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B.Com Honours | Semester V | Calicut University

SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT

Course Code: COM5EJ302 • Module 3 Notes

Module III: Security Analysis & Behavioral Finance

Covers fundamental EIC framework, equity valuation models, technical chart analysis, Efficient Market Hypothesis (EMH), and psychological behavioral biases.

Unit 11: Fundamental Analysis – EIC Framework & Equity Valuation

1. EIC Framework: Economy Analysis (GDP, inflation, interest rates) → Industry Analysis (Life cycle, Porter's 5 forces) → Company Analysis (Financial ratios, earnings).
2. Gordon Dividend Growth Model (DDM):

$$\text{Intrinsic Value } V_0 = \frac{D_1}{k_e - g} = \frac{D_0 (1 + g)}{k_e - g}$$

Unit 12: Technical Analysis – Principles, Theories, & Indicators

Assumes market action discounts everything, prices move in trends, and history repeats. Dow Theory (Primary, Secondary, Minor trends), Elliott Wave Theory (5 impulse waves + 3 corrective waves), Candlestick patterns (Head & Shoulders, Double Top/Bottom), Technical Indicators (RSI, Moving Averages, MACD).

Unit 13: Efficient Market Hypothesis (EMH)

Weak Form: Stock prices reflect all past trading info (technical analysis useless).
Semi-Strong Form: Prices reflect all publicly available info (fundamental analysis useless).
Strong Form: Prices reflect all public and private/insider info.

Unit 14: Behavioral Finance – Cognitive & Emotional Biases

Studies psychological influences on investor decisions. Prospect Theory (loss aversion - pain of loss is twice pleasure of gain), Heuristics, Overconfidence, Anchoring, Herd Behavior.

Practical Problem 1 (Gordon Dividend Growth Model DDM Equity Valuation): A company paid a dividend of Rs. 10 per share last year (D_0). Dividends are expected to grow at a constant rate of 6% p.a. ($g = 0.06$). Required Rate of Return on Equity (k_e) = 14% p.a. Current Market Price = Rs. 115. Calculate (a) Expected Dividend next year (D_1), (b) Intrinsic Value of Share (V_0), and (c) Determine whether the stock is Overvalued or Undervalued.

Step-by-Step Solved Equity Valuation Statement:

- **1. Expected Dividend Next Year (D_1):**

$$D_1 = D_0 \times (1 + g) = \text{Rs. 10} \times (1 + 0.06) = \mathbf{\text{Rs. 10.60 per share}}$$

- **2. Intrinsic Value (V_0):**

$$V_0 = \frac{D_1}{k_e - g} = \frac{\text{Rs. 10.60}}{0.14 - 0.06} = \frac{\text{Rs. 10.60}}{0.08} = \mathbf{\text{Rs. 132.50 per share}}$$

- **3. Investment Recommendation:**
  Intrinsic Value ((V_0 = ext{Rs. 132.50})) > Current Market Price ((P_0 = ext{Rs. 115.00})).

  > **Stock is UNDERVALUED by Rs. 17.50 → BUY RECOMMENDATION!**