A survey to ascertain the Sentimental inclination of the Average Capital Market investor in Kenya.

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Abstract

For a little over three years (2004-2007), the Kenyan stock market was on a roller coaster, maintaining a sustained bullish trend. Billions of funds from all shades and characters of investors entered the market as quantum gains were reaped by way of capital appreciation. Between 2005 and 2007, investors enjoyed an average return of 54% capital appreciation (NSE-ASI: 2005-2007). In 2007, for instance, investors raked in a 75% return on their portfolios, as the All-shares Index, an indicator of market growth, climbed from 33, 189.30 year-end 2006 to 57,990.22 year-end 2007. The market capitalization climbed from Ksh. 5.12 trillion to Ksh. 13.30 trillion, a 159.7% appreciation. Nowhere in the world were these kinds of returns made. Then, abruptly, the party ended and many were caught with gargantuan hangovers that have refused to go. Between April 2008 and March 2009, the market has depreciated by over 70%. And the loss has continued to mount. The new face of the market is characterized by the following challenges: Increasing awareness of capital market opportunities is quite distant from the sophisticated expertise and skill required and possessed by analysts to review stocks and the market in general; Most of the over Ksh. 1.0 trillion loss in stock dealings in 2008/09 were borne by new entrants who were taken in by the rumble of quick gain in the midst of high volatility; The nature of the boom and burst experienced in the capital market bellies the novice, crowd mentality syndrome, greed, and profit seeking investment attitude devoid of strategic entry and exit stock trading approach. The average Kenyan investor is said not to be prepared for the market in terms of the required psychological balance in the face of inherent market risks. A survey of individual investors and Asset Managers was carried out to ascertain the psychological or sentimental inclination of the average capital market investor especially Kenyan investor. The questionnaire was the major survey instrument. The key finding of this study is that stock investment in Kenya is largely driven by sentiments or the bandwagon effect and the sentiments are not supported by any fundamentally or technically verifiable strategy. The stock market can be seen as an engine of discovery that reflects sentiments and emotions, rather than seen as a mathematical abstraction.

Key words: Survey, Sentimental inclination, Average, Capital market investor.

1.0 Introduction

Market psychology is the overall sentiment or feeling that the market is experiencing at any particular time. Greed, fear, expectations and circumstances are all factors that contribute to the investors overall investing mentality or sentiment. Though all the players in the market are expected to behave rationally, the above situations can be described as irrational as they account for the emotional aspect of the market which sometimes leads to unexpected outcomes that are not predicted by looking at the fundamentals. Technical analysts use charts, patterns and other indicators to assess the market's current psychological state in order to predict whether the market is heading in an upward or downward direction. Beyond the fundamental and technical analysis, market psychology or investors' sentiment is the missing link that must be connected to guide successful and profitable stock trading strategy.

In 2004, the government, through its agency, the Central Bank of Kenya (CBK) felt the country's financial institutional structure was too small and weak to drive any meaningful economic growth. To address this, the CBK announced a holistic banking sector reform agenda aimed at implementing a process of restructuring and consolidating the operational platforms of the banks, as the driver of other sectors of the economy. A major plank of the policy was the increase in the minimum shareholders' funds of the banks to Ksh. 25 billion from Ksh. 2.0 billion, with the overall effect of making the banks more responsive to the demands of the economy. In compliance with the order, the banks and other corporate entities from other sectors turned to the investing public to mobilize funds. They rolled out the drums and, using the media and innovative marketing strategy, galvanized the populace. Hence, a watershed in public participation in the stock market in Kenya was marked on the strength of the financial market reforms to strengthen particularly the banking sector to drive the other sectors of the economy. At the end of the recapitalization exercise on December 31, 2005, 25 banks had succeeded in raising Ksh. 25 billion apiece, with some pooling well above that. Expectedly the banking sub-sector of the Nairobi Stock Exchange (NSE) became the growth drivers of the capital market as the sector emerged the most capitalized, shoving the traditional leader, the breweries sector, to second place.

As a result of the hype created by recapitalization, fuelled by market operators: brokers, fund managers, analysts, many took to investing in stocks and shares. Data from the NSE show that between 2005 and June 2008, the volume of shares traded increased by 355.87% from 26.49 billion in 2005 to 120.76 billion by June 2008. Applications for new listings also witnessed a sharp growth. In 2005, 33 applications to issue 168.3 billion shares valued at Ksh. 526 billion were said to have been considered by the NSE Council and rose to 46 applications for 141.3 billion shares worth Ksh. 775.24 billion in 2006; a trend which was maintained in 2007. In spite of the investment frenzy, very few actually understood how the market worked and fewer still were bothered with the soundness or otherwise of companies they put their monies in as long as the company was listed on the Exchange. The result was an unprecedented rise in prices of stocks, due mainly to speculations, unsupported by fundamentals. The Frenzy took hold and continued to be fuelled by other key drivers. Other underlying fundamentals that drove the astronomical growth include: improved macro-economic governance, rising income, pension reforms, market reforms, and margin facility.

Many new investors in the market had been weaned on the notion that it was huge money making machine, capable of increasing investments unceasingly. The idea of a crash was never part of their learning process. So, to such people who are in the majority, the market crash of 2008 in Kenya was a strange phenomenon and that was why it caught many unawares. The signs were there alright, but few understood them. After attaining an unprecedented peak of 66, 121.93 points in mid March 2008 from 33,189.30 points at 2006 year end, the All-share Index suddenly changed direction, heading downwards hitting a low of 19,000 points. Also market capitalization rose to a peak of Ksh. 12.4 trillion from about Ksh. 5.0 trillion before it plunged to a low of Ksh. 4.8 trillion. Ironically, the change was unwittingly set in motion.

For a little over three years, the Kenyan stock market was on a roller coaster, maintaining a sustained bullish trend. Billions of funds from all shades and characters of investors entered the market as quantum gains were reaped by way of capital appreciation. Between 2005 and 2007, investors enjoyed an average return of 54% capital appreciation. In 2007, for instance, investors raked in a 75% return on their portfolios, as the All-shares Index, an indicator of market growth, climbed from 33, 189.30 year-end 2006 to 57, 990.22 year-end 2007. The market capitalization climbed from Ksh. 5.12 trillion to Ksh. 13.30 trillion, a 159.7% appreciation. Nowhere in the world were these kinds of returns made. Then, abruptly, the party ended and many were caught with gargantuan hangovers that have refused to go. Between April 2008 and March 2009, the market has depreciated by over 70%. And the loss has continued to mount. The new face of the market is characterized by the following challenges: Increasing awareness of capital market opportunities is quite distant from the sophisticated expertise and skill required and possessed by analysts to review stocks and the market in general. Most of the over Ksh. 1.0 trillion loss in stock dealings in 2008/09 were borne by new entrants who were taken in by the rumble of quick gain in the midst of high volatility. The nature of the boom and burst experienced in the capital market bellies the novice, crowd mentality syndrome, greed, and profit seeking investment attitude devoid of strategic entry and exit stock trading approach. The average Kenyan investor is said not to be prepared for the market in terms of the required psychological balance in the face of inherent market risks.

Until recently, stock trading or investment in the stock market was seen as an exclusive preserve of the elite. In early 90’s, public participation was put at less than 2% of the population. This has suddenly changed with active trading public estimated at over 5% of the country’s population currently. This growth is buoyed by massive awareness following various reforms in the financial sector. Therefore, with the consolidation exercise conducted by banks and other corporate organizations, the investing public in the stock market peaked to over 5% of the over 140 million strong population in 2007/2008(NSE Fact book 2009) and there were good returns. But from the first quarter of year 2008 to date the Kenyan stock market investment environment has been hostile to securities of companies quoted and unquoted and also to investors. The development therefore calls for a reappraisal of the market psychology.

From the above background, the major problem the study sets out to address is that the new entrants to the Kenyan capital market who, though constitute a significant number of investors in the market, lack the basic knowledge of how to trade in the market. Accordingly, the study examines the sentiments and emotions that build up to define market direction. It will ascertain the psychological or sentimental inclination of the average capital market investor with particular interest on Kenyan investor. The relevance of the study can be captured from the manner the author has tried to demystify the cult-image attached to the stock market and highlight its openness to the investing public. The study will position the investor in the right frame of mind to confidently trade and profit from the stock market. It will assist budding traders to become cool, calm, and collected traders. It will also provide the framework that will guide investors on how to profit from reading the behavior of the market. Above all, the study is organized in a way that will instill discipline of mind, show the methods for trading the markets, and show how one can manage money in trading accounts so that no string of losses can kick one out of the markets. Most importantly, the huge losses suffered by Kenyan stock traders under the current financial crisis would be significantly reduced in a future occurrence as the study provides guides to systematic trading strategy that will give early warning signal to such risks.

2.0 Literature Review

Bachelier (1900), a French mathematician, after observing the workings of the bond market on the French bourse in 1900, asked why bond prices move up and down. He asserted that sellers wanted to sell at the highest possible price, while buyers wanted to buy at the lowest possible price. In other words, a seller who thought the price was too high would sell immediately at the bid price, while a buyer who thought the price was too low would buy immediately at the price offered to the market. He therefore concluded that the bid and offer spread in the market had to represent the market's collective assessments of value of the securities. Elder (1993) noted that the stock market is a loosely organized crowd whose members bet that prices will rise or fall. He noted that since each price represents the consensus of the crowds at the moment of transaction, all traders are in effect betting on the future mood of the crowd. For Elder the crowd keeps swinging from indifference to optimism or pessimism, and from hope to fear. Most people do not follow their own trading plan because they let the crowd influence their feelings, thoughts, and actions. In the stock market, the bulls and bears battle, and the value of one's investment sinks or soars, depending on the actions of total strangers one cannot control the markets, you can only decide whether and when to enter or exit trades. There is the tendency for one's judgment to become clouded by emotions on entering the market crowd. These crowd-induced emotions make traders deviate from their trading plans and end up losing money. According to Elder, trades may be based on fundamental or technical analysis. It may also be based on hunches about economic and political trends, use of insider information, or simply based on hope. But the basic underlying factor is that the feelings of thousands of traders merge into huge psychological tide that moves the market. Tracy (2003) pointed out that "if your mind is not in gear with the market, or if you ignore changes in mass psychology of crowds, then you have no choice of making money trading in stocks. All wining professionals know the enormous importance of psychology in trading. All losing amateurs ignore it".

Bismark-Rewane (2007) among others identified mass psychology or band wagon effect on the part of the investing public as the major factor that accounted for the huge inflow of funds into the market. "In Kenya we have this 'herd mentality' when it comes to any investment or business idea that turns out good profit. Many others join the fray to take profit without being acquainted with the nitty-gritty of such business. This same mentality seems to have played out in the Kenyan capital market." According to Elder (1993) When you analyze the market, you are analyzing crowd behavior. Crowds behave alike in different cultures on all continents. Social psychologists have uncovered several laws that govern crowd behavior. A trader needs to understand how market crowds influence his mind. A successful trader must think independently. He needs to be strong enough to analyze the market alone and to carry out his trading decisions. Gann (1951) drew an analogy to describe the individual trader in the market thus: "If eight or ten people place their hands on your head and push you down, your knees will buckle, no matter how strong you are. The crowd may be stupid, but it is stronger than you. Crowds have the power to create trends. Never buck a trend. If a trend is up, you should only buy or stand aside. Never sell short because "the prices are too high" – never argue with

the crowd. You do not have to run with crowd – but you should never run against it." He asserts that successful trading stands on three pillars: psychology, market analysis, and money management. "Every winner needs to master the three essential components of trading: a sound individual psychology, a logical trading system, and a good money management plan." These essentials are like three legs of a stool – remove one and the stool will fall, together with the person who sits on it. Losers try to build a stool with only one leg, or two at the most. They usually focus exclusively on trading systems.
O'neil (1995) also posits that "your trades must be based on clearly defined rules. You have to analyze your feelings as you trade, to make sure that your decisions are intellectually sound. You have to structure your money management so that no string of losses can kick you out of the game." According to Shapiro (1991), "a successful trader is a realist. He knows his abilities and limitations. He sees what is happening in the markets and knows how to react to them. He analyzes the markets without cutting corners, observes his own reactions, and makes realistic plans. A professional trader cannot afford illusions." He further pointed out that one's feelings have an immediate impact on his equity account. You may have a brilliant trading system, but if you feel frightened, arrogant, or upset, your account is sure to suffer. Your success or failure as a trader depends on controlling your emotions. Once an amateur takes a few hits and gets a few margin calls, he becomes fearful and starts developing strange ideas about the markets. Losers buy, sell, or miss trades as a result of their fantasies. Fantasies, he explained, influence our behavior even if we are not consciously aware of it; they distort reality and stand in the way of trading success. A successful trader must identify his fantasies and get rid of them.

In one of the best known books on mass psychology, LeBon (1982) wrote that when people gather in a crowd, "Whoever be the individuals that compose it, however like or unlike be their mode of life, their occupations, their character, or their intelligence, the fact that they have been transformed into a crowd puts them in possession of a sort of collective mind which makes them feel, think, and act in a manner quite different from that in which each individual of them would feel, think, and act were he in a state of isolation." His expose gives deep insight into the understanding of behavioral patterns of the market crowd and the individual trader. People change when they join crowds. They become more credulous and impulsive, anxiously search for a leader, and react to emotions instead of using their intellect. An individual who becomes involved in a group becomes less capable of thinking for himself.

The experiments of American social psychologists in the 1950s have proven that people think differently in groups than they do alone. For example, an individual can easily tell which of the two lines on a piece of paper is longer. He loses that ability when he is put into a group whose other members deliberately give wrong answers. Intelligent, college-educated people believe a group of strangers more than they believe their own eyes. Group members believe others, and particularly group leader, more than they believe themselves. Theodore Adorno (1974) and other sociologists showed in their two-volume study, The American Soldier, that the single best predictor of an individual's effectiveness in combat was his relationship with his sergeant. A soldier who trusts his leader will literally follow him to his death. A trader who believes he is following a trend may hold a losing position until his equity is wiped out. Sigmund Freud(1974) explained that groups are held together by the loyalty of members to the leader. Our feelings toward group leaders stem from our childhood feelings toward our fathers – a mixture of trust, awe fear, the desire for approval, and potential rebellion. When we join groups, our thinking on issues involving that group regresses to the level of a child. A leaderless group cannot hold itself together and falls apart. This explains buying and selling panics. When traders suddenly feel that the trend they have been following has abandoned them, they dump their positions in a panic.

A trader may have rationally decided to take position in the market, but the moment he puts on a trade, the crowd starts sucking him in. There is therefore, need to pay attention to several signs that indicate when a trader starts turning into a panicky and sweaty crowd member instead of an intelligent trader. Many traders are puzzled why markets always seem to reverse immediately after they dump their losing position. According to Appel (1989), this happens because crowd members are gripped by the same fear – and everybody dumps at the same time. Once the fit of selling has ended, the market has nowhere to go but up. Optimism returns to the marketplace, and the crowd feels greedy and goes on a new buying binge. When you put on a trade, you feel the desire to imitate others and overlook objective trading signals. This is why you need to develop and follow trading systems and money management rules. They represent your rational individual decisions, made before you enter a trade and become a crowd member.

Belland (1989) notes that, “a trade begins when you decide to enter the market and ends only when you decide to take yourself out. Having a good trading system is not enough. Most traders with good trading system wash out of the markets because psychologically they are not prepared to win.” Many traders think they would be successful if they could trade a bigger account. A loser is not undercapitalized – his mind is undercapitalized. A loser can destroy a big account almost as quickly as a small one. He overtrades, and his money management is sloppy. He takes risks that are too bit, whatever the size of his account. No matter how good his system is, a streak of bad trades is sure to put him out of business. *A trader who wants to survive and prosper must control his losses. You do that by risking only a tiny fraction of your equity on any single trade. Give yourself several years to learn how to trade. Do not lose more than 2 percent of your equity on any single trade. Learn from cheap mistakes in a small account.*

Angell (1979) corroborated Shilling (2005) as he said “markets always change and defeat automatic trading systems. Yesterday’s rigid rules work poorly today and will probably stop working tomorrow. A competent trader can adjust his methods when he detects trouble. An automatic system is less adaptable and self-destructs. There are good trading systems out there, but they have to be monitored and adjusted using individual judgment.” A computer allows you to speed up your research and follow up on more leads. It is not a substitute for making trading decisions. A computer helps you analyze more markets in greater depth, but the ultimate responsibility for every trade rests with you.

Charles Mackay (1980) in his book *Extraordinary Popular Delusions and the Madness of Crowds* first drew attention to market manias. Belland (1989) noted that due to modern telecommunications, guru manias spring up faster and continue to sweep the markets. Belland (1989) identified three types of gurus in the financial markets: Market Cycle Gurus, Magic Method Gurus, and Dead Gurus. Some Gurus call important market turns, others promote “unique methods” – new highways to riches. A new market cycle guru emerges in almost every major stock market cycle, one every four years. A guru’s fame tends to last for 2 to 3 years. The reigning period of each guru coincides with a major bull market in the United States.

A market cycle guru forecasts all major rallies and declines. Each correct forecast increases his fame and prompts even more people to buy or sell when he issues his next forecast. As more and more people take notice of the guru, his advice becomes a self-fulfilling prophecy. When you recognize a hot new guru, it pays to follow his advice. He noted that the success of a market cycle guru depends on more than short-term luck. He has a pet theory about the market. That theory – cycles, volume, Elliott Wave, and whatever is usually developed several years prior to reaching stardom. At first, the market refuses to follow an aspiring guru's pet theory. Then the market changes and for several years comes in gear with theory. That is when the star of the market guru rises high and bright above the marketplace.

A market cycle guru is an outsider with a unique theory. A guru remains famous for as long as the market behaves according to his theory –usually for less than the duration of one 4-year market cycle. At some point the market changes and starts marching to a different tune. A guru continues to use old methods that worked spectacularly well in the past and rapidly loses his following. When the guru's forecasts stop working, public admiration turns to hatred. It is impossible for a discredited market cycle guru to return to stardom. The reigning guru in the early 1970s was Edson Gould. He based his forecasts on policy changes of the Federal Reserve, as reflected in the discount rate. His famous rule of "three steps and a stumble" stated that if the Federal Reserve raised the discount rate three times, that showed tightening and led to a bear market. Lowering the discount rate in three steps revealed a loosening of the monetary policy and led to a bull market. Gould also developed an original charting technique called speed lines - shallow trend lines whose angles depended on the velocity of a trend and the depth of market reactions.

Gould became very hot during the bear market of 1973-1974. He vaulted to prominence after correctly calling the December 1974 bottom, when the Dow Jones Industrials fell to near 500. The market rocketed higher, Gould persistently identified its important turning points using speed lines, and his fame grew. But soon the United States was flooded with liquidity, inflation intensified, and Gould's methods, developed in a different monetary environment stopped working. By 1976, he had lost most of his following, and few people today even remember his name.

The new market cycle guru emerged in 1978. Joseph Granville (1976) stated that changes in stock market volume preceded changes in prices. He expressed it colorfully: "volume is the steam that makes the choo-choo go." Granville developed his theory while working for a major Wall Street brokerage firm. He wrote in his autobiography that the idea came to him while sitting on a toilet contemplating the design of floor tiles. Granville took his idea from the bathroom to the chartroom, but the market refused to follow his forecasts. He went broke, got divorced and slept on the floor of his friend's office. By the late 1970s, the market started to follow Granville's scripts as never before or since, and people began to take notice. Granville toured the United States speaking to overflow crowds. He arrived on stage in a carriage, issued forecasts, and chided "bag holders" who would not recognize his theory. He played piano, sang, and, on occasion, even dropped his pants to make a point. His forecasts were spectacularly correct; he drew attention to himself and became widely quoted in the mass media. Granville became big enough to move the stock market. When he announced that he was bearish, the Dow dropped over 40 points in a day – a huge decline by the standards of that time. Granville became intoxicated with his success. The market surged higher in 1982, but he remained very bearish and kept advising his dwindling band of followers to continue to sell short. The market rocketed higher into 1983. Granville finally gave up and recommended buying when the Dow doubled in value. He continued to publish a market newsletter, a shadow of his former successful self.

A new guru entered the spotlight in 1984. Robert Prechter has made a name for himself as an Elliott Wave theorist. Elliott was an impecunious accountant who developed his market theory in the 1930s. He believed that the stock market rallied in 5 waves and fell in 3 waves, which in turn could be subdivided into lesser waves. Like other market cycle gurus before him, Prechter had been writing an advisory letter for many years with modest success. When the bull market penetrated the 1000 level on the Dow, people began to pay attention to the young analyst who kept calling for the Dow to reach 3000. The bull market went from strength to strength, and Prechter's fame grew by leaps and bounds.

In the roaring bull market of the 1980s, Prechter's fame swept outside the narrow world of investment newsletters and conferences. Prechter appeared on national television and was interviewed by popular magazines. In October 1987, he appeared to vacillate, first issuing a sell signal, then telling his followers to get ready to buy. As the Dow crashed 500 points, mass adulation of Prechter gave way to scorn and hatred. Some blamed him for the decline, others were angry that the market never reached his stated target of 3000. Prechter's advisory business shrank, and he largely retired from it.

Elder further observed that all market cycle gurus have several traits in common: They become active in the forecasting business several years prior to reaching stardom. Each has a unique theory, a few followers, and some credibility, conferred by sheer survival in the advisory business. The fact that each guru's theory did not work for a number of years is ignored by his followers. When the theory becomes correct, the mass media take notice. When a theory stops working, mass adulation of a guru turns to hatred. When you recognize that a successful new guru is emerging, it is profitable to jump on his bandwagon. It is even more important to recognize when a guru has reached his peak. All gurus crash – and by definition, they crash from the height of their fame. When a guru becomes accepted by the mass media, it is a sign that he has reached his crest. The mainstream media is wary of outsiders. When several mass magazines devote space to a hot market guru, you know that his end is near.

According to Douglas (1990), "mass psychology being what it is, new guru will certainly emerge. An old cycle guru never fully comes back. Once he stumbles, the adulation turns to derision and hatred. An expensive vase, once shattered, can never be fully restored." Douglas pointed out that market cycle gurus are creatures of the stock market, but "Magic Method Gurus" are more prominent in the derivatives markets, especially in the futures markets. A "method guru" erupts on the financial scene after discovering a new analytic or trading method. A magic method guru sells a new set of keys to market profits. As soon as enough people become familiar with a new method and test in the markets, it inevitably deteriorates and starts losing popularity. Markets are forever changing, and the methods that worked yesterday are not likely to work today and even less likely to work a year from now.

The third type of a market guru is a dead guru. His books are reissued; his market courses are scrutinized by new generations of eager traders. Other promoters profit from his reputation and from expired copyrights. R. N. Elliot is one of the known dead gurus, while W.D. Gann remains the best example of such a legend. The public wants gurus, and new guru will come. As an intelligent trader, you must realize that in the long run, no guru is going to make you rich. You have to work on that yourself. Trading is a very hard game. A trader who wants to be successful in the long run has to be very serious about what he does. He cannot afford to be naïve or to trade because of some hidden psychological agenda.

Your feelings have an immediate impact on your account equity. You may have a brilliant trading system, but if you feel frightened, arrogant, or upset, your account is sure to suffer. When you recognize that gambler's high or fear is clouding your mind, stop trading. Your success or failure as a trader depends on controlling your emotions. Markets evoke powerful greed for more gains and a great fear of losing what we've got. Those feelings cloud our perceptions of opportunities and dangers. Nison (1991) counseled "You need to make trading as objective as possible. Keep a diary of all your trades with 'before and after' charts, keep a spreadsheet listing all your trades, including commissions and slippage, and maintain very strict money management rules. You may have to devote as much energy to analyzing yourself as you do to analyzing the markets."

Traders turn to gurus, trading system vendors, newspaper columnists, and other market leaders. But, as Plummer (1991) brilliantly pointed out, the main leader of the market is price. Price is the leader of the market crowd. Traders all over the world follow the market's upticks and downticks. Price seems to say to traders, "Follow me, and I will show you the way to riches." Most traders consider themselves independent. Few of realize how strongly to focus on the behavior of the group leader price. Vince (1990) described the characters of the market animals that influence price trends in the market – these are the bulls, the bear, the sheep and the hogs. A bull fights by striking up with his horns. A bull is a buyer – a person who bets on a rally and profits from a rise in prices. A bear fights by striking down with his paws. A bear is a seller – a person who bets on a decline and profits from a fall in prices. Hogs are greedy. They get slaughtered when they trade to satisfy their greed. Some hogs buy or sell positions that are too large for them and get destroyed by a small adverse move. Other hogs overstay their positions – they keep waiting for profits to get bigger even after the trend reverses. Sheep are passive and fearful followers of trends, tips and gurus. They sometimes put on a bull's horns or a bear skin and try to swagger. You recognize them by their pitiful bleating when the market becomes volatile. Whenever the market is open, bulls are buying, bears are selling, hogs and sheep get trampled underfoot, and the undecided traders wait on the side the latest prices for any trading vehicle. Thousands of eyes are focused on each price quote as people make trading decisions.

According to Belveal (1989) price means different things to different people. For some "Price is a perceived value." Others say, "Price is what a person at one particular point in time is willing to pay another person for a commodity." Some others say "Price is what the last person paid for it. That's the price right now." Another suggests, "It is what the next person will pay." So it was the difference in the perception and the willingness of the next person to pay for it. What you're paying for is just a piece of a paper whose value depends on the intrinsic dividend value. He posits that traders who cannot give a clear definition of price do not know what they are analyzing. Your success or failure as a trader depends on handling prices – and you had better know what they mean.

Using his animal character analogy, Vince(1990) explained further that there are three groups of traders in the market: buyers, sellers and undecided traders. "Ask" is what a seller asks for his merchandise. "Bid" is what a buyer offers for that merchandise. Buyers and sellers are always in conflict. Buyers want to pay as little as possible, and sellers want to charge as much as possible. If members of both groups insist on having their way, no trade can take place. No trade means, no price – only wishful quotes of buyers and sellers. A seller has a choice: to wait until prices rises, or to accept a lower offer for his merchandise. A buyer also has a choice: to wait until prices come down, or to offer to pay more to the sellers. A trade occurs when there is a momentary meeting of two minds: An eager bull agrees to a seller's terms and pays up, or an eager bear agrees to a buyer's terms and sells a little cheaper. The presence of undecided traders puts pressure on both bulls and bears. When a buyer and a seller bargain in private, they may haggle at a leisurely pace. The two must move much faster when they bargain at the Exchange. They know that they are surrounded by a crowd of other traders whom may but in on their deal at any moment. The buyer knows that if he thinks for too long, another trader can step in and snap away his bargain. A seller knows that if he tries to hold out for a higher price, another trader may step in and sell at a lower price. T he crowd of undecided traders makes buyers and sellers more anxious to accommodate their opponents. A trade occurs when there is a meeting of two minds.

Buyers are buying because they expect prices to rise. Sellers are selling because they expect prices to fall. Buyers and sellers trade while surrounded by crowds of undecided traders. They may become buyers or sellers as prices change or as time passes. Buying by bulls pushes markets up, selling by bears pushes markets down, and undecided traders make everything happen faster by creating a sense of urgency in buyers and sellers. Traders come to the markets from all over the world: in person, via computers, or through their brokers. Everybody has a chance to buy and to sell. Elder(1993), Vince(1990) and Belveal(1989) were all in agreement as they held that each price is a momentary consensus of value of all market participants, expressed in action. Price is a psychological event – a momentary balance of opinion between bulls and bears. Prices are created by masses of traders – buyers, sellers and undecided people. The patterns of prices and volume reflect the mass psychology of the markets. This position was strongly supported by Alexander and Sharpe (1991). They however, hinged their position on Markowitz's Efficient Market Hypothesis (EMH), and states that an externally efficient market is one in which information is quickly and widely disseminated, thereby allowing each security's price to adjust rapidly in an unbiased manner to new information so that it reflects investment value.

Technical analysts or chartist build on the crowd or mass behavior to determine price movements in the market. As noted earlier, each price represents a momentary consensus of value between buyers, sellers, and undecided traders at the moment of transaction. Wilder & Welles Jr. (1976) noted that "there is a crowd of traders behind every pattern in the chart book. Crowd consensus changes from moment to moment. Sometimes it gets established in a very low-key environment, and at other times the environment turns wild. Prices move in small increments during quiet times. When a crowd becomes either spooked or elated, prices begin to jump. Imagine bidding for a life preserver aboard a sinking ship – that's how prices leap when masses of traders become emotional about a trend. An astute trader tries to enter the market during quiet times and take profits during wild times."

Technical analysts study swings of mass psychology in the financial markets. Each trading session is a battle between bulls, which make money when prices rise, and bears, which profit when prices fall. The goal of technical analysts is to discover the balance of power between bulls and bears and bet on the winning group. If bulls are much stronger, you should buy and hold. If bears are much stronger, you should sell and sell short. If both camps are about equal in strength, a wise trader stands aside. He lets bullies fight with each other and puts on trade only when he is reasonably sure who is likely to win.

Mckay(1980) remarked that when you analyze the market, you are analyzing crowd behavior. Crowds behave alike in different cultures on all continents. Social psychologists have uncovered several laws that govern crowd behavior. A trader needs to understand how market crowds influence his mind. A successful trader must think independently. He needs to be strong enough to analyze the market alone and to carry out his trading decisions. Corroborating Mckay, Angell (1979) in his analogy says "if eight or ten people place their hands on your head and push you down, your knees will buckle, no matter how strong you are. The crowd may be stupid, but it is stronger than you. Crowds have the power to create trends. Never buck a trend. If a trend is up, you should only buy or stand aside. Never sell short because 'the prices are too high' – never argue with the crowd. You do not have to run with crowd – but you should never run against it."

Kannerman and Tversky (1984) counseled, "You need to base your trades on a carefully prepared trading plan and not jump in response to price changes. It pays to write down your plan. You need to know exactly under what conditions you will enter and exit a trade. Do not make decisions on the spur of the moment, when you are vulnerable to being sucked into the crowd." You can succeed in trading only when you think and act as an individual. The weakest part of any trading system is the trader himself. Traders fail when they trade without a plan or deviate from their plans. Plans are created by reasoning individuals. Impulsive trades are made by sweaty group members. You have to observe yourself and notice changes in your mental state as you trade. Write down your reasons for entering a trade and the rules for getting out of it, including money management rules. You must not change your plan while you have an open position. You ensure your survival as a trader when on a clear day you tie yourself to the mast of a trading plan and money management rules.

Plummer(1989) gave the under-currents of the market wave thus: Few traders act as purely rational human beings. There is a great deal of emotional activity in the markets. Most market participants act on the principle of "monkey see, monkey do." The waves of fear and greed sweep up bulls and bears. Markets rise because of greed among buyers and fear among short sellers. Bulls normally like to buy on the cheap. When they turn very bullish, they become more concerned with not missing the rally than with getting a cheap price. A rally continues as long as bulls are greedy enough to meet sellers' demands. The sharpness of a rally depends on how traders feel. If buyers feel just a little stronger than sellers, the market rises slowly. When they feel much stronger than sellers, the market rises fast. It is the job of a technical analyst to find when buyers are strong when they start running out of steam. Short sellers feel trapped by rising markets, as their profits melt and turn into losses. When short sellers rush to cover, a rally becomes nearly vertical. Fear is a stronger emotion than greed, and rallies driven by short covering are especially sharp. Markets fall because of greed among bears and fear among bulls. Normally bears prefer to sell short on rallies, but if they expect to make a lot of money on a decline, they don't mind shorting on the way down. Fearful buyers agree to buy only below the market. As long as short sellers are willing to meet those demands and sell at a bid, the decline continues. As bulls' profits melt and turn into losses, they panic and sell at almost any price. They are so eager to get out that they hit the bids under the market. Markets can fall very fast when hit by panic selling.

The longer a rally continues, the more technicians get caught up in bullish sentiment, ignore the danger signs, and miss the reversal. The longer a decline goes on, the more technicians get caught up in bearish gloom and ignore bullish signs. Pacelli (1989) reflecting on the above opined that it helps to have a written plan for analyzing the market. "We have to decide in advance what indicators we will watch and how we will interpret them." He explained that floor traders use several tools for tracking the quality and intensity of a crowd's feelings. They watch the crowd's ability to break through recent support and resistance levels. They keep an eye on the flow of "paper" – customer orders that come to the floor in response to price changes. Floor traders listen to the changes in pitch and volume of t he roars on the exchange floor. If you trade away from the floor, you need other tools for analyzing crowd behavior. Your charts and indicators reflect mass psychologist, often armed with a computer.

Hunches and gut feel more than anything else drive activities at the stock market. This is more so given the influx of new investors into the market. But as Kleinfield (1983) pointed out, there are two alternatives to "hunches and gut feel trading": One is fundamental analysis; the other is technical analysis. Major bull and bear markets result from fundamental changes in supply and demand. Fundamental analysts follow crop reports, study the actions of the Federal Reserve, track industry utilization rates, and so on. Even if you know those factors, you can lose money trading if you are out of touch with intermediate – and short-term trends. They depend on the crowd's emotions. Technical analysts believe that prices reflect everything known about the market, including all fundamental factors. Each price represents the consensus of value of all market participants – large commercial interests and small speculators, fundamental researchers, technicians and gamblers. Technical analysis is a study of mass psychology. It is partly a science and partly an art. Technicians use many scientific methods, including mathematical concepts of game theory, probabilities, and so on. Many technicians use computers to track sophisticated indicators. Technical analysis is also an art. The bars on a chart coalesce into patterns and formations. When prices and indicators move, they produce a sense of flow and rhythm, a feeling of tension and beauty that helps you sense what is happening, how to trade. Individual behavior is complex, diverse, and difficult to predict. Group behavior is primitive. Technicians study the behavior patterns of market crowds. They trade when they recognize a pattern that precede past market.

Many traders believe that the aim of a market analyst is to forecast future prices. The amateurs in most fields ask for forecasts, while professionals simply manage information and make decisions based on probabilities. But Lefevre (1985) argued that to make money trading, you do not need to forecast the future. You have to extract information from the market and find out whether bulls or bears are in control. You need to measure the strength of the dominant market group and decide how likely the current trend is to continue. You need to practice conservative money management aimed at long-term survival and profit accumulation. You must observe how your mind works and avoid slipping into greed or fear. A trader who does all of this will succeed more than any forecaster.

A tremendous volume of information pours out of the markets during trading hours. Changes in prices tell us about the battles of bulls and bears. A trader's job is to analyze this information and bet on the dominant market group. Use your common sense when you analyze markets. When some new development puzzles you, compare it to life outside the markets. For example, indicators may give you buy signals in two markets. Should you buy the market that declined a lot before the buy signal or the one that declined a little? Compare this to what happens to a man after a fall. If he falls down a flight of stairs, he may dust himself off and run up again. But if he falls out of a third story window, he's not going to run anytime soon; he needs time to recover. Neill (1985) observes that prices seldom rally very hard immediately after bad decline. Successful trading stands on three pillars. You need to analyze the balance of power between bulls and bears. You need to practice good money management. You need personal discipline to follow your trading plan and avoid getting high in the markets.

3.0 Research Methodology

In this study, archival research was combined with oral interview of individual investors, stockbrokers and asset Managers to ascertain the psychological or sentimental inclination of the average capital market investor relative to stock market investors in Kenya. The major sources of data were textbooks, journals, periodicals, NSE Fact books and oral interviews of active stock market players.

4.0 Results and Discussions

The Kenyan stock market is a huge crowd of investors, united by modern telecommunications, in pursuit of profit at each other's expense. Each member of the crowd tries to take money away from other members by outsmarting them. The market is a uniquely harsh environment because every investor is against each other. In trading, each investor competes against the brightest minds in the market while fending off the weight of commissions and other charges.

Kurfi (2007) speaking on the level of awareness created by banks during the rain of public offerings captured the sudden upsurge and the underlying low market knowledge of the participants. He said, "I cannot compare the number of investors playing the market now with what it used to be; both literates and illiterates. Some don't even know what a dividend warrant is, some see it as receipt. I dealt with a man who came from one of the villages with a bundle of dividend warrants and he said 'I have only been getting these receipts from the companies'. Some will come with laminated share certificates, they do not know they can trade on the certificates and they laminate them like a photo album. When companies are doing their public offers, marketers will go to the interior areas and sell the offers. After they are sold, the investors do not know what they have bought. And so, when they receive warrants, they do not appreciate it. How I wish that the companies should be more involved in providing enlightenment to investors so that they will know the importance of what they have bought and not to leave them ignorant." This is the picture that characterizes the Kenyan stock market.

Abegunde (2004) in a presentation to Capital Market Correspondence noted that level of awareness of the opportunities in the capital market in Kenyan is rapidly increasing. He attributed it to the high level of return being delivered by the market and the elaborate daily press coverage of market activities. He traced the typical price cycle that reflects bear and bull markets. When the stock market undergoes a significant price decline, it generates a climate of fear. When a market bottom is reached, extreme pessimism reigns. At that time, a bull market starts. As price gains are made, fear starts to recede. As further gains are made, caution sets in. However, as significant price appreciation takes place with the bull market continuing, investors tend to forget the pessimistic bear market days. At that time investor attitude can be described as confident and euphoric. By the time a top is reached, most investors remain convinced that the market will keep going up indefinitely. At that point, the bear market starts. As the market starts declining, the same emotions characterize the market but in the reverse direction – confidence, caution, and fear. Finally, when the bottom is reached, the feeling is widespread that prices will continue to decline even further. At that time, the next bull market is ready to start.

Unegbu (2009) explained that a combination of several factors starts a bull market. These include turn-around in the economy or recovery from recession, reduction in interest rates that eases credit and improves liquidity in the system, increase in inflation and performance of company. Generally, factors that affect upward price movement tend to initiate a bullish market. A bear market is every investor's nightmare. Many bear markets begin when the economy and markets are steaming ahead and catch investors by surprise. When it does arrive, a bear market creates panic and pessimism. However, for those who are able to forecast the onset of a bear market and lighten stock investments in time, it presents a great opportunity.

The Kenyan stock market is influenced by a number of seasonal factors that have a bearing on the behavior of the stock market. For example, it is known that prices fall in December because of Christmas. A trader should know these seasons in order to take appropriate vantage position. Some of these seasons are peculiar to each market and related to local occurrences. The Kenyan Stock Market reacts to several development and timings as highlighted. For example, information shows that over Ksh. 1 billion is paid out every January as upfront and housing allowances by banks, parastatals and multinational companies. The bulk of this amount is invested in stocks and the resulting pressure on the stock market induces price appreciation. End of months are usually characterized by price fall. This has been attributed to margin traders. Banks usually put pressure on margin traders that have overtraded and exceeded overdraft limit during the month to make their account good and cover up before last day of the month when returns would be made. End of regular quarters usually witness price increases especially of blue chip companies due to window dressing by portfolio managers. Fund managers file their report and render statements of valuation at the end of every quarter. To look good, fund managers sell their poorly performing stocks and dress up their portfolio with blue chip stocks and dilute cost on earlier high price purchase. It is characteristic of share prices to fall in December because of the desire of investors to realize money to fund the expenses of the yuletides season. This increases the supply of stocks in the market and consequently price fall. The effect of Christmas on the Nairobi Stock Market has reduced in recent times. Financial year for most banks end between March and June. In order to improve their liquidity position and comply with liquidity ratio requirement, bank recall facilities earlier granted and this results in dumping of stocks.

Stock price does not rise in an uninterrupted manner when it is in an upward trend or rates. Price movements upward hit some imaginary resistance line it turns and starts falling until it hits the level of support. These imaginary points of resistance and support are referred to as pivot points. Pivot points are those levels that are specified by traders as limits. Although some analysts believe that pivot points can be scientifically deduced, they are largely speculative and sentimental. It however has a bearing on the last price low, volume traded and the duration of the low. The pivot point relative to the previous low increases as the price of the stock rises.

Stock prices exhibit a particular trend before and after benefit payment (Close of Register). When benefits are to be declared the rumor of it is usually in the market long before it is officially declared. This rumor occurs at two levels before the result is officially declared. At the first level, proactive traders, fundamental analysts and inner caucus of the company will have an indication of the benefit to be declared. At this point the stock price will rise steeply and stagnate until the second stage. At the second stage, more analysts, traders and a wider range of insiders will have knowledge of the benefit. At this point market hearsay is prominent and stock price experience the second significant rise and stagnates or rises gradually until the benefit is officially declared. Upon the declaration of the benefit, the majority of the market starts to buy and the final flight of price is experienced. This will last until the day of closure of register when the share price is adjusted for the benefit. Post adjustment, share price rises slightly for a short period as a result of perceived under valuation of the stock. However, as soon as bonus certificates are released, the shares hit the market and induce a price fall to a level below the ex div., ex-script price.

Stock generally exhibit price rise or decline post public offering. The direction depends largely on the offer price for IPO and Offer price vis-à-vis secondary market price for quoted stocks. IPOs have reputation of price increase after listing of the offer. Price movement after listing depends on level of success of the offer and market trend during the period of technical suspension. Price movement after rights offering depends largely on the discount at which the Rights were offered i.e. the difference between the quoted price and the offer price and also the market trend during the period of technical suspension.

5.0 Recommendations

Based on the findings of this study, a trader who wants to survive and prosper must control his losses. He does that by risking only a tiny fraction of his equity on any single trade. He should give himself enough time to learn how to trade. He should avoid loss of more than 2 percent of his equity on any single trade. Every winner needs to master three essential components of trading: a sound individual psychology, a logical trading system, and a good money management plan. These essentials are like three legs of a stool – remove one and the stool will fall, together with the person who sits on it. Losers try to build a stool with only one leg, or two at the most. They usually focus exclusively on trading systems. Trades must be based on clearly defined rules. You have to analyze your feelings as you trade, to make sure that your decisions are intellectually sound. You have to structure your money management so that no string of losses can kick you out of the game.

Understanding stock market behavior is a pre-requisite to successful trading. Mapping out an effective trading strategy is dependent on one's ability to play the market, which also requires an extensive grasp of how the market behaves. It is very important for traders to learn how to select stocks and after buying, monitor their performance. They should also develop the ability to read the overall market. This is important because the health and performance of the market influence the performance of individual stocks in the short term.

Stock markets exhibit daily, weekly, monthly, quarterly and annual behaviors. Similarly, stocks markets respond to internal and external developments. In view of this, it is important that a trader understands the state of the market (bear market, bull market) because each one of these factors can affect any stock. Market behavior and trends can be monitored through the major market averages and indices. These indices include Market Capitalization, All share Index and the various indices of fund managers. The primary objective is to highlight the underlying trend and use them as a bench mark against which performance of portfolio can be measured. To keep abreast of market behavior a trader should monitor and observe the following: Market capitalization, All share Index, Trading Volumes, Price high and low, Fund Manager Indices. This information can be sourced from daily official list of the Nairobi Stock Exchange, Newspapers or Stockbrokers.

To get the maximum benefit in a bull market, a trader should have the courage to buy stocks when the economic and market picture look very bleak. A trader should invest when a bull market starts in order to generate huge gains. Stocks should not be bought indiscriminately during the early stage of a bull market. A trader should analyze and identify the potential leaders because they are the first to rise. The following signs indicate emergence of bullish market: Decreasing interest rate, High inflation, Excessive pessimism, Market moving to new highs without widespread activity, High level of cash in circulation, Few significant price declining, Decreasing flow of new stock issues (new issues can adversely affect the market's supply/demand balance), More buyers than sellers, Accumulation taking place as indicated by high volume on up days and low volume on down days, Net asset per share at below market price.

There are many signs of a bear market. However many investors ignore them. These signs typically are at market top when there is a tendency to ignore bad news and warning signs. Traders start believing that the market will continue to go up and up and suddenly there is a crash. It is important that traders recognize bear market signals and remain prepared for it. This is not too difficult, as bear markets do not arrive overnight. When bearish signs are identified it is recommended that a trader takes action by reducing exposure to stocks. Below are some of the signs of a bear market: Similarities with stock market crashes e.g 1996/97, Increasing interest rate plus economic recession, Market rising when interest rates are rising, Corporate earnings reports coming in below expectation, Over-valued Price Earning – markets rise too much from normal valuation levels, Professionals show of excessive enthusiasm and euphoria, which typically occur near the end of a bullish market and the start of a bear market, Low quality and low priced stocks start to appreciate in price, Excessive speculation, Increased trading volume, Investors seeking shelter in blue-chips, Distribution as indicated by high volume on down days and low volume on up day, Rallies failing on lighter volume.

A trader should learn to recognize market tops and bottom, which can lead to making more profitable decisions either at the top or at the bottom by delaying buying to a more favorable time or by selling before investors start dumping en masse. The best time to sell is at the top and the best to buy is at the bottom. The following signs can be recognized as indication of a market top: High valuation level net asset per share, Dividend yield falling below 5%, Widespread bullishness, Belief that present scenario is different and history will not repeat itself this time, Trumpeting enormous gains to be made in the stock market by professionals and media, Rising interest rate, Stocks no longer reacting positively to strong earnings, Traded volume expanding significantly, Excessive speculation among low price stocks, Breakdown/weakening of a large number of blue chip stocks, Market unable to move higher despite increasing volume.

When the market declines in a bear market a trader should be able to recognize the bottom. This is the level where all sellers have dumped their shares. It is at this level that the market stabilizes and starts its rebound. This is the most profitable phase of the market and it pays to recognize it. The market bottom signs include: Intense selling on heavy volume, Successive lows on decreasing volume, Increase in market price with increasing volume on successive days of rally, Extreme-pessimism-very high bearish numbers and low bullish numbers, Under valuation of stock, Improving earning/dividend yield.

A trader must decide to sell before or after adjustment of price. Price adjustment formula when cash dividend and bonus issue are involved is {(Market Price – Dividend)(Units of Current holding that qualify for bonus)}/[Bonus + units of current holding that qualify for bonus]. For example, if a company declared a dividend of 50 kobo and bonus of 1:3 and the share price is N15.00 on the day of closure of register. The price will be adjusted thus: (15.00 – 50 cents) X (3/ (1+3) = Ksh. 14.50 X (3/4)Ex Div., Ex Scrip = Ksh. 10.87. It is advisable for a trader to sell before closure. A trader should not wait for bonus and dividend because his working capital will be trapped in the dividend and or bonus.

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