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B.Com Honours

Semester I

Calicut University

Stock Market Fundamentals

Course Code: COM1FM105 (2) • Module 3 Notes

1. Fundamental Analysis: Selecting the Right Stocks

To build a profitable long-term portfolio, investors must evaluate the intrinsic value of businesses rather than speculating on daily price charts. Fundamental analysis is the method of evaluating a security by measuring its intrinsic value through examining related economic, financial, and qualitative factors. This module covers the EIC framework, key financial ratios, technical analysis basics, and stock taxation rules.

The EIC Analysis Framework

Fundamental analysis follows a top-down three-step sequence:

1. **Economy Analysis:** Examining macroeconomic indicators (GDP growth rates, inflation, interest rates, government fiscal policies) to check the overall business environment.
2. **Industry Analysis:** Analyzing specific sectors (e.g., IT, Banking, EV) using Porter's Five Forces, assessing industry growth potential, regulatory barriers, and market lifecycle.
3. **Company Analysis:** Reviewing the individual firm's competitive advantages, financial statements, management quality, and growth indicators.

Tools for Company Analysis & Key Financial Ratios

Investors analyze the financial health of a company using standard mathematical ratios:

- **Promoter Holding & Pledge:** Promoters represent the company founders. A high promoter holding shows commitment. However, investors must check the ****Pledge****—if promoters have pledged their shares as collateral for loans, it represents high financial risk.
- **Valuation Ratios:**
 - **Price-to-Earnings (P/E) Ratio:** Compares share price to Earnings Per Share (EPS). Indicates if a stock is overvalued or undervalued relative to earnings.
 - **Price-to-Book (P/B) Ratio:** Compares share price to the book value per share.
- **Profitability Ratios:**
 - **Return on Equity (ROE):** Measures how efficiently a company generates profits from shareholder capital.
 - **Return on Capital Employed (ROCE):** Measures profit relative to total capital (debt + equity) employed. E.g., $ROCE = \text{EBIT} / \text{Capital Employed}$.

2. Technical Analysis, Portfolio, and Taxation

Technical Analysis Basics

Unlike fundamental analysis, technical analysis evaluates securities by analyzing statistics generated by market activity, such as past prices and volume. It assumes that market prices reflect all known information, and prices move in trends that repeat over time.

Core Tools: **Candlestick Charts** (showing Open, High, Low, Close visually), **Support & Resistance Levels** (Support is the price level where buying interest stops a downward trend; Resistance is the price level where selling pressure halts an upward climb), and **Moving Averages** (smoothing out price noise to identify trends).

Portfolio Diversification

Diversification: The risk-management strategy of spreading investments across different assets, sectors, and companies to minimize the impact of any single asset's poor performance (the principle of "not putting all eggs in one basket"). **Portfolio Revision** is the process of periodically buying or selling assets to maintain the desired risk-return profile.

Dividends and Taxation on Stock Investments

Investors earn returns via capital gains (selling at a profit) and dividends (corporate profits shared with shareholders).

Capital Gains Tax in India:

- **Short-Term Capital Gains (STCG):** Applicable on shares sold within **12 months** of purchase. Taxed at a flat rate of **20%** (plus applicable cess/surcharge).
- **Long-Term Capital Gains (LTCG):** Applicable on shares held for **more than 12 months** before sale. Taxed at **12.5%** on gains exceeding ₹1.25 Lakhs per financial year.
- Dividends are taxed at the investor's individual income tax slab rates.

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