returns.

Fixed Income Risk: Includes interest rate risk and credit risk, affecting bond prices.

Real Estate Risk: Involves market fluctuations, location-specific factors, and illiquidity.

Commodity Risk: Arises from global supply-demand imbalances and geopolitical events.

Derivative Risk: Stems from leverage and market volatility, requiring sophisticated understanding.

Global Diversification: Investing across countries mitigates political and economic risks.

Investment Constraints: Include liquidity, time horizon, legal, and tax-related factors.

Return Components: Comprise income (dividends/interest), capital gains, and reinvestment returns.

Risk Measurement: Involves assessing volatility, beta, and other metrics to quantify uncertainty.

Portfolio Construction: Balances risk and return to meet investor objectives.

Investment Process: Involves setting objectives, analyzing markets, and selecting assets.

Speculation Motivation: Driven by profit potential rather than fundamental value.

Risk Aversion: Conservative investors prioritize capital preservation over high returns.

Market Volatility: Impacts all asset classes, requiring careful risk management.

Investment Education: Understanding financial markets enhances decision-making.

Long-Term Investing: Focuses on sustained growth, reducing the impact of short-term volatility.

CHAPTER 2: INTRODUCTION TO SECURITIES MARKETS

Securities Definition: Securities include equities, bonds, derivatives, and mutual fund units, as defined by the Securities Contracts Regulation Act.

Primary Market: Where securities are issued directly to investors, such as through IPOs or private placements.

Secondary Market: Facilitates trading of securities among investors, providing liquidity.

Private Placement: Issuance of securities to fewer than 200 persons, as per the Companies Act 2013.

Offer for Sale (OFS): A secondary market transaction executed through the primary market, often by promoters.

Over-The-Counter (OTC) Market: Involves direct trading between parties without an exchange, less regulated.

Exchange-Traded Market: Standardized trading on regulated exchanges, ensuring transparency and safety.

Market Participants: Include buyers, sellers, brokers, custodians, and depositories in securities markets.

Brokers Role: Facilitate buy and sell transactions on stock exchanges, acting as intermediaries.

Sub-Brokers Transition: Sub-brokers migrated to Authorized Persons (AP) or Trading Members post-2018 SEBI regulation.

Clearing Members: Ensure settlement of trades on exchanges, managing pay-in and pay-out.

Custodians Role: Safekeep securities and manage corporate actions for institutional investors.

Depositories Function: Hold securities in dematerialized form, enabling seamless transfers.

Market Makers: Provide liquidity by quoting bid and ask prices in the market.

Retail Investors: Individuals investing for personal accounts, typically with smaller capital.

Institutional Investors: Include mutual funds, insurance companies, and pension funds with large capital.

Foreign Portfolio Investors (FPIs): Non-residents investing in Indian securities, regulated by SEBI.

Mutual Fund Role: Pool investor funds to invest in diversified portfolios, managed professionally.

Insurance Companies: Major investors in capital and money markets, managing large corpora.

Treasury Management: Corporate treasuries raise long-term funds and minimize capital costs.

SEBI Regulation: Oversees securities markets to ensure transparency and investor protection.

Stock Exchanges: Platforms like NSE and BSE facilitate trading and price discovery.

Clearing Corporations: Manage risk and ensure trade settlement on exchanges.

Mark-to-Market (MTM) Margin: Reflects unrealized losses in trades due to price movements.

Derivatives in Securities: Include futures, options, and swaps, used for hedging or speculation.

Primary Market Issuance: Includes public issues, rights issues, and private placements.

****@: Secondary Market Transactions:** Occur between investors, not involving the issuer directly.

Liquidity Provision: Exchanges ensure liquidity through standardized trading mechanisms.

Regulatory Framework: SEBI ensures fair practices and investor protection in securities markets.

IPO/FPO Limits: Retail investors can bid up to Rs. 2 lakh in IPOs/FPOs, as per SEBI rules.

Market Transparency: Exchanges provide real-time price and volume data to investors.

Broker Registration: All secondary market transactions must go through registered brokers.

Depository Participants (DPs): Facilitate demat account services for investors.

Trading Members: Individuals or firms registered to trade on stock exchanges.

Clearing Process: Ensures smooth settlement of buy and sell transactions.

Securities Transfer: Handled electronically through depositories like NSDL and CDSL.

Market Volatility: Secondary markets experience price fluctuations based on supply and demand.

Investor Protection: SEBI regulations safeguard retail and institutional investors.

Corporate Actions: Include dividends, bonus shares, and rights issues affecting securities.

Exchange Counterparty: Exchanges act as counterparties to ensure trade completion.

OTC Risks: Less transparency and higher counterparty risk compared to exchanges.

Market Efficiency: Secondary markets enable quick price adjustments to new information.

Regulatory Compliance: Market participants must adhere to SEBI guidelines.

Securities Types: Include equity, debt, derivatives, and hybrid instruments.

Price Discovery: Market interactions determine fair security prices.

Trading Volumes: High volumes indicate strong market activity and liquidity.

Investor Categories: Divided into retail, institutional, and foreign investors.

Market Intermediaries: Include brokers, custodians, and clearing members facilitating trades.

Public Issue: Securities offered to the general public through IPOs or FPOs.

Rights Issue: Securities offered to existing shareholders at a discounted price.

SEBI Circulars: Provide guidelines for market operations and compliance.

Stock Exchange Role: Ensures fair and transparent trading of securities.

CHAPTER 3: INVESTING IN STOCKS

Equity Investment: Ownership in companies, offering capital gains and dividends.

Market Risk (Beta): Measures a stock's volatility relative to the market.

Sector-Specific Risk: Impacts specific industries, not diversified away easily.

Equity Returns: Historically outpace inflation and other asset classes over the long term.

Dividends: Periodic payments from company profits, providing steady income.

Capital Gains: Profits from selling shares at a higher price than purchased.

Equity Research: Involves analyzing companies and their environments for investment decisions.

EIC Approach: Economy-Industry-Company framework for stock selection.

Economic Analysis: Assesses macroeconomic factors like GDP and interest rates.

Industry Analysis: Evaluates sector trends and competitive dynamics.

Company Analysis: Examines financials, management, and growth prospects.

Fundamental Analysis: Focuses on intrinsic value based on financial metrics.

Technical Analysis: Predicts price movements using historical data and patterns.

Valuation Metrics: Include P/E, P/B, EV/EBITDA, and P/S ratios for stock evaluation.

Dividend Discount Model (DDM): Estimates intrinsic value based on future dividends.

Gordon Growth Model: Simplifies DDM for stocks with stable dividend growth.

Free Cash Flow Models: FCFF and FCFE used for valuing firms with irregular dividends.

Relative Valuation: Compares stocks using metrics like P/E or P/B ratios.

PEG Ratio: Adjusts P/E for expected earnings growth, indicating value.

Technical Indicators: Include moving averages, RSI, and support/resistance levels.

Market Efficiency Hypothesis: Suggests stock prices reflect all available information.

Value Investing: Seeks undervalued stocks with strong fundamentals.

Growth Investing: Targets companies with high growth potential.

Momentum Investing: Buys stocks with strong recent performance trends.

Contrarian Investing: Invests in undervalued or out-of-favor stocks.

Portfolio Diversification: Reduces unsystematic risk by holding varied stocks.

Beta Measurement: Quantifies a stock's systematic risk relative to the market.

Risk Management: Involves hedging and diversification to mitigate losses.

Stock Selection: Combines fundamental and technical analysis for optimal picks.

Economic Cycles: Impact sector performance, guiding investment timing.

Defensive Sectors: Stable industries like utilities perform well in downturns.

Cyclical Sectors: Like automotive, tied to economic cycles, are riskier.

Intrinsic Value: The true value of a stock based on cash flow projections.

Market Timing: Attempting to buy low and sell high, often challenging.

Dividend Yield: Annual dividend divided by stock price, a key income metric.

P/E Ratio: Price divided by earnings per share, indicating valuation.

Book Value: Net asset value of a company, used in P/B ratio.

EBITDA: Earnings before interest, taxes, depreciation, and amortization.

Competitive Advantage: Strong brands or cost leadership enhance stock value.

Stock Volatility: Price fluctuations driven by market and company factors.

Investment Horizon: Long-term equity investments reduce volatility impact.

Portfolio Weighting: Allocates capital based on risk and return expectations.

Sector Rotation: Shifts investments to sectors expected to outperform.

Stock Screening: Uses financial metrics to identify potential investments.

Earnings Growth: Key driver of stock price appreciation.

Market Sentiment: Investor psychology influences short-term price movements.

Regulatory Impact: Government policies affect stock market performance.

Stock Splits: Increase share count, reducing per-share price, without changing value.

Corporate Governance: Impacts investor confidence and stock valuation.

Analyst Reports: Provide insights into stock performance and valuation.

CHAPTER 4: INVESTING IN FIXED INCOME SECURITIES

Fixed Income Overview: Securities like bonds provide regular interest and principal repayment.

Bonds vs. Debentures: Bonds issued by PSUs or DFIs; debentures by other entities.

Coupon Payments: Fixed interest payments based on bond face value.

Zero Coupon Bonds: Issued at a discount, redeemed at face value, no periodic coupons.

Bond Indenture: Legal agreement between issuer and investor, detailing terms.

Credit Ratings: Indicate issuer creditworthiness, affecting bond risk and yield.

Investment Grade Bonds: High credit quality, lower risk, and lower yields.

Non-Investment Grade Bonds: Higher risk, higher yields, also called junk bonds.

Yield to Maturity (YTM): Total return expected if bond is held until maturity.

Bond Pricing: Inverse relationship with market interest rates; prices fall as rates rise.

Interest Rate Risk: Bond prices decline when market interest rates increase.

Credit Risk: Possibility of issuer defaulting on interest or principal payments.

Bond Valuation: Present value of future cash flows, discounted at market rates.

Day Count Convention: Determines interest calculation periods (e.g., 30/360 or actual/actual).

Callable Bonds: Issuers can redeem bonds before maturity at a specified price.

Convertible Bonds: Can be converted into equity shares, offering upside potential.

Government Securities: Low-risk bonds backed by sovereign guarantees.

Corporate Bonds: Higher yields than government bonds, with increased risk.

Bond Market: Divided into money market (short-term) and capital market (long-term).

Liquidity Risk: Some bonds may be hard to sell without price concessions.

Inflation Risk: Fixed coupon payments lose purchasing power during inflation.

Bond Duration: Measures sensitivity to interest rate changes.

Macaulay Duration: Weighted average time to receive bond cash flows.

Modified Duration: Estimates price change for a 1% change in yield.

Bond Convexity: Measures curvature in bond price-yield relationship.

Treasury Bills: Short-term government securities, sold at a discount.

Commercial Paper: Unsecured short-term debt issued by corporations.

Certificate of Deposit: Time deposits issued by banks, offering fixed interest.

Bond Yield Curve: Plots yields against maturities, indicating market expectations.

Credit Spread: Difference in yield between bonds of different credit qualities.

Bond Portfolio: Diversifies across issuers, maturities, and credit ratings.

Reinvestment Risk: Interest payments may be reinvested at lower rates.

Bond Ratings Agencies: CRISIL, ICRA, and CARE provide credit ratings in India.

Fixed Income Returns: Comprise coupon payments and capital gains/losses.

Bond Market Conventions: Vary by country and market (e.g., India vs. global).

Floating Rate Bonds: Coupon rates adjust periodically based on market rates.

Bond Discounts: Issued below face value to attract investors.

Premium Bonds: Issued above face value, offering lower yields.

Bond Maturity: Time until principal repayment, affecting risk and return.

Sovereign Risk: Risk of government default, minimal for stable economies.

Bond Covenants: Restrictions in bond agreements to protect investors.

Secondary Bond Market: Trading of bonds after issuance, affecting liquidity.

Primary Bond Market: Issuance of new bonds to raise capital.

Bond Laddering: Investing in bonds with staggered maturities to manage risk.

Interest Rate Sensitivity: Longer-maturity bonds are more sensitive to rate changes.

Bond Defaults: Failure to pay interest or principal, impacting investor returns.

Credit Enhancement: Mechanisms like guarantees to improve bond ratings.

Bond Stripping: Separating coupon and principal payments into separate securities.

Fixed Income Strategies: Include buy-and-hold, laddering, and barbell strategies.

Regulatory Oversight: SEBI regulates bond issuance and trading in India.

CHAPTER 5: DERIVATIVES

Derivatives Definition: Contracts deriving value from underlying assets like stocks or commodities.

Forward Contracts: Bilateral OTC agreements to buy/sell assets at a future date.

Futures Contracts: Standardized forward contracts traded on exchanges.

Options Contracts: Grant the right, not obligation, to buy/sell at a set price.

Swaps: Agreements to exchange cash flows on future dates, e.g., interest rate swaps.

OTC Markets: Non-exchange traded derivatives with higher counterparty risk.

Exchange-Traded Derivatives: Standardized, regulated, and transparent contracts.

Hedging Purpose: Derivatives reduce risk by locking in prices or rates.

Speculation Purpose: Derivatives allow betting on price movements for profit.

Arbitrage Opportunities: Exploit price differences between markets for riskless profit.

Zero-Sum Game: Derivative contracts result in equal gains and losses for counterparties.

Underlying Assets: Include equities, bonds, commodities, and currencies.

Derivative Risks: Leverage and volatility increase potential losses.

Futures Margin: Initial and maintenance margins ensure contract performance.

Options Premium: Price paid for the right to buy or sell the underlying asset.

Strike Price: Predetermined price at which an option can be exercised.

Expiration Date: Date until which an option or futures contract is valid.

Commodity Derivatives: Based on physical goods like gold or agricultural products.

Currency Derivatives: Based on exchange rates, traded on NSE, BSE, and MCX.

SEBI Regulation: Governs derivative markets to ensure transparency and fairness.

RBI Oversight: Regulates currency derivatives alongside SEBI.

Derivative Pricing: Influenced by underlying asset price, volatility, and time to expiration.

Mark-to-Market: Daily settlement of gains/losses in futures contracts.

Notional Value: Total value of the underlying asset in a derivative contract.

Leverage in Derivatives: Amplifies returns and risks with small initial investments.

Derivative Strategies: Include straddles, spreads, and covered calls.

Counterparty Risk: Risk of default in OTC derivative contracts.

Exchange Counterparty: Exchanges act as counterparties, reducing default risk.

Derivative Liquidity: Exchange-traded derivatives offer higher liquidity than OTC.

Hedging Strategies: Use derivatives to offset potential losses in other investments.

Arbitrage Mechanism: Buying low and selling high to eliminate price discrepancies.

Derivative Markets: Include equity, commodity, and currency derivatives.

Forward Pricing: Based on spot price, interest rates, and time to maturity.

Options Pricing Models: Black-Scholes and binomial models estimate option value.

Swap Valuation: Based on present value of expected cash flow exchanges.

Derivative Settlement: Cash or physical delivery upon contract expiration.

Margin Calls: Additional funds required if account balance falls below maintenance margin.

Derivative Regulation: SEBI and RBI ensure fair practices and investor protection.

PMS Derivative Use: Limited to hedging or client-approved strategies.

Commodity Futures: Standardized contracts for delivery of physical goods.

Currency Futures: Contracts to exchange currencies at a future date.

Derivative Volatility: High sensitivity to underlying asset price changes.

Speculative Trading: Involves high risk for potentially high returns.

Derivative Contracts: Specify price, quantity, and delivery terms.

Exchange-Traded Funds (ETFs): Some ETFs use derivatives for enhanced returns.

Risk Management Tools: Derivatives are key for managing portfolio risks.

Arbitrage Profit: Riskless gains from price differences in related markets.

Derivative Transparency: Exchange-traded derivatives offer greater transparency.

SEBI Guidelines: Regulate derivative usage in PMS for investor protection.

Client Consent: Required for derivative use in PMS portfolios.

CHAPTER 6: COLLECTIVE INVESTMENT VEHICLES

Mutual Funds: Pooled investments managed professionally, offering diversification.

Diversification Benefits: Mutual funds reduce risk by investing across multiple securities.

Equity Funds: Invest in stocks for capital appreciation, higher risk.

Debt Funds: Focus on fixed-income securities for stable income, lower risk.

Hybrid Funds: Combine equity and debt for balanced risk-return profiles.

Index Funds: Track market indices, offering low-cost passive investing.

ETFs: Exchange-traded funds with low expense ratios and high liquidity.

REITs: Real Estate Investment Trusts provide income from property investments.

InvITs: Infrastructure Investment Trusts pool funds for infrastructure projects.

AIFs: Alternative Investment Funds target high-net-worth investors with high-risk strategies.

SEBI Regulation: Ensures transparency and governance in collective investment vehicles.

Transparency: Mutual funds provide regular NAV and portfolio disclosures.

Liquidity: ETFs and mutual funds offer easy entry and exit options.

Risk Reduction: Diversification in mutual funds mitigates unsystematic risk.

Professional Management: Fund managers make investment decisions based on expertise.

Venture Capital Funds: AIF Category I, invest in startups and early-stage companies.

Private Equity Funds: AIF Category II, invest in private companies for growth.

Hedge Funds: AIF Category III, use aggressive strategies like long-short.

Social Venture Funds: Invest in companies with social impact, e.g., education.

Angel Funds: Pool investments for startup funding, high-risk high-reward.

Factor Funds: Smart beta funds target specific factors like value or momentum.

Value Factor Funds: Invest in undervalued stocks with low P/E or P/B ratios.

Momentum Factor Funds: Buy stocks with strong recent performance.

Low Volatility Funds: Target stable stocks to minimize downside risk.

Quality Factor Funds: Invest in companies with strong financial health.

REIT Types: Equity REITs (rental income), Mortgage REITs (interest income), Hybrid REITs.

InvIT Types: Public and private InvITs, with varying risk and return profiles.

Tax Incentives: AIFs and REITs may offer tax benefits for investors.

Minimum Investment: AIFs require Rs. 1 crore, targeting HNIs and institutions.

Portfolio Diversification: Collective vehicles spread risk across asset classes.

Passive Investing: Index funds and ETFs track benchmarks with minimal active management.

Active Management: Equity and hybrid funds aim to outperform benchmarks.

Fund Expenses: Include management fees, exit loads, and transaction costs.

NAV Calculation: Net Asset Value reflects the per-unit value of a fund.

Risk Profiles: Funds are categorized by risk levels (low, moderate, high).

Investment Objectives: Funds align with goals like growth, income, or stability.

Regulatory Compliance: SEBI ensures fair practices and investor protection.

Fund Categories: Equity, debt, hybrid, and solution-oriented funds.

Dividend Distribution: Funds may distribute profits as dividends or reinvest.

Capital Gains: Profits from selling fund units, taxed as per holding period.

Systematic Investment Plans (SIPs): Allow regular, small investments in mutual funds.

Liquidity Risk: Some AIFs and REITs have limited liquidity compared to mutual funds.

Taxation: Capital gains and dividends from funds are subject to tax.

Fund Performance: Measured by returns, risk-adjusted metrics, and benchmarks.

Investor Suitability: Funds cater to varying risk appetites and financial goals.

Portfolio Management: Professional managers optimize fund performance.

Market Volatility: Impacts fund returns, especially equity and hybrid funds.

Fund Selection: Based on risk tolerance, investment horizon, and objectives.

Regulatory Oversight: SEBI ensures transparency and investor protection.

Investor Education: Understanding fund types aids better investment decisions.

CHAPTER 7: ROLE OF PORTFOLIO MANAGERS

Portfolio Managers: Professionals managing client investments to achieve specific goals.

Discretionary PMS: Managers make investment decisions without client approval.

Non-Discretionary PMS: Managers execute trades based on client instructions.

Advisory PMS: Provide investment advice without managing funds directly.

Asset Management Companies: Major PMS providers, leveraging expertise and resources.

Independent Managers: Offer personalized PMS services, often for HNIs.

Client Agreement: Defines investment scope, fees, and manager responsibilities.

Segregated Accounts: Each client's funds and securities are held separately.

Bank Account: Client funds maintained in a separate scheduled commercial bank account.

Net Worth Requirement: PMS providers must maintain SEBI-specified net worth.

Regulatory Compliance: SEBI oversees PMS operations for investor protection.

Client Consent: Required for changes in investment strategy or derivative use.

Premature Withdrawal: Clients can withdraw funds/securities before maturity under specific conditions.

Investment Restrictions: Defined in the client agreement, per SEBI regulations.

Code of Conduct: Portfolio managers must adhere to ethical and professional standards.

Client Communication: Regular updates on portfolio performance and transactions.

Risk Management: Managers mitigate risks through diversification and hedging.

Investment Objectives: Aligned with client goals, such as growth or income.

Portfolio Customization: Tailored to client risk tolerance and financial needs.

SEBI Regulations: Govern PMS operations, ensuring transparency and fairness.

Due Diligence: Managers conduct thorough research before investment decisions.

Performance Reporting: Regular reports on portfolio returns and fees.

Fee Structure: Includes fixed fees, performance-based fees, or both.

High Water Mark: Ensures performance fees are charged only on new gains.

Client Approval: Non-discretionary PMS requires client consent for transactions.

Portfolio Rebalancing: Adjusts holdings to maintain desired asset allocation.

Investment Strategies: Include growth, value, and income-focused approaches.

Risk Assessment: Managers evaluate client risk tolerance and market risks.

Compliance Officer: Ensures adherence to SEBI regulations and reports violations.

Transaction Records: Maintained for five years, as per SEBI requirements.

Investor Protection: SEBI mandates fair practices and grievance redressal.

Portfolio Monitoring: Continuous tracking of investments to optimize returns.

Client Funds: Segregated to prevent co-mingling with manager's funds.

Investment Universe: Defined in the agreement, limiting asset choices.

Execution Role: Managers handle trade execution for client portfolios.

Advisory Services: Provide strategic guidance without direct fund management.

Regulatory Reporting: Managers submit periodic reports to SEBI.

Client Risk Profile: Assessed to align investments with risk tolerance.

Portfolio Diversification: Reduces risk by spreading investments across assets.

Performance Fees: Charged on gains above a specified hurdle rate.

Hurdle Rate: Minimum return threshold for performance fee calculation.

Client Consent for Derivatives: Required for derivative use in PMS portfolios.

Transparency: Managers provide detailed portfolio and fee disclosures.

Investment Horizon: Aligns with client's short-term or long-term goals.

Tax Considerations: Managers account for tax implications in portfolio planning.

Market Analysis: Managers use economic and industry data for decision-making.

Client Communication: Ensures transparency through regular updates.

Regulatory Audits: SEBI conducts inspections to ensure compliance.

Portfolio Adjustments: Made based on market conditions and client needs.

Ethical Standards: Managers adhere to SEBI's code of conduct for fairness.

CHAPTER 8: OPERATIONAL ASPECTS OF PORTFOLIO MANAGERS

Disclosure Document: Provided to clients before account opening, detailing services and risks.

Account Opening Form: Includes client details, investment objectives, and risk profile.

SEBI Regulations: Mandate standardized disclosures for investor protection.

Client Agreement: Specifies investment scope, fees, and manager duties.

Segregated Accounts: Client funds and securities held separately to ensure safety.

Bank Account: Client funds maintained in a scheduled commercial bank.

Direct Onboarding: Clients can onboard without intermediaries, per SEBI rules.

KYC Compliance: Portfolio managers verify client identity and financial details.

Risk Profiling: Assesses client risk tolerance, investment horizon, and objectives.

Investment Restrictions: Defined in the agreement, limiting asset choices.

Transaction Execution: Managers handle trades as per client instructions or discretion.

Audit Trail: Records of all transactions maintained for transparency.

Order Management: Ensures fair allocation of securities among clients.

Performance Reporting: Regular reports on portfolio returns and fees.

High Water Mark: Performance fees charged only on gains above previous highs.

Hurdle Rate: Minimum return required before performance fees apply.

Fee Structure: Includes fixed fees, performance fees, or a combination.

Custodian Services: Third-party custodians safekeep client securities.

Regulatory Reporting: Periodic submissions to SEBI, including client complaints.

Client Consent: Required for changes in investment strategy or derivative use.

Portfolio Rebalancing: Adjusts holdings to maintain desired allocation.

Compliance Officer: Monitors adherence to SEBI regulations.

Transaction Records: Maintained for five years, as per SEBI requirements.

Investor Grievance: SEBI mandates a mechanism for resolving client complaints.

Disclosure to SEBI: Includes client details, fees, and transaction data.

Performance Fees: Charged on net positive returns above the hurdle rate.

TWRR Reporting: Time-weighted rate of return used for performance evaluation.

Client Risk Profile: Guides investment decisions and portfolio construction.

Investment Objectives: Align with client goals like growth or income.

Regulatory Audits: SEBI inspections ensure compliance with regulations.

Portfolio Monitoring: Continuous tracking to optimize performance.

Fee Transparency: Detailed disclosure of all fees and expenses to clients.

Direct Onboarding Process: Simplifies client registration, per SEBI guidelines.

Client Communication: Regular updates on portfolio status and market conditions.

Risk Management: Includes diversification and hedging strategies.

SEBI Circulars: Provide guidelines for operational compliance.

Portfolio Adjustments: Based on market conditions and client needs.

Custodian Role: Ensures safekeeping and transfer of securities.

Transaction Allocation: Fairly distributed among clients, per SEBI rules.

Investment Strategy: Tailored to client risk profile and financial goals.

Tax Reporting: Portfolio managers provide tax-related documents to clients.

Client Funds: Segregated to prevent co-mingling with manager's funds.

Order Execution: Efficiently managed to minimize costs and delays.

Performance Metrics: Include TWRR and benchmark comparisons.

Regulatory Compliance: Adherence to SEBI's operational guidelines.

Client Approval: Required for non-discretionary PMS transactions.

Due Diligence: Thorough research before investment decisions.

Portfolio Transparency: Detailed reports enhance investor confidence.

Fee Structure Variations: Depend on asset class and portfolio type.

Investor Protection: SEBI ensures fair practices and grievance redressal.

CHAPTER 9: PORTFOLIO MANAGEMENT PROCESS

Asset Allocation: Divides investments across asset classes to balance risk and return.

Strategic Asset Allocation (SAA): Long-term allocation based on investor goals.

Tactical Asset Allocation (TAA): Short-term adjustments to exploit market opportunities.

Investment Policy Statement (IPS): Documents investor objectives, constraints, and strategy.

Risk Profiling: Assesses client risk tolerance, investment horizon, and goals.

Diversification: Reduces risk by investing in uncorrelated assets.

Correlation Analysis: Identifies assets with low or negative correlation for stability.

Investment Objectives: Include capital appreciation, income, and preservation.

Liquidity Needs: Influence asset allocation based on access to funds.

Investment Horizon: Determines suitability of asset classes for client goals.

Capital Market Forecasts: Guide asset allocation and return expectations.

Portfolio Rebalancing: Restores original allocation after market shifts.

Risk-Return Tradeoff: Balances expected returns with acceptable risk levels.

SAA Benefits: Provides stability and disciplined investing.

TAA Benefits: Exploits short-term market inefficiencies for higher returns.

Factor-Based Investing: Targets specific factors like value, momentum, or quality.

Value Factor: Invests in undervalued stocks with strong fundamentals.

Momentum Factor: Buys stocks with strong recent performance.

Low Volatility Factor: Targets stable stocks to reduce downside risk.

Portfolio Monitoring: Tracks performance and adjusts for market changes.

Risk Management: Uses diversification and hedging to mitigate losses.

Investment Constraints: Include tax, legal, and liquidity considerations.

Client Risk Profile: Guides portfolio construction and asset allocation.

Economic Analysis: Considers macroeconomic factors like GDP and interest rates.

Sector Allocation: Balances exposure to different industries.

Rebalancing Challenges: Include transaction costs and market timing risks.

Disciplined Investing: Prevents emotional decisions through predefined plans.

Tax Efficiency: Strategies to minimize tax liabilities in portfolio management.

Portfolio Optimization: Balances risk and return for maximum efficiency.

Investment Flexibility: Allows adjustments to market opportunities.

SEBI Regulations: Govern portfolio management processes for fairness.

Performance Benchmarks: Used to evaluate portfolio manager effectiveness.

Client Communication: Regular updates on portfolio performance and strategy.

Risk Assessment: Quantifies market, sector, and security-specific risks.

Portfolio Construction: Aligns with client goals and market conditions.

Investment Strategies: Include growth, value, and income-focused approaches.

Market Timing: Challenging due to unpredictable price movements.

Rebalancing Frequency: Periodic adjustments to maintain allocation.

Factor Overcrowding: Excessive investment in popular factors reduces returns.

Active Management: Seeks to outperform benchmarks through active decisions.

Passive Management: Tracks benchmarks with minimal intervention.

Portfolio Adjustments: Based on market conditions and client needs.

Investment Knowledge: Client understanding of markets influences strategy.

Life Cycle Phases: Impact asset allocation based on age and financial goals.

Regulatory Compliance: Adherence to SEBI guidelines for portfolio management.

Risk Scoring: Categorizes investors as aggressive, moderate, or conservative.

Goal-Based Investing: Aligns portfolios with specific financial objectives.

Capital Appreciation: Focuses on long-term growth through equities.

Income Generation: Prioritizes stable income from fixed-income securities.

Portfolio Stability: Achieved through diversification and low-correlation assets.

CHAPTER 10: PERFORMANCE MEASUREMENT AND EVALUATION OF PORTFOLIO MANAGERS

Rate of Return: Measures portfolio growth over a specific period.

Time-Weighted Rate of Return (TWRR): Eliminates impact of cash flows for accurate performance.

Risk Measures: Include standard deviation, beta, and downside risk.

Sharpe Ratio: Measures excess return per unit of total risk.

Treynor Ratio: Measures excess return per unit of systematic risk.

Risk-Adjusted Return: Evaluates performance relative to risk taken.

Performance Benchmarking: Compares portfolio returns to market indices.

Peer Group Analysis: Evaluates performance against similar portfolios.

Performance Attribution: Breaks down returns into allocation and selection effects.

Asset Allocation Effect: Impact of portfolio weighting on returns.

Security Selection Effect: Impact of individual security choices on performance.

Interaction Effect: Combined impact of allocation and selection decisions.

Standard Deviation: Measures total portfolio volatility.

Beta: Quantifies systematic risk relative to the market.

Alpha: Excess return above expected, based on risk level.

Risk-Free Rate: Return on government securities, used in risk-adjusted metrics.

Excess Return: Portfolio return minus risk-free rate.

Portfolio Volatility: Fluctuations in portfolio value due to market changes.

Benchmark Selection: Must align with portfolio's risk-return profile.

Customized Benchmarks: Tailored to specific investment strategies.

Performance Reporting: Regular updates on returns and risk metrics.

Due Diligence: Thorough evaluation of portfolio manager performance.

Management Fees: Impact net returns and performance evaluation.

Gross vs. Net Return: Gross includes fees; net excludes them.

Post-Tax Return: Accounts for tax liabilities on portfolio gains.

Performance Metrics: Include TWRR, Sharpe, and Treynor ratios.

Portfolio Risk: Combination of systematic and unsystematic risks.

Valuation Agencies: Provide fair valuation for debt and money market securities.

Risk Management: Strategies to minimize portfolio losses.

Performance Evaluation: Combines quantitative metrics and qualitative factors.

Benchmark Measurability: Ensures benchmark performance is trackable.

Attribution Analysis: Explains outperformance or underperformance.

Portfolio Returns: Driven by income, capital gains, and reinvestment.

Risk Premium: Additional return for bearing investment risk.

Systematic Risk: Market-wide risk, measured by beta.

Unsystematic Risk: Security-specific risk, reduced by diversification.

Sharpe Ratio Advantage: Accounts for total risk, suitable for diversified portfolios.

Treynor Ratio Advantage: Focuses on systematic risk, ideal for market-driven portfolios.

Performance Consistency: Evaluates manager's ability to deliver stable returns.

Fee Impact: High fees can erode portfolio returns.

Tax Considerations: Taxes reduce net portfolio performance.

Portfolio Monitoring: Continuous tracking of returns and risks.

Regulatory Compliance: SEBI mandates accurate performance reporting.

Client Objectives: Performance measured against investor goals.

Risk-Return Profile: Aligns portfolio with client risk tolerance.

Investment Strategy: Impacts performance metrics and evaluation.

Market Conditions: Influence portfolio returns and risk levels.

Manager Skill: Assessed through alpha and attribution analysis.

Portfolio Diversification: Reduces risk, enhancing risk-adjusted returns.

Performance Transparency: Detailed reports ensure investor confidence.

CHAPTER 11: TAXATION

Resident Individual Taxation: Taxed based on income slabs, no PMS deductions allowed.

Non-Resident Indians (NRIs): Subject to TDS on capital gains and dividends.

Long-Term Capital Gains (LTCG): Equity gains held over 12 months, taxed at 10%.

Short-Term Capital Gains (STCG): Equity gains held less than 12 months, taxed at 15%.

Dividend Income: Taxed at slab rates for residents, subject to TDS for NRIs.

Indexation Benefit: Removed for debt investments post-2023, increasing tax liability.

Business Income: Derivative gains in PMS taxed as business income at slab rates.

TDS on Equity Gains: 15% on STCG, 10% on LTCG exceeding Rs. 1.25 lakh.

Tax Reporting: PMS providers issue capital gains and TDS certificates.

Tax Compliance: Accurate ITR filing requires detailed PMS tax reports.

Capital Gains Report: Details gains/losses for tax filing purposes.

Fee Deductibility: PMS fees not deductible for individual investors.

NRE PMS Account: Repatriable funds, subject to TDS on gains.

NRO PMS Account: Non-repatriable, taxed similarly to resident accounts.

Tax Treaties: NRIs may benefit from double taxation avoidance agreements.

Equity-Oriented Funds: LTCG taxed at 10%, STCG at 15%, similar to equity shares.

Debt Fund Taxation: LTCG taxed at 20% with indexation (pre-2023).

Tax Planning: Strategies to minimize tax liability in PMS investments.

Dividend Distribution Tax (DDT): Abolished, dividends now taxed in investor's hands.

Set-Off Losses: Business losses from derivatives can offset other income.

Taxable Income: Includes capital gains, dividends, and interest from PMS.

Tax Slabs: Resident individuals taxed at progressive rates up to 30%.

Exemption Limits: LTCG up to Rs. 1.25 lakh exempt for equity investments.

Tax Certificates: Form 16A/TDS certificates issued for tax deducted.

Tax Filing: PMS investors must report all gains and income accurately.

Regulatory Compliance: SEBI mandates proper tax reporting by PMS providers.

Capital Losses: Can be set off against capital gains in the same year.

Carry Forward Losses: Capital losses can be carried forward for eight years.

Tax Audits: Required for high-value PMS transactions under tax laws.

NRI Taxation: Subject to TDS and slab rates, depending on account type.

Tax Transparency: PMS providers ensure clear tax-related disclosures.

Dividend Income Taxation: Taxed at investor's slab rate post-DDT abolition.

Tax Implications: Impact net returns from PMS investments.

Tax Efficiency: Portfolio strategies aim to minimize tax liabilities.

Capital Gains Calculation: Based on sale price minus purchase price.

Indexation Removal: Increases tax burden on debt fund gains post-2023.

TDS Compliance: PMS providers deduct tax as per regulatory requirements.

Tax Reports: Essential for accurate income tax return filing.

Investment Horizon: Impacts tax rates (LTCG vs. STCG).

Tax Treaties Benefits: Reduce tax liability for NRIs under DTAA.

Business Income Taxation: Derivative gains taxed at investor's slab rate.

Tax Documentation: PMS providers supply detailed tax statements.

Tax Planning Strategies: Include loss harvesting and tax-efficient investments.

Regulatory Oversight: SEBI ensures proper tax reporting by portfolio managers.

Client Tax Profile: Influences portfolio tax planning strategies.

Taxable Events: Sale of securities or receipt of dividends triggers tax.

Capital Gains Exemption: Limited exemptions for equity LTCG up to Rs. 1.25 lakh.

Tax Deductions: No deductions for PMS fees or operational expenses.

Tax Reporting Frequency: Quarterly and annual reports for tax compliance.

Investor Responsibilities: Accurate reporting of PMS income for tax purposes.

Tax Law Changes: Impact PMS investment strategies and net returns.

CHAPTER 12: REGULATORY, GOVERNANCE AND ETHICAL ASPECTS OF PORTFOLIO MANAGERS

SEBI Regulations 2020: Govern portfolio managers, ensuring investor protection.

Net Worth Requirement: Portfolio managers must maintain specified net worth.

Client Agreement: Outlines investment scope, fees, and manager duties.

Segregated Accounts: Client funds and securities held separately.

Disclosure Document: Details services, risks, and fees, provided before onboarding.

Code of Conduct: Ethical standards for portfolio managers, per SEBI.

Investor Charter: Outlines client rights and grievance redressal mechanisms.

KYC Norms: Mandatory client identity and financial verification.

Anti-Money Laundering (AML): Compliance with PMLA to prevent illegal transactions.

Transaction Records: Maintained for 10 years under PMLA regulations.

Confidentiality: Client information kept confidential, per SEBI rules.

Due Diligence: Enhanced checks for high-risk clients under PMLA.

SEBI Circulars: Provide guidelines for compliance and operations.

Grievance Redressal: SEBI mandates mechanisms for resolving client complaints.

Regulatory Reporting: Portfolio managers submit periodic reports to SEBI.

Client Consent: Required for changes in investment strategy or derivatives.

Portfolio Transparency: Detailed reports on performance and fees.

Compliance Officer: Ensures adherence to SEBI regulations.

Fraud Prevention: SEBI prohibits fraudulent securities transactions.

Insider Trading: Prohibited under SEBI regulations to ensure fairness.

Disclosure Requirements: Include client details, fees, and transaction data.

Audit Trail: Records of all transactions for transparency and compliance.

Performance Reporting: TWRR and benchmark comparisons provided to clients.

Risk Disclosure: Clients informed of investment risks and portfolio controls.

Fee Transparency: Detailed disclosure of fixed and performance fees.

Investor Protection: SEBI ensures fair practices and grievance redressal.

Regulatory Audits: SEBI inspections to verify compliance.

Client Communication: Regular updates on portfolio status and risks.

Ethical Standards: Portfolio managers adhere to SEBI's code of conduct.

PMS Agreement: Specifies investment restrictions and manager duties.

Direct Onboarding: Clients can onboard without intermediaries, per SEBI.

Transaction Execution: Managers ensure fair and efficient trade execution.

Portfolio Rebalancing: Maintains desired asset allocation.

Risk Management: Diversification and hedging to mitigate losses.

Investment Restrictions: Defined in client agreement, per SEBI rules.

Performance Fees: Charged on gains above high water mark or hurdle rate.

Client Funds: Segregated to prevent co-mingling with manager's funds.

Tax Reporting: PMS providers issue tax-related documents for compliance.

Portfolio Monitoring: Continuous tracking to optimize performance.

SEBI Oversight: Ensures transparency and fairness in PMS operations.

Client Risk Profile: Guides investment decisions and portfolio construction.

Regulatory Compliance: Adherence to SEBI and PMLA regulations.

Investor Grievances: SEBI-mandated mechanisms for quick resolution.

Confidentiality Rules: Client data protected under regulatory guidelines.

Due Diligence Process: Thorough checks to prevent financial misconduct.

Portfolio Adjustments: Based on market conditions and client needs.

Ethical Conduct: Portfolio managers maintain high ethical standards.

Regulatory Updates: Managers stay compliant with evolving SEBI rules.

Client Approval: Required for non-discretionary PMS transactions.

Transparency Standards: Detailed disclosures enhance investor trust.

Important Formulas

Gordon Growth Model (DDM): $P_0 = D_1 / (r - g)$

Sharpe Ratio: $S = (\text{Portfolio Return} - \text{Risk-Free Rate}) / \text{Standard Deviation}$

Treynor Ratio: $T = (\text{Portfolio Return} - \text{Risk-Free Rate}) / \text{Beta}$

Rate of Return: $R = (\text{End Value} - \text{Beginning Value} - \text{Contributions} + \text{Withdrawals}) / (\text{Beginning Value} + \text{Contributions} - \text{Withdrawals})$

Annual TWRR: $\text{Annual TWRR} = (1 + \text{TWRR})^{(1/n)} - 1$

Cost of Equity (CAPM): $r_e = R_F + \beta (R_M - R_F)$

Bond Pricing: $\text{Price} = \sum (\text{Coupon} / (1 + \text{YTM})^t) + (\text{Face Value} / (1 + \text{YTM})^T)$

Yield to Maturity (YTM): $\text{YTM} = (\text{Coupon} + (\text{Face Value} - \text{Price})/T) / ((\text{Face Value} + \text{Price})/2)$

Modified Duration: $\text{Modified Duration} = \text{Macaulay Duration} / (1 + \text{YTM}/\text{Frequency})$

Performance Attribution: Total Excess Return = Asset Allocation Effect + Security Selection Effect + Interaction Effect

Nominal Risk-Free Rate: Nominal rate = Real risk-free rate + Inflation.

Required Rate of Return: Required return = Nominal risk-free rate + Risk premium.

Free Cash Flow to Equity (FCFE): FCFE = Net Income + Depreciation – CapEx – Change in WC + Net Borrowing.

Free Cash Flow to Firm (FCFF): FCFF = EBIT(1 – Tax Rate) + Depreciation – CapEx – Change in WC.

IMPORTANT NOTE :

1. Attend **ALL** Questions.
2. For the questions you don't know the right answer – Try to eliminate the wrong answers and take a guess on the remaining answers.
3. DO NOT MEMORISE the questions & answers. It's not the right way to prepare for any NISM exam. Good understanding of Concepts is essential.

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All the Best ☺

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