INVESTOR EDUCATION

INVESTING IN THE STOCK MARKET

Over the last five years, the Kenyan economy has been reinventing itself. From virtual stagnancy in 2001, the economy has expanded steadily to register a remarkable growth of more than 6% in 2006. This economic dynamism is expected to continue for the foreseeable future, fueled by capital formation and favourable macroeconomic environment.

One of the obvious beneficiaries of this economic renaissance is the stock market. In the past four years, the stock market in Kenya has grown by leaps and bounds with stock prices appreciating to record levels. On the average, the prices of quoted shares have more than quadrupled in as many years, a performance that is difficult to replicate in conventional types of investments – savings and deposit accounts, real estate, etc. Naturally, this has generated unprecedented interest in the stock market by investors of all hues. In an area traditionally considered the preserve of the sophisticated investor, it is gratifying to see virtually insatiable appetite for investment in stocks and shares from ordinary Kenyans of all social strata. One direct result of this new interest in the stock market is that all the recent six public offering of shares have been massively oversubscribed. KenGen, despite its large size, was oversubscribed more than three times; Scangroup, a little understood concept company, was oversubscribed six times; Eveready, a provincial company, was oversubscribed eight times; and despite the relatively high minimum subscription threshold for retail investors, AccessKenya was oversubscribed four times. More recently, Kenya Re IPO was a resounding success with oversubscription of more than four times. The message is clear: investors are thirsty for viable investment opportunities and thousands of ordinary mwananchi who never gave shares a thought a few years ago are buying them today.

There is no doubt that the stock market provides an excellent investment vehicle for putting your extra money to work so that it will earn a good return for you, either in the form of a regular income from dividends or in the form of capital appreciation or both. Studies carried out in the developed markets have shown that over the years investments in the capital markets, especially in equities, consistently out-perform all other investment classes. Sound stocks, purchased for investment – not for speculation – when their prices are low and held for the long pull, are likely to produce high profits through dividends and increases in capital value. Nevertheless it should never be forgotten that there is some kind of risk in virtually all types of investments, stocks and shares included. And for many people, the risk inherent in stock market investments can be greater than it needs to be because investors, especially small retail investors, do not take the time to understand the companies they are buying into –

their management, their products and their competitive environment, their corporate governance, et cetera. They do not take the trouble to learn the art of investing in stocks and shares.

Markets move in cycles with the ebb and flow of supply and demand and share prices can rise as well as fall. So every decision you make about what to do with your disposable income should take into consideration the potential risks in addition to the return you hope to realize on your investment. In general, in most forms of investment, the greater the return you try to get the greater the risk you must be prepared to take. If you put your money in a savings account, the risk that you may lose your money is relatively small compared to other types of investments. But you must also be prepared to earn only a small return on your investment. Your investment will not grow except by the redeposit of the interest you get and then only slowly. What does this mean for the stock market investor and especially the small investor? It means that investors should clearly understand the concept of risk and return and assume more interest and responsibility over their investments.

We believe that investor education is an important supervisory tool to promote investor protection. To this end the Authority has identified public and investor education as a key driver of its market growth agenda. But while Authority will always endeavour, as part of its mandate, to provide as much protection to investors as the law permits it, we also believe that the best protection is, and will always be an informed and knowledgeable investor. An educated investor is a protected investor, and a protected investor is a more willing player in the market. All too often, investors chase rumours resulting in losses through poor risk management and following of the herd. Therefore, investors should continuously take interest in their investments and seek all the information they need to know about a target company to enable them to act as effective watchdogs over their investments. They should know their rights, ask the right questions of their financial advisers, and know where to check to verify and clarify their doubts. The Authority has set out elaborate rules that specify minimum disclosure requirements for issuers of securities and listed companies in order to elicit full and accurate disclosure of material information that will enable investors make informed decisions.

Recently, initial public offerings (IPOs) have become very popular with investors. This is not surprising considering that all recent issues have significantly appreciated in prices immediately upon their debut at the Nairobi Stock Exchange and the lucky investors must have made a lot of money. Nevertheless, the securities issued by each company should be considered on their own merit and investors should take trouble to know as much as possible about the companies in which they invest their money: Many factors, some of which are perceptual and subjective in nature, combine to determine the quality of a stock. Highly important among these are:

- Management: Is the company a solid and reputable firm and does it have able, efficient and seasoned management?

- Products: Is the company producing goods and services for which there will be a continuing demand for the foreseeable future?

- Market share: Is the company operating in a field that is dangerously overcrowded, and is it in a strong competitive position?

- Earnings: Does the company have a satisfactory earnings record, and have reasonable dividends been paid regularly to shareholders? What are its future prospects?

- Asset base: Are the net assets per share reasonable relative to the market price of the share?

- Liquidity: Are the shares issued available in sufficient numbers and dispersion to enable the script to be bought and sold at any given time?

- Volatility: Has the price of the stock moved up and down without violently wide inexplicable fluctuations?

- Corporate governance: How strong is the company in terms of corporate governance scorecard?

Remember too that investors have widely divergent investment tastes and some are more risk averse than others. This is likely to reflect in the choice of securities in which they invest. Some Investors will be more concerned about capital preservation and growth while others are more attracted by liberal and generous dividend payouts. The type of investor you are will be a rough guide to the type of securities you should buy into.

The information contained in this article is meant to be a general guide issued in the interest of investor education. It should not be construed as constituting investment advice which can be obtained from one's investment adviser.