A SURVEY OF FACTORS INFLUENCING INVESTMENT COMPANIES PORTFOLIO CHOICE

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A MANAGEMENT RESEARCH PAPER SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI.
DECLARATION

I hereby declare that this management research paper is my original work it has not been presented by any other person whatsoever from the University of Nairobi or any other institution.

Singed: [Signature] Date: 09/11/2007
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Supervisor's approval

This research project has been presented for examination with my approval as university supervisor.

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DEDICATION

This study is dedicated first to him who has always prepared a way for me.
(1 Timothy 1:17)

To my parents, George K. A. Mwangi and Margaret K. Karanja for your encouragement and willingness to bring the best out of me in my incessant search for a sunlight pathway of hope and fulfillment.
# TABLE OF CONTENTS

DECLARATION .................................................................................................................. i
DEDICATION .................................................................................................................... i
DEDICATION ................................................................................................................... ii
LIST OF TABLES ............................................................................................................... v
ACKNOWLEDGEMENT ................................................................................................. vi
ABSTRACT ....................................................................................................................... vii
ABBREVIATIONS ........................................................................................................... vii

CHAPTER ONE: INTRODUCTION ................................................................................. 1

1.1 Background ............................................................................................................... 1
1.2 Statement of the Problem ......................................................................................... 3
1.3 Objective of the Study ............................................................................................ 4
1.4 Importance of the Study ......................................................................................... 4
1.4.1 Portfolio Managers ......................................................................................... 4
1.4.2 Capital Market Authority ............................................................................... 4
1.4.3 Academic Community .................................................................................... 5
1.4.4 Investment Advisors ..................................................................................... 5
1.4.5 Investors ......................................................................................................... 5

CHAPTER TWO: LITERATURE REVIEW .................................................................. 6

2.1 Portfolio Theory ..................................................................................................... 6
2.2 Investment vehicles considered when making portfolio choice .......................... 7
2.3 Issues considered while making portfolio choice ............................................... 9
2.3.1 Diversification ............................................................................................... 9
2.3.2 Selectivity ...................................................................................................... 12
2.3.3 Timing ............................................................................................................ 12
2.4 Factors influencing portfolio choice ................................................................... 13
2.4.1 Investment objectives .................................................................................. 13
2.4.2 Risk tolerance .............................................................................................. 14
2.4.3 Liquidity ....................................................................................................... 14
2.4.4 Time Horizon ................................................................. 15
2.4.5 Portfolio Re-balancing ................................................... 16
2.4.6 Personnel Availability .................................................... 16
2.4.7 Regulatory Framework and Taxation .............................. 16
2.5 Investment Companies ..................................................... 17
2.6 Empirical Evidence .......................................................... 18

CHAPTER THREE: RESEARCH METHODOLOGY ...................... 19
3.1 Research Design .............................................................. 19
3.2 Population ...................................................................... 19
3.3 Data collection ............................................................... 19
3.3.1 Type and source of data .............................................. 19
3.3.2 Data collection instrument ......................................... 20
3.3.3 Data Collection Procedure ....................................... 20
3.4 Data Analysis and Presentation ....................................... 20

CHAPTER FOUR: DATA ANALYSIS AND FINDINGS .................. 23
4.0 Data analysis .................................................................. 23
4.1 Response Rate ................................................................ 23
4.2 Aim of Fund Manager Investment Objective .................... 24
4.3 Factors Influencing Portfolio Choice ............................... 25
4.3.1 Ranking of factors influencing portfolio choice .......... 25
4.4 Number of security constituting a portfolio ................. 27
4.5 Re-Balancing Portfolio Choice ....................................... 28
4.7 Liquidity of investment vehicles .................................... 32

CHAPTER FIVE: SUMMARY, CONCLUSIONS, LIMITATIONS AND
SUGGESTIONS FOR FURTHER STUDY .................................... 33
5.1 Summary of Findings, and Interpretation ....................... 33
5.2 Conclusions .................................................................. 35
5.3 Recommendation for policy and practice ....................... 35
5.3.1 To investment companies and policy makers .................................................35
5.3.2 Enhance availability of literature review material ........................................36
5.3.3 Research sponsorship ..................................................................................36
5.3.4 Sensitization to companies and general public on importance of research ....36
5.4 Limitations of the study ..................................................................................36
5.4.1 Data accessibility ..........................................................................................36
5.4.2 Time resource ..............................................................................................37
5.4.3 Cost ...............................................................................................................37
5.4.4 Lack of adequate local literature material ....................................................37
5.4.5 Company Versus Personal views ................................................................37
5.5 Suggestions for further research .....................................................................37
References ..............................................................................................................39

Appendix I: Letter Of Introduction ........................................................................43
Appendix II: Questionnaire A Survey Of Factors Influencing Investment Company
Portfolio Choice ......................................................................................................44
Appendix III: Fund Managers Registered By Capital Market Authority
As At 30/9/2006 ......................................................................................................49
APPENDIX IV: Ranking of consideration and importance of Factors influencing
portfolio choice amongst investment companies ..................................................30

List of Tables

Table 1: Response Rate ..........................................................................................24
Table 2: Representation of aim of fund manager investment objective ...................24
Table 3: Factors influencing portfolio choice and their importance ..........................25
Table 4: Number of Securities in a portfolio ............................................................27
Table 5: Time horizon for re-balancing portfolio choice ........................................28
Table 6: Correlation Analysis ..................................................................................30
Table 7: Average importance and consideration ranking ........................................33
Table 8: Liquidity of investment vehicles ...............................................................34
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ABSTRACT

Making portfolio choice is one of the major policy issues in an investment company. An inappropriate portfolio choice may lead to an erosion of investors' wealth and subsequent reduction of investors' confidence in an investment company. Indeed, portfolio choice reflects the investment objective of an investment company. Investing in a portfolio provides an attractive option to the investment companies as it provides maximization of returns and minimization of risks when compared to investing in segregated securities hence need to make an intelligent portfolio choice. The main objective of this study was to identify factors influencing investment companies portfolio choice.

To facilitate attainment of the objective this research was designed as a survey study. The population of interest comprised all fund managers registered by capital market authority in Kenya. The respondents were the fund managers and the research used primary data gathered using a questionnaire. The response rate for questionnaires administered was 80%. Data was presented using tables, graphs and charts. Both descriptive and inferential statistics was used to analyze the data. Descriptive statistics such as weighted mean and proportion was used to bring out the relationship of variables under the study. Correlation analysis was used to test the degree of relationship between consideration of factors influencing portfolio choice and importance of the same amongst investment companies.

The findings from this research indicated that investment objective and regulatory framework are the most important factors influencing portfolio choice amongst investment companies. These factors were consistently ranked as very important by all respondents without any deviation of opinion.

Factors like risk tolerance, liquidity preference, time horizon, ability to rebalance and availability of personnel were rated differently by different respondents they were important but at varying degrees.

This study recommends that investment companies should consider all factors influencing portfolio choice as findings indicate all are important in initiating an investment process.

The main challenges and limitations encountered during the research were. Suspicion from some respondents on the confidentiality of information provided and lack of adequate local literature and research materials on subject of portfolio choice.
ABBREVIATIONS

AFR  African Alliance (k) Management Ltd
AIG  AIG Global Investment Co. (EA) Ltd
AKM  Aurcos Kenya Managers
BRITAK  British American Asset Managers Ltd
CMA  Capital Market Authority.
COOP  Co-op Trust Investment Services Ltd
FTD  Fund Trust Deed.
GM  Genesis (k) Management Ltd
IC  Investment Company.
ICEA  ICEA Investment Services Ltd
ICL  Inveteq Capital Ltd
NSE  Nairobi Stock Exchange.
OM  Old Mutual Investment Services Ltd
OM (EA)  Old Mutual Asset Managers (EA) Ltd
OM (K)  Old Mutual Asset Managers (k) Ltd
RBA  Retirement Benefit Act.
RIMS  Royal Investment Management Services Ltd
SIMS  Stanbic Investment management Services Ltd
STAN  Standard Chartered Investment Services Ltd
TB  Treasury bill.
ZAM  Zimele Asset Management Co. Ltd
CHAPTER ONE: INTRODUCTION

1.1 Background

Over the years fund management companies have realized that it is advantageous to hold a portfolio rather than a single asset or investment since the risk of an optimal portfolio is lower than the average risk of individual securities. Holding a portfolio requires making intelligent portfolio choices. Markowitz (1952) notes that using the mean-variance approach well established portfolio choices can be made. Well thought of portfolio choices should aim at; either maximizing expected returns for a given portfolio variance, or minimize portfolio variance for a given expected return (Johnson 1995).

Making portfolio choice is the cornerstone of investment process. In this regard factors influencing making of portfolio choice are critical in ensuring continuous achievement of investment objectives namely; capital appreciation, capital preservation, and current income (Reilly and Brown, 2000). Investment objectives entail a trade off between risk and return while critically considering time horizon of investment.

Madura (1995), defines a fund manager as a firm that attracts funds from clients and invest pooled funds into a portfolio of individual investments such as stocks and bonds. Investment companies invest in a portfolio with the aim of meeting its investment objectives and those of various stakeholders. Pooled funds must generate attractive returns so as to continually attract clients while achieving investment companies objectives.

In Kenya fund managers are licensed and regulated by the capital market authority (CMA). Fund managers do manage portfolio of securities on behalf of clients pursuant to a contract (CMA handbook, 2006). Fund managers control and invest a large pool of funds entrusted in their care. This fiduciary duty calls for making an effective portfolio choice so as to meet their investment objectives in alignment to diverse client's objectives. Fund managers do exercise complete discretion over the investment of funds.
Making portfolio choice is therefore an investment company
sole discretion.

Fund managers are increasingly becoming popular as an agent and mobilizer of
investment. This can be attributed to the fact that clients who invest with Investment
Companies enjoy two advantages, benefits arising from economies of scale and those
arising from professional management of their portfolios (Sharpe 1996).

Indeed over a short period of time mutual funds have become fourth largest type of
financial institution, only commercial banks, savings and loan institutions and life
insurance companies are larger in terms of assets (Mutual fund fact book, 1989). Such
continuous growth of investment companies coupled with holding vast amount of funds
calls for continuous making of intelligent portfolio choices.

Fund managers act in a position of trust investing funds entrusted to their care by
investors into a portfolio of securities. Thus a greater degree of prudence and caution is
required in making portfolio choices. In this regard, knowledge of factors influencing
such portfolio choices is salient.

Success or failure of an investment company depends on how it makes its portfolio
choice. In making their portfolios, fund managers can either invest in real or financial
assets. In financial assets investment vehicles to constitute a portfolio are; ordinary
shares, preferred shares, government and corporate bonds, treasury bills, bank certificate
of deposit and commercial papers.

From such a wide source of available possible constituent of their portfolio make up,
fund managers consider various factors in making their portfolio choice namely; Return
objectives (Markowitz 1952); risk tolerance (Reily and Brown 2000); investment
duration (time horizon) (Marshal 1994); liquidity needs (Leibonitz 1986); ability to
rebalance in future (Merton 1971); regulatory and tax constraints (Giles et al 2003) and
availability of personnel.

It is with this background in mind that this research has been carried out to establish the
factors that influence Investment Companies portfolio choice.
1.2 Statement of the Problem

Making portfolio choice is the cornerstone of investment process. Failure or success of an investment depends on portfolio choice made by investors. Johnson (1995) notes that well-established portfolio choices can be made using mean variance approach. Investment companies invest in a combination of assets as this helps in mitigating effects of uncertainties associated with investments. Such investments are initiated by making intelligent portfolio choice aiming at either maximizing expected return for a given variance or minimizing portfolio variance for a given expected return. Thus knowledge of factors influencing investment company portfolio choice is crucial and this is what this study documents.

In making choice of what to include in their portfolio investment companies may invest in either real or financial asset. Fund managers are expected to conduct an analysis of economic and industry factors before making portfolio choice. Portfolio choice reflects the investment objective of an investment company. Portfolio choice is the foundation upon which portfolio is built. As such it is desirable to know factors influencing investment companies portfolio choice as they will contribute greatly to success or failure of an investment.

According to Retirement Benefits Act of 2000 fund managers play various roles that enhance proper running of funds. They provide advice to clients on available investment vehicles and possible expected risk with inclusion of expected return for each investment. Fund managers are expected to manage portfolios under their care. They are at liberty to make portfolio choice which will contribute to meeting their investment objectives. This survey seeks to establish factors influencing Investment Companies portfolio choice.

Several studies have been done focusing on investment companies in Kenya. Mugo (1999), studied factors that institutional investors consider when making investment in shares at Nairobi stock exchange and identified these factors as economic factors, individual factors return and risk. However fund managers invest in a portfolio which is
not restricted to stocks only. Its therefore worthwhile to consider factors influencing investment companies portfolio choice as such portfolio constitute both real and financial assets. Wachira (2003) conducted a survey on investment strategies of investment companies in Kenya: A case of ICDC and Alum (2006) conducted a survey on trading strategies employed by fund managers in Kenya and documented buy-and-hold strategy as the highly recognized strategy in Kenya.

This study seeks to add to the existing literature by documenting factors influencing portfolio choice of investment companies. Findings of this survey will enable fund managers to make intelligent portfolio choice as they will have knowledge of factors influencing such.

1.3 Objective of the Study

1. To identify factors influencing investment companies portfolio choice.

1.4 Importance of the Study

The study will be of great interest to:

1.4.1 Portfolio Managers

The study will enlighten portfolio managers on different factors influencing portfolio choice. This will enable them to make portfolio choices that ultimately reflect their investment objectives. They will learn the most important factors influencing portfolio choice.

1.4.2 Capital Market Authority

As a regulatory body of fund managers they may use results of this study to formulate policies and regulations concerning fund managers portfolio choices as they will have adequate knowledge on factors influencing Investment Company’s portfolio choice.
1.4.3 Academic Community
Findings will contribute to the body of knowledge as it will document factors influencing portfolio choice. It will also provide a basis for further research in related fields.

1.4.4 Investment Advisors
Knowledge generated in this study will help investment advisors with information on which to advise clients on what influences portfolio choice.

1.4.5 Investors
The study will provide them with knowledge on factors influencing portfolio choice.
2.1 Portfolio Theory

Over the years, investors have held their investment in portfolio. But this idea was first formalized by Markowitz (1952). He showed us that all information needed to choose the best portfolio for any given level of risk is contained in three simple statistics: mean, standard deviation and correlation.

Cooley (1996) explains that modern portfolio theory was concerned with ensuring systematic diversification of risk when making portfolio choice. In our times, investment companies routinely follow precepts of modern portfolio theory as laid down by Markowitz. Investors base their portfolio choice primarily on basis of expected return and standard deviation of each security contained in their chosen portfolio, while upholding correlation of the different securities. Markowitz (1952), model indicates that the aim of making portfolio choice is to choose a portfolio that provides highest return at a given level of risk through formation of efficient portfolio. Investment companies making portfolio choice in terms of mean return and variance can restrict their choice to portfolios lying on the efficient frontier. This helps in focusing attention on one set of portfolios from the unlimited number of possible choices. (De Fusco et al. AIMR, 2001)

Mean-variance relationship and efficient frontier can be used to form an optimal portfolio that provides the highest possible return for any specified degree of risk or the lowest possible risk, for any specified degree of return. Indeed portfolio theory deals with the selection of optimal portfolio by risk averse investors (Weston and Copeland, 1988).

Investment companies should strive to identify and eventually choose the optimal portfolio, so as to enjoy full benefits associated with investing in portfolio.

Making portfolio choice entails consideration of willingness to exchange return and standard deviation. Investments companies should trace the efficient set and then based on their investment objectives, determine the optimal portfolio.
Proper portfolio choice helps in mitigating effects of uncertainty associated with investments. Fisher and Jordan (1996), point out that a portfolio is a combination of assets. In essence, making portfolio choice entails choosing assets to include in a portfolio.

2.2 Investment vehicles considered when making portfolio choice

Portfolio being a collection of securities, Investment companies must choose which securities to own. (Gitman and Joehnk, 2002). Investment companies can either invest in real assets or in financial assets. Traditionally, portfolio chosen has been confined to stocks, bonds and cash and cash equivalents. In recent times real estate is gaining in popularity (Goeztmann, 1990). As real estate investment portfolios, show returns comparable to those on bonds and stocks.

Firms investment objective namely; capital appreciation, capital preservation and current income needs. (Reilly and Brown, 2000), determines likeliness of inclusion of an investment vehicle into a portfolio while making portfolio choice. Different investment vehicles have diverse characteristics which make them admirable in making portfolio choice.

Gitman and Joehnk (2001) note that stocks are popularly considered when making portfolio choice because not only do they provide avenue for dividends, but also an opportunity exists to derive capital gains. This gives an investment company opportunity to meet its objectives. Generally, stocks provide attractive and highly competitive returns over the long run. (Marshal, 1994). Albeit being subject to business, financial, purchasing power and event risk. These risks adversely affect a stock’s earnings and dividends, its appreciation and rate of return earned by investment companies.

Stocks returns may be volatile. Investment companies should set screening criteria that facilitate inclusion of stocks, when making portfolio choice they may use parameters such as; earnings growth, price/earning ratio, dividends, market size and relative strength.
Making portfolio choice with regard to stocks require adequate knowledge on various economic conditions impacting on stock prices as they will ultimately affect stock returns. Return regularities are normally associated with macro economics drivers such as inflation or exchange rate. Thus understanding sources and effect of these regularities can open the door to opportunities to fund managers.

Gitman and Joehnk (2000) note that real growth in GDP, increased industrial production and increased corporate profits impact on stock prices positively whereas inflation, trade imbalances and rising interest rate impact on stock price negatively,政府 债券 associated with less risk especially when considering default risk. Corporate bond yields higher returns because issuing company is viewed as less secure. They tend to show a more positive correlation to equities but are less volatile. Commercial properties tend to be uncorrelated with other assets classes except in the level of yield obtainable. Bonds add stability to a portfolio as they exhibit excellent portfolio diversification properties. Bonds interest payments generate current incomes to the investment company. Interest rate and bond prices move in opposite direction. (Sharpe, 1996). Gitman and Joehnk (2000) note that Bonds are negatively related to equities. Cash and cash equivalent creates an available pool of funds to meet obligations of investment companies. Bonds are considered to be more responsive to change in interest rate than other investment.

Real asset as an investment vehicle does provide static income and preserves capital while over time it contributes to capital appreciation. However, caution should be taken when including real assets into an investment portfolio. Steven Devaney (2000) observed that real assets like property tend to be uncorrelated with other asset classes except perhaps in level of yield obtainable and therefore offer performance unrelated to how rest of portfolio is doing.
2.3 Issues considered while making portfolio choice

Sharpe, Alexander and Bailey (2003) note that in portfolio construction issues of diversification, selectivity and timing need to be considered by investors.

2.3.1 Diversification

It has been widely accepted that investment companies can reduce risk facing it while making portfolio choice by investing in several securities rather than just one. This is the concept of “spreading the risk” or “not putting all eggs in one basket” (Kitchen R. L., 1986). Sharpe, Alexander and Bailey (2003) note that diversification leads to an averaging of market risk, as portfolio returns will always be susceptible to market wide influences. When making portfolio choice, investment companies should consider issue of diversification as it leads to risk reduction, because the standard deviation of a portfolio is generally less than weighted average of the standard deviation of the component securities. Diversification requires an investment company to choose a portfolio whose component security returns do not move together. Hence choose investment with low correlation.

Investment companies diversify their portfolios by investing in stocks of companies belonging to diverse industry groups or choose stock to include in their portfolio choice from amongst different categories of stocks such as growth, value and income stocks. Potential bonds categories include government and corporate bonds.

Diversification reduces extremes in portfolio returns, thereby lowering portfolios volatility. Diversification eliminates unsystematic risk. In the USA, for example, it has been determined that unsystematic risk can almost totally be eliminated by holding above 15 shares (Evans J. L. and Archer S. H., 1968). In India, a portfolio of about 40 shares almost totally eliminates the unsystematic risk (Gupta, L. C., 1981).

In U.K, it is between 15 to 20 securities that almost eliminate the unsystematic risk (Lumby, 1994). Elton and Gruber (1977) note that you would come very close to achieving optimal diversity after adding the twentieth stock. Gitman and Joehnk (2000)
note that on average, most of benefits associated with risk reduction can be gained by forming portfolios containing 8 to 15 randomly selected securities. Investment companies in making portfolio choice, aims at ensuring a well diversified portfolio as the risk or average deviation from the mean of each stock contributes little to portfolio risk. Instead it is the covariance between individual stock levels of risk that determines overall portfolio risk, as a result investment company benefits from holding diversified portfolios instead of individual stocks.

Choosing a well diversified portfolio is the best bet for consistent long term growth of investments. Considering diversification while making portfolio choice increases a firm’s chances of long term financial success.

Coddington and Moore (1987) asserts that diversification is a strategy that attempts to spread risk by investing in various assets or markets. Portfolio choice is the ultimate decision since investor must decide what securities to include in his portfolio. Investment companies choose a portfolio whose risk and expected return will maximize fund manager expected utility. Portfolio composition is used as a means of diversifying away unsystematic risk and therefore reducing the risk that is incurred.

![Diagram](image)

**Portfolio risk**

**Risk eliminated by diversification**

**Total risk**

**Undiversifiable or market risk**

**Number of securities held**

Source: Sharpe, Alexander and Bailey (2003) p.g 187
As depicted above, the risk of a portfolio consists of two components: diversifiable and non diversifiable risk. Beta is used to measure non diversifiable or market risk. Beta indicates how the price of a security responds to market forces. (Sharpe Alexander and Bailey, 2003).

While making a portfolio choice of combining assets with imperfect correlation in different chosen proposition, this can generate an efficient frontier of different expected returns and risk combinations, which may suit different investors.

Nancy and Pettit (1988), inform us that portfolio choice entails how the fund manager chooses from amongst the available portfolio on the efficient set. Portfolio choice involves consideration of willingness to exchange return and standard deviation.

![Efficient frontier](image)

Sharpe, Alexander and Baily (2003) pg. 173

Sharpe et al (2003) note that an investor will choose his or her optimal portfolio from the efficient set. Efficient frontier is curved because diversification aids in improving returns to risk ratio. The maximum level of risk that an Investment Company takes determines the position of the portfolio on the efficient set.
2.3.2 Selectivity

Sharpe et al (2003), notes that selectivity refers to security analysis. Security analysis is fundamental in making informed portfolio choices. Financial analysts falls into two broad categories; those using fundamental analysis and those using technical analysis in analyzing securities.

Fundamental analysis forecasts timing and size of cash flow and then converts them to their equivalent present value, using an appropriate discount rate. This is compared with correct market price to see whether the security is fairly priced. (Sharpe et al, 2003). In making precise choices, investment companies may use fundamental analysis to identify mispriced security and make such portfolio choices from a point of information.

Lowe (1997) defines technical analysis as a form of investment analysis which focuses on the study of historical, known, market price data of securities and uses this to forecast how unknown prices are likely to fluctuate.

Security analysis is an essential ingredient in making portfolio choice as information gathered can be used to predict expected portfolio risk and returns. Security analysis determines what a security is worth and influences its suitability to be included in a portfolio, thereby making it an important consideration in making portfolio choice.

2.3.3 Timing

Sharpe et al (2003), defines timing as macro forecasting, involves the forecasting of price movements of common stocks in general relative to fixed income securities such as corporate bonds and treasury bills. Timing is essential in making a portfolio choice as it eliminates risk of a missed opportunity and risk of diminished purchasing power because of inflation. Goal of making appropriate portfolio choice is to produce long term gains with relatively less volatility overtime. Investment objectives dictate timing in making of portfolio choices.

Ibboston Associates (1990), note that great variation in portfolio performance can be attributed to choices made during asset allocation. This is asserted by a study done by
Brinson, Singer and Bee bower (1991), which concluded that 91% of variability in return is based on asset allocation in a portfolio, security selection 5%, market timing 2% and other factors 2%. Proper asset allocation is achieved by effective diversification. It is essential and it should be weighed when making portfolio choices as it contributes to a greater percentage of overall portfolio performance.

Benefits of diversification when making portfolio choice are undisputable. Diversification is essential for economic survival and prosperity. In today’s volatile market environment investor’s greatest risk is not having a diversified portfolio. Portfolio choice made by investment companies should ensure diversification.

2.4 Factors influencing portfolio choice

Investment companies portfolio choice may be influenced by amongst others.

2.4.1 Investment objectives

Portfolio choice is made with anticipation of meeting an investment objective based on return and risk. Satisfactory return depends on whether the present value of benefits equals or exceeds the present value of its cost. (Levy and Sernt, 1999).

In making portfolio choice, Investment Company ought to consider investment objectives which are based on return expectation and adjusted for risk. Reilly and Brown (2000), notes that investment objectives may be categorized as capital appreciation, capital appreciation and current income.

Zurich learning centre (2002), observed that funds have two main objectives; growth which involves increasing the value of principal amount and income which involves generating a constant flow of income.

Current income and capital preservation are portfolio objectives consistent with low risk and conservative investment strategy. A chosen portfolio should be oriented with low
beta (low risk) securities. Capital appreciation calls for taking high risk and expecting high return over a long period of time. Investment objectives are based solely on expected return and its associated risk. A viable portfolio choice is one in which the return is adequate enough to compensate the investors for taking extra risk. Sharpe, Alexander and Bailey (2003), note that when sensible investments are made return and risk tend to go together. That is portfolio that have higher average returns tend to have greater amount of risk. This maxim is worth considering as return and risk requirements as reflected in investment objectives do influence portfolio choice.

Gitman and Joehnk (2001), inform us that a portfolio is a collection of investment vehicles assembled to meet one or more investment goals. Thus investment goals impact heavily on making portfolio choice.

2.4.2 Risk tolerance

Risk tolerance can be viewed as the amount of risk or loss investment companies are willing and able to tolerate in order to achieve their investment objectives.

In making portfolio choice risk tolerance influence asset association and making a choice amongst various investment vehicles. Risk tolerance can be ranked hierarchically as either being a conservative, moderate and aggressive as risk tolerance increases so does return. Indeed risk that Investment Company is willing to cushion influence the portfolio choice. Campbell (2000), points out those aggressive investors should hold stocks, conservative investors should hold bonds.

2.4.3 Liquidity

Fisher and Jordan (1996) define liquidity as ease of converting an asset into money quickly, conveniently and at little exchange cost. Whereas Gonzalez (2007),view liquidity as ease of trading any security without affecting its price. A security is taken to be more liquid, the lower its price impact, the tighter its bid-ask spread or higher its volume or turn over. Eric Chisel (2006).
Liquidity needs of a portfolio may be met by the cash flows emanating from income producing investments. Achieving liquidity requires a sacrifice of level of income and potential capital gains. Such trade offs may influence portfolio choice. Holding long term investments require foregoing liquidity needs as such investments cannot be traded easily without affecting their price. Ability to meet future liabilities when they fall due is an influencer of how portfolio choice is made. Leibonitz (1986), observes that fund managers do have a set of future liabilities. Thus, when making portfolio choice future fund inflows should match liability streams. Investment companies pay higher transaction cost when selling illiquid assets in future and they require higher expected return to hold them in a portfolio.

Liquidity calls for ease in converting a portfolio to cash at fair market value. Liquid investments have low returns. (Gitman and Joehnk, 2002). Liquidity needs may influence how portfolio constituents are chosen.

### 2.4.4 Time Horizon

Time horizon is the number of years in the investment company strategy. It is the length of time for which an investment is made or held before it is liquidated. There is no “right” time horizon it depends on the investment company objectives as indicated in its fund trust deed.

Time horizon can vary from short, intermediate, and long term, time horizon help in risk analysis, portfolio risk decreases over time, stocks and shares are relatively volatile, high risk investment that have generated superior returns over the long term. Surely, time horizon helps in making portfolio choice of whether to invest in short or long maturity investments. Investors should shift to less risky portfolio choices as time horizon shorten. Amihud (2002), argue that an investor with a long investment horizon compared to an investor with shorter horizon will require a smaller premium as reflected on bid-ask spread. On contrary Samuelson (1969), observed that if investment companies are constant overtime, then long-horizon expected returns and long-horizon risks compound in precisely same way under condition of constant risk aversion, long term investors
should hold the same portfolio as short time investor. Kritzman and Rich (1998), state that investors favour risky assets over long time periods thus a long term investor should allocate more to stocks than a short term investor. The tendency of high risk portfolio to dominate low risk portfolio increases with length of investment horizon. (Marshal, 1994).

During making of a portfolio choice it is worth considering over what time horizon is portfolio choice expected to prevail.

2.4.5 Portfolio Re-balancing

Ability to rebalance in future to reflect changes in market movements and to reflect uprisin reality of change in investment objectives, risk tolerance and time horizon. Ability to rebalance a portfolio in future does influence portfolio choice, overtime investors alter their portfolios to offset market risk exposures. (Merton, 1971). Thus future flexibility of portfolio does influence making of portfolio choice.

2.4.6 Personnel Availability

Adequacy of qualified personnel to carry out portfolio decisions will impact on portfolio choice. Personnel will put a restriction on investment vehicles chosen as they can only invest on portfolios that they understand.

2.4.7 Regulatory Framework and Taxation

Regulatory framework entailing legislation should be well set up for smooth and successful operations of fund managers. Licensing and legal constraints may influence portfolio choice made by fund manager. Giles et al (2003), notes that investment funds only develop successfully where legal system provide for clear and fair mechanisms of asset ownership and transfer redress if things go wrong. A legal system gives a fund manager confidence in exercising its portfolio choice.
Different taxation for different investment vehicles will influence portfolio choice as investment companies strive to minimize their tax burden. Managers should strive not to share a penny of their profits with the tax man (Invest it magazine summer, 2002).

Regulatory framework does influence and limit portfolio choice. Retirement benefit Act (RBA) of 2000 has developed CAPS that serve as investment guidelines for fund managers. According to these guidelines, a manager should invest a maximum of:

- 5% of fund in cash,
- 30% of the fund in deposits,
- 15% of the fund in commercial paper and bonds,
- 70% of the fund in government paper or quoted shares,
- 5% of the fund in unquoted shares,
- 15% of the fund in offshore securities,
- 70% of the fund in government paper or quoted shares,
- 5% of the fund in unquoted shares,
- 15% of the fund in offshore securities,
- 30% of the fund in real properties and up to 100% of the fund in guaranteed investment.

Consequently, legal framework restricts investment options of fund managers and in totality it does influence portfolio choice. Taxation affects portfolio choice by affecting the relative risk of different assets, by taxing away part of any positive return and providing partial tax deductions for losses may affect the variance and covariance of return on various assets. Portfolio choice should aim at reducing present value of tax burdens.

2.5 Investment Companies

An investment Company may be viewed as a firm that holds itself out as being primarily engaged or proposing to engage in business of investing, re-investing and divesting based on various considerations made when making a portfolio.

Madura (1995) defines an investment company as one that invests in a pool of funds belonging to many individuals in a portfolio of individual investments such as stocks and bonds. Fisher and Jordan (1996), note that a fund manager’s pool resources and invest on behalf of investors, they are open to public. Investment companies acts in a fiduciary position based on trust and therefore must discharge their duties with sobriety and due diligence. Portfolio choice must be made in the best interest of all stakeholders as they
are charged with higher degree of care and standards of knowledge than average person. As a trustee and as a fiduciary investment company is instructed.

“To observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable, safety of capital to be invested” and investment managers must adhere to prudent man rule as described in the case of Harvard Vs Amory. (AIMR, 1999).

Effective portfolio choices contribute to continued existence of investment companies. The investment company must always be careful to ensure that value of fund entrusted with them does not deplete widely because they live on a fee and this fee is taken as a percentage of assets under management. Fee will go down in absolute term if value of asset under management goes down. (The economists, 5-11, July 2003).

Thus in making portfolio choice upholding assets value should be ensured.

2.6 Empirical Evidence

Mugo (1999) studied the factors that institutional investors consider when making investments in shares quoted at the Nairobi stock exchange and identified these factors as economic factors, industry factors and company factors. However fund management companies invest in various assets other than investing only in stocks. In making their portfolio choice fund managers do invest in both real and financial assets. It is therefore worthwhile to consider factors influencing investment companies portfolio choice as their portfolio constitute both financial and real assets.

Alum (2006) Conducted a survey on trading strategies employed by fund managers in Kenya and documented that buy and hold strategy is the most recognized strategy in Kenya. The Kenyan market is still emerging hence the high percentage in the buy and hold use. It is critical to establish the factors influencing portfolio choice of investment companies in this emerging markets as such have not been documented by earlier studies.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design
The research was carried out through a survey. Cooper and Emory (1998) observed that a survey entails questioning people and recording their responses for analysis. A survey is desirable where respondents are uniquely qualified to provide the desired information. Mugenda and Mugenda (2003) note that a survey research attempts to collect data from members of a population and describes existing phenomena by asking individuals about their perceptions, attitudes, behaviour or values. More over, it explores the existing status of two or more variables at a given point in time. Primary data collected from such a population or census is more reliable and up to date. In this study the researcher surveyed the factors influencing Investment Companies portfolio choice.

3.2 Population
This was a census study where the entire population was studied. Cooper and Emory (1998), note that a census study includes all elements in the population. The population of the study consisted of the fifteen investment companies licensed by the capital market authority (CMA) as at 30th September 2006 (See Appendix III).

3.3 Data collection

3.3.1 Type and source of data
The study used primary data which is factual data collected for the first time to address the research problem outlined in this survey, instrument that was used to collect this data is outlined below:
3.3.2 Data collection instrument

Mugenda et al (2003) notes that a questionnaire is one of the best tool of collecting primary data.

In this survey, primary data was collected using a structured questionnaire (See Appendix II). A structured questionnaire was used since it is easier to administer, analyze and economical in terms of time and money. Each item in questionnaire is developed to address adequately the research problem and research objective.

The questionnaire comprised both open and closed ended questions and was administered through drop and pick later method.

The use of structured questionnaire ensured consistency of question and answers from the respondents. The respondents were investment managers of firms registered as fund managers by CMA.

Part one of the questionnaire aims at gathering background information of a fund manager, its investment objective and investment vehicles frequently considered to meet investment objective. Part two covers factors influencing portfolio choice and different issues considered when making portfolio choice amongst fund managers.

3.3.3 Data Collection Procedure

Each questionnaire was preceded by a letter of introduction (See Appendix I) questionnaire was administered to the respondents during official working hours. A polite deadline was suggested after which the filled in questionnaire was collected ready for analysis.

3.4 Data Analysis and Presentation

Gay (1992) observed that, data analysis involves organizing, accounting for and explaining the data; that is, making sense of the data in terms of respondents definition of the situation noting patterns, themes, categories and regularities.
After the field work, before analysis, the entire questionnaire was adequately checked for completeness. This was done through scrutiny so as to minimize the variations due to missing responses, multiple entries and blank questionnaires. The information was coded and exploratory analysis was first performed to ensure that the output is free from outliers and effect of missing responses is at minimum.

Data was analyzed using both inferential and descriptive statistics. Descriptive statistics such as mean score tabulations, frequency distribution and standard deviation enabled the researcher to meaningfully describe factors influencing portfolio choice amongst investment companies.

The use of descriptive statistics also precisely indicate what number and percent of respondent rate and rank variable under study. Rank analysis was used to analyze qualitative data summarizing the factors influencing portfolio choice amongst investment companies.

The inferential statistics that was used is correlation analysis; which enabled the researcher to test the degree of relationship between consideration of factors influencing portfolio choice and importance of the same amongst investment companies.

Correlation is the covariance of standardized variables that is, of variables after making them comparable by subtracting the mean and dividing by the standard deviation. Correlation is the ratio of observed covariance of two standardized variables divided by the highest possible covariance when their values are arranged in the best possible match by order when the observed covariance is as high as the possible covariance, the correlation will have a value of 1, indicating perfectly matching order of the two variables. A value of -1 is perfect negative covariance. A correlation value of a 0 indicates a random relationship by order between the two variables.
In this study the following formula that was used to compute the correlation coefficient is:

\[ r = \frac{1}{n} \sum \frac{(c - \bar{c})(I - \bar{I})}{\sigma_c \sigma_I} \]

Where

- \( r \) is the correlation coefficient between consideration of and importance of factors influencing portfolio choice amongst investment companies.
- \( C \) is consideration of ranked on a likert scale of 1-5
- \( I \) is importance of ranked on a likert scale 1-5
- \( \sigma_c \) is standard deviation of consideration ranking
- \( \sigma_I \) is standard deviation of importance ranking
- \( \bar{C} \) is mean rank of consideration ranking
- \( \bar{I} \) is mean rank of importance ranking

Data was presented using frequency distribution tables, graphs and pie charts. These tools are selected because of their ease of understanding and clarity in presentation.
CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.0 Data analysis

For the purpose of data analysis, the fifteen registered fund managers will be abbreviated as follows:

1. AIG Global Investment Co. (EA) Ltd
2. Old Mutual Asset Managers (k) Ltd
3. Old Mutual Investment Services Ltd
4. African Alliance (k) Management Ltd
5. Stanbic Investment management Services Ltd
6. Zimele Asset Management Co. Ltd
7. Aurcos Kenya Managers
8. ICEA Investment Services Ltd
9. Co-op Trust Investment Services Ltd
10. Standard Chartered Investment Services Ltd
11. Royal Investment Management Services Ltd
12. Genesis (k) Management Ltd
13. British American Asset Managers Ltd
14. Old Mutual Asset Managers (EA) Ltd
15. Inveteq Capital Ltd

4.1 Response Rate

Out of fifteen fund managers targeted only twelve responded through filing of a questionnaire, which was administered through the drop and pick later method. This represents a response rate of 80%. This response was considered sufficient for data analysis.
### Table 1: Response Rate

<table>
<thead>
<tr>
<th>Nature of response</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Successful</td>
<td>12</td>
<td>80%</td>
</tr>
<tr>
<td>Unsuccessful</td>
<td>3</td>
<td>20%</td>
</tr>
<tr>
<td>Total</td>
<td>15</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Survey Questionnaire

### 4.2 Aim of Fund Manager Investment Objective

#### Table 2: Representation of aim of fund manager investment objective

<table>
<thead>
<tr>
<th>Aim of investment objective</th>
<th>Number of respondents</th>
<th>Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital appreciation, capital preservation, current income and growth in current income</td>
<td>9</td>
<td>75%</td>
</tr>
<tr>
<td>2. Capital appreciation and capital preservation</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>3. Current income and growth in current income</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100%</td>
</tr>
</tbody>
</table>

As from analysis above 75% of fund managers questioned their investment portfolio aim at meeting diverse clients needs using a wide range of desirable investment vehicles, their investment objective aim at capital appreciation, capital preservation, current income and growth in current income all at a time depending on client mandate. These fund managers choose ordinary shares to ensure capital appreciation, corporate bonds to ensure their current income needs are met, to preserve capital when making portfolio choice they choose government bonds and bank certificate of deposits.
4.3 Factors Influencing Portfolio Choice

The main objective of this study was to identify factors influencing portfolio choice amongst investment companies. The factors were graded as “very important (5), “important” (4), “fairly important” (3), “less important” (2) and “not important (1). Responses were coded (See appendix IV). Tables and charts/graphics were designed to facilitate analysis.

4.3.1 Ranking of factors influencing portfolio choice

The table below gives a summary of factors influencing portfolio choice and their relative importance. Since the total number of respondents were twelve and the maximum point for a factor was 5 (very important), then maximum score was supposed to be 60. The table was constituted from the data in appendix IV.

Table 3: Factors influencing portfolio choice and their importance

<table>
<thead>
<tr>
<th>Factor</th>
<th>Maximum score</th>
<th>Actual score</th>
<th>Percentage score (%)</th>
<th>Mean</th>
<th>Standard deviation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Investment objective</td>
<td>60</td>
<td>60</td>
<td>100</td>
<td>5</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>2. Risk tolerance</td>
<td>60</td>
<td>50</td>
<td>83</td>
<td>4</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>3. Liquidity measurement</td>
<td>60</td>
<td>53</td>
<td>88</td>
<td>4</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>4. Regulatory framework</td>
<td>60</td>
<td>60</td>
<td>100</td>
<td>5</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>5. Time horizon</td>
<td>60</td>
<td>48</td>
<td>80</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>6. Ability to rebalance</td>
<td>60</td>
<td>51</td>
<td>85</td>
<td>4</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>7. Personnel availability</td>
<td>60</td>
<td>37</td>
<td>62</td>
<td>3</td>
<td>2</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: Survey Questionnaire
From the table above, investment companies consider both investment objective and regulatory framework as the most critical factors influencing their portfolio choice.

These factors were rated as very important since they have a mean of 5. These factors were closely followed by liquidity requirement, ability to rebalance, risks tolerance and time horizon of investment which were ranked as important.

Investment companies consider personnel availability as fairly important in influencing portfolio choice.

Investment objective and regulatory framework had a standard deviation of 0 implying that all investment companies were consistent in ranking of these factors without any diversity of opinion standard deviation of 1 for risk tolerance, liquidity requirement, time horizon and ability to rebalance imply that investment companies were not significantly diverse in their opinion and that they were not indifferent in their perception as to influence of these factors on portfolio choice.

The figure below further show factors influencing portfolio choice and their importance amongst investment companies.

Figure 4.3.1: Factors influencing portfolio choice and their importance
4.4 Number of security constituting a portfolio

This analysis focus on the average number of security chosen to constitute a portfolio when making portfolio choice amongst investment companies. The results are shown below.

Table 4: Number of Securities in a portfolio

<table>
<thead>
<tr>
<th>Average number of securities</th>
<th>Number of investment companies</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-5</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>6-10</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>11-15</td>
<td>1</td>
<td>8%</td>
</tr>
<tr>
<td>16-20</td>
<td>7</td>
<td>58%</td>
</tr>
<tr>
<td>Over 20</td>
<td>2</td>
<td>17%</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Survey Questionnaire

The table above shows that 58% of respondents put 16-20 securities in their portfolio. These managers stated that these are equity portfolios where there is a diversity of firms with traded securities. Investment companies with over 20 securities in their portfolio had also invested in different equity securities. The 17% with 6-10 securities indicated that the investment was mainly in money market securities which are considered few in Kenya. Largely dominated by treasury bills and bonds. The inclusion of many securities when making portfolio choice has attributed to the need for diversification of risk while maximizing return.
4.5 Re-Balancing Portfolio Choice

The analysis is premised on finding out time period over which portfolio choice is expected to prevail.

The table below indicates the distribution of rebalancing portfolio choice within given time ranges amongst investment companies.

<table>
<thead>
<tr>
<th>Time horizon</th>
<th>Number of investment companies re-balancing portfolio choice</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-3 years</td>
<td>9</td>
<td>75</td>
</tr>
<tr>
<td>4-6 years</td>
<td>3</td>
<td>25</td>
</tr>
<tr>
<td>Over 6 years</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Survey Questionnaire

75% of investment companies re-balance their portfolio choice in between a period of 1-3 years. The reason given by managers for the prevalence of the period was volatility associated with Kenyan investment market therefore they avoid portfolio associated with long period of time because of uncertainty of such investments. They consider investment vehicle with life span of 1-3 years to achieve their investment objectives.
The analysis involves determination of the strength of relationship (correlation coefficient) between consideration and importance of factors influencing portfolio choice amongst investment companies.

The analysis is based on "consideration" and "importance" ranking by the respondents. The average ranking and standard deviation of each respondent is computed in addition to correlation coefficient. The results of the analysis are shown in the table below.

<table>
<thead>
<tr>
<th>Table 6: Correlation Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AG</strong></td>
</tr>
<tr>
<td>-------</td>
</tr>
<tr>
<td>INVESTMENT OBJECTIVE</td>
</tr>
<tr>
<td>RISK TOLERANCE</td>
</tr>
<tr>
<td>LIQUIDITY REQUIREMENT</td>
</tr>
<tr>
<td>TIME HORIZON</td>
</tr>
<tr>
<td>ABILITY TO RE-BALANCE</td>
</tr>
<tr>
<td>REGULATORY FRAMEWORK</td>
</tr>
<tr>
<td>PERSONNEL AVAILABILITY</td>
</tr>
<tr>
<td>STANDARD DEVIATION</td>
</tr>
<tr>
<td>CORRELATION</td>
</tr>
</tbody>
</table>

Where

C is consideration ranking

Key

1. Unconsidered
2. Less considered
3. Fairly considered
4. Considered
5. Mostl considered

I is important ranking

Key

1. Unimportant
2. Less important
3. Fairly important
4. Important
5. Very important

29
From both the table and figure above, the average level of importance for the twelve respondents is 4.36 therefore on average fund managers consider those factors influencing portfolio choice as important. The average ranking of consideration for the twelve respondents was 4.23. Generally factors influencing portfolio choice were considered by fund managers when making portfolio choice.

The table below indicates the average “consideration” and “importance” ranking of factors influencing portfolio choice by all the twelve respondents.
Table 7: Average importance and consideration ranking

<table>
<thead>
<tr>
<th>Factors influencing portfolio choice</th>
<th>Average importance</th>
<th>Average consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment objective</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Risk tolerance</td>
<td>4.77</td>
<td>4.25</td>
</tr>
<tr>
<td>Liquidity requirement</td>
<td>4.42</td>
<td>4.5</td>
</tr>
<tr>
<td>Time horizon</td>
<td>4</td>
<td>3.75</td>
</tr>
<tr>
<td>Ability to re-balance</td>
<td>4.25</td>
<td>4.42</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>5</td>
<td>4.83</td>
</tr>
<tr>
<td>Personnel availability</td>
<td>3.08</td>
<td>2.83</td>
</tr>
</tbody>
</table>

Source: Survey Questionnaire

Using a bar graph, this is shown as follows:

Figure 4.6.2 Average importance and consideration ranking
Personnel availability was least important and considered factor when making portfolio choice.

On correlation between importance and consideration of factors influencing portfolio choice one manager (8%) had a perfect positive correlation while nine managers out of twelve (75%) share a positive correlation between importance and consideration. One manager (8%) had a zero correlation.

4.7 Liquidity of investment vehicles

The analysis focus on ability of an investment vehicle to be traded without affecting its price and low transaction cost on such trading.

The table below gives a summary of investment vehicle and their relative liquidity since total number of respondents were twelve and maximum rank for a factor was 4 (very liquid) then maximum score was supposed to be 48.

<table>
<thead>
<tr>
<th>Investment vehicle</th>
<th>Maximum score</th>
<th>Actual score</th>
<th>Mean</th>
<th>Standard deviation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock</td>
<td>48</td>
<td>48</td>
<td>4</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>48</td>
<td>42</td>
<td>3.5</td>
<td>0.5</td>
<td>2</td>
</tr>
<tr>
<td>Government bond</td>
<td>48</td>
<td>30</td>
<td>2.5</td>
<td>1.5</td>
<td>3</td>
</tr>
<tr>
<td>Real estate</td>
<td>48</td>
<td>12</td>
<td>1</td>
<td>4</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Survey Questionnaire

There was no diversity or opinion in ranking of stocks as most liquid investment vehicle and ranking of real estate as the most illiquid investment vehicle.
CHAPTER FIVE: SUMMARY, CONCLUSIONS, LIMITATIONS AND SUGGESTIONS FOR FURTHER STUDY

5.1 Summary of Findings, and Interpretation

The results analyzed relates to twelve respondents out of a population of fifteen respondents (80%). Fund managers investment objective aims at meeting diverse client needs. Client mandate determines whether to pursue an objective aiming at capital appreciation, capital preservation, and current income and growth in current income. 75% of respondents pursue all these investment objectives to cater for diversity in client needs. There seem to have a high inclination towards use of ordinary shares to ensure capital appreciation, corporate bonds to ensure current incomes need are met, to preserve capital when making portfolios choice respondents preferred government bonds and bank certificate of deposit.

The fund managers generally prefer 16-20 securities in a portfolio in order to diversify risk in their portfolio choice. There seem to be a general consensus that this number of securities will significantly reduce portfolio risk. Based on their investment objective and clients mandate. 75% of the respondents prefer rebalancing their portfolio choice between a period of 1-3 years this has largely attributed to volatility of Kenyan investment market holding a portfolio for a larger period of time calls for venturing into high uncertainties hence fund managers generally prefer a shorter period of 1-3 years to rebalance their portfolio.

Portfolio choice amongst fund managers is made by an investment committee chaired by a fund manager. All investment companies indicated that portfolio chosen is a result of concerted effort by an investment team. Standard deviation amongst respondent was zero indicating portfolio choice is a team effort not an individual preserve.

The objective of the study was to identify factors influencing investment companies portfolio choice. The results from this study show that several factors are considered
when making portfolio choice. Whereas, some factors consideration elicited mixed reactions from respondents. All respondents consider investment objective and regulatory frameworks as very important factors influencing portfolio choice. Other factors like risk tolerance ability to rebalance, liquidity requirement and personnel availability were considered important to different degrees by different respondents.

There seems to be an importance and consideration of factors influencing portfolio choice amongst investment companies. The “importance ranking” by respondents was attributed to usefulness of factors influencing portfolio choice in making portfolio decisions. Consideration of factors influencing portfolio choice is attributed to fact that when probably considered they help a firm in achieving its investment objective based on client mandate.

The respondents have recognized ordinary shares as risky investment vehicles and government bonds as least risky investment vehicle when making portfolio choice. All respondents regard investment in stocks as high risk investment when investing in stocks investment companies prefer companies that consistently report high profits, and have good management as this would guarantee continued growth in profits in which case dividends are expected to continually flow to the investors. This is generally good to fund managers whose objective is constant source of income. All the respondents consider interest rate as the dominating factor when making portfolio choice with regard to bonds. Tax rate was unimportant while inflation was important to different investment companies at varying degrees.

Generally, respondents risk tolerance level cut across conservative, moderate and aggressive as risk tolerance varies from client to client and therefore portfolio choice made caters for all clients risks tolerance levels. 75% of respondents view stock as a very liquid investment vehicle. It can easily be traded without affecting its price and has lower transaction cost. Whereas all respondents agree that real asset is an illiquid investment vehicle.
5.2 Conclusions

Making portfolio choice is important to ensure continuous achievement of investment objectives. A proper balance of tradeoffs has to be achieved between risk and return of a portfolio when making portfolio choice.

This balance can only be achieved by considering factors influencing portfolio choice. Investment companies investment objectives and regulatory framework set by RBA are the key factors that influence portfolio choice amongst investment companies in Kenya. These factors together with liquidity requirements, risk tolerance, time horizon of investment and ability to rebalance a portfolio need to be considered when making portfolio choice. In this regard factors influencing making portfolio choice are critical in ensuring continuous success of investment process initiated by an investment company.

5.3 Recommendation for policy and practice

5.3.1 To investment companies and policy makers

The study reveals that portfolio choice is influenced by different factors to different degrees apart from investment objective and regulatory framework where fund managers were consistent in ranking other factors varies to different degree amongst fund managers.

Investment management companies require to continuously analyze these very important factors influencing portfolio choice as these factors translate into maximizing value of a portfolio by maximizing expected return and minimizing risk and as such aid in making portfolio choice satisfying investors objectives like capital growth, stability of income and increasing the level of wealth.

Policy makers when designing portfolio should consider relevancy of various factors influencing portfolio choice inorder to achieve their desired investment objectives. Because R.B.A investment guidelines are very important in influencing portfolio choice they should be up to date and reflecting current economic reality.
5.3.2 Enhance availability of literature review material

The University of Nairobi should undertake efforts to provide additional finance literature through, for example acquisition of latest journals of finance and economics, periodical and books on the subject of finance. This will greatly assist future researchers in finance and related disciplines.

5.3.3 Research sponsorship

Due to ever increasing cost of conducting research, universities should consider allocating or increasing funds allocated to research students. This would enable more extensive research to be conducted and thus more conclusive findings.

5.3.4 Sensitization to companies and general public on importance of research

A people effort by universities, private sector and other interested stakeholders spearheaded by government should sensitize the companies and the general public on the importance of research to development of a country and hence need to co-operate with researchers especially during data collection. This sensitization would greatly increase response rate and accuracy of research findings.

5.4 Limitations of the study

The research was constrained by factors such as:-

5.4.1 Data accessibility

It was difficult to gather all relevant information from the respondents. Some respondents did not have all the relevant data required for the purpose of the study. Three fund managers did not give any response. Respondents were suspicious about the study and declined to provide information. These respondents feared that the confidentiality of certain information about their operations may be exposed to competition by other parties. This fear was inspite of the respondents not being required to necessarily disclose the identities of their companies and that their responses would be used solely for academic purposes.
5.4.2 Time resource
Time resource was constrained especially due to the long time the respondents took with the questionnaire. The time resource did not, however, compromise the quality of data analysis.

5.4.3 Cost
Constant follow-ups were made to ensure that the respondents filled their questionnaire. This made the study more expensive than was planned for. At times, several visits were made to one data source without response.

5.4.4 Lack of adequate local literature material
Researchers on the subject of portfolio choice and especially factors influencing portfolio choice in relation to Kenyan situation are few. Much of the literature review for this research was obtained from researches conducted in the developed countries whose economic circumstances are different from those existing in Kenya.

5.4.5 Company Versus Personal views
It was extremely difficult to assess whether the fund managers filling the questionnaires were expressing their personal opinions on factors influencing portfolio choice or they were expressing the company policy.

Despite the above limitations, the researcher is confident that the limitations did not significantly impair the results.

5.5 Suggestions for further research
This study focused on investment management companies only, however, a study of factors influencing portfolio choice amongst institutional investors such as commercial banks, insurance companies, unit trust and mutual fund can be conducted. These results
can be compared and contrasted to highlight any major similarities or differences on factors influencing portfolio choice. A further study may focus on factors influencing portfolio choice on investment companies not regulated by capital market authority. The big questions is whether the same factors influence portfolio choice amongst investment companies not registered by CM.A.

A study should be carried out to determine the reasons behind home bias when selecting investment vehicles to constitute a portfolio. Investment companies were observed to make portfolio mostly from local investment vehicles.

A study can be conducted on a multinational fund manager with interests across Africa to assess factors influencing portfolio choice amongst different economies.
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APPENDIX I

LETTER OF INTRODUCTION

John Patrick K. Karanja
University of Nairobi
School of Business
P.O. Box 30197
Nairobi.

Dear Sir/Madam,

I am a master’s degree student in the School of Business, University of Nairobi. In partial fulfillment of the MBA degree, I am conducting a survey on “Factors influencing Portfolio Choice amongst Investment Management Companies.” Targeting firms registered by Capital Market Authority in Kenya.

I have chosen your company as one of those registered by Capital Market Authority. I am therefore kindly requesting you to fill in the given questionnaire, which will take you just about 15 minutes.

The information and data required is needed for academic purposes only and will be treated with strict confidence.

A copy of the research project will be made available to your firm on request.

Thank you.

Yours sincerely,

John Patrick K. Karanja
APPENDIX II

QUESTIONNAIRE

A SURVEY OF FACTORS INFLUENCING INVESTMENT COMPANY PORTFOLIO CHOICE

This questionnaire has been designed to gather information on factors influencing investment companies portfolio choice. Kindly answer the questions as accurately as possible your response will be treated with strict confidence. Your answers shall be used for academic purposes only.

Part I

1. Name of the company ____________________________
   Designation of officer ____________________________
   Date ____________________________

2. What is the aim of your firm investment objective?
   Aim of objective                        Tick
   1. Capital appreciation, capital preservation, current income and growth in current income
   2. Capital appreciation and capital preservation
   3. Current income and growth in current income
   Any other (please specify) ____________________________

3. Which of the following investment vehicle is most dominant in helping you achieve aim of your investment objective (Tick the most appropriate)

<table>
<thead>
<tr>
<th>Dominant Investment vehicle</th>
<th>Capital appreciation</th>
<th>Capital preservation</th>
<th>Current income</th>
<th>Growth in current income</th>
<th>Other (please specify)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary shares</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preference shares</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate bonds</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government bonds</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank certificate of deposit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others (please specify)</td>
<td>1.</td>
<td>2.</td>
<td>3.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

44
Part II

4. Portfolio choice is influenced by various factors. Please rate the following factors using the key provided below.

Key

1. Unimportant
2. Less important
3. Fairly important
4. Important
5. Very important

<table>
<thead>
<tr>
<th>Factor</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Investment objective</td>
<td>1</td>
</tr>
<tr>
<td>2. Risk tolerance</td>
<td>2</td>
</tr>
<tr>
<td>3. Liquidity requirement</td>
<td>3</td>
</tr>
<tr>
<td>4. Regulatory framework</td>
<td>4</td>
</tr>
<tr>
<td>5. Time horizon</td>
<td>5</td>
</tr>
<tr>
<td>6. Ability to re-balance</td>
<td>1</td>
</tr>
<tr>
<td>7. Personnel availability</td>
<td>2</td>
</tr>
</tbody>
</table>

5. Over what time period is your portfolio choice expected to prevail (After how long do you re-balance your portfolio choice)

Time horizon       Tick
1 - 3 years        1
4 - 6 years        2
Over 6 years       3
6. In making portfolio choice what preference do you give to an investment vehicle over specified time period.

<table>
<thead>
<tr>
<th>Investment vehicle</th>
<th>Most Preferred time horizon for portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1-3 years</td>
</tr>
<tr>
<td>1. Stocks</td>
<td></td>
</tr>
<tr>
<td>2. Corporate bonds</td>
<td></td>
</tr>
<tr>
<td>3. Government bonds</td>
<td></td>
</tr>
<tr>
<td>4. Real assets</td>
<td></td>
</tr>
<tr>
<td>5. Others specify and rank</td>
<td></td>
</tr>
</tbody>
</table>

8. Various factors influence making of portfolio choice. Rate your degree of consideration of each outlined factors.

**Key**
1. Unconsidered
2. Less considered
3. Fairly considered
4. Considered
5. Strongly considered

<table>
<thead>
<tr>
<th>Factor</th>
<th>Rank</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Investment objective</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Risk tolerance</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Liquidity requirement</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Regulatory framework</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Time horizon</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Ability to re-balance</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Personnel availability</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
9. On average what number of securities do you hold?

<table>
<thead>
<tr>
<th>Number of securities</th>
<th>Tick</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 5</td>
<td></td>
</tr>
<tr>
<td>6 - 10</td>
<td></td>
</tr>
<tr>
<td>11 - 15</td>
<td></td>
</tr>
<tr>
<td>16 - 20</td>
<td></td>
</tr>
<tr>
<td>Over 20</td>
<td></td>
</tr>
</tbody>
</table>

10. When making portfolio choice in context of Kenyan investment market what do you consider easy to be traded without affecting its price and has lower transaction cost

<table>
<thead>
<tr>
<th></th>
<th>Illiquid 1.</th>
<th>Fairly liquid 2</th>
<th>Liquid 3</th>
<th>Very liquid 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Stock</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Corporate bonds</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Government bond</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Real estate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Other(s) specify and rank</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

11. On aggregate how do you classify your firm risk tolerance level

<table>
<thead>
<tr>
<th>Level</th>
<th>Tick</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conservative, moderate and aggressive</td>
<td></td>
</tr>
<tr>
<td>Conservative</td>
<td></td>
</tr>
<tr>
<td>Moderate</td>
<td></td>
</tr>
<tr>
<td>Aggressive</td>
<td></td>
</tr>
</tbody>
</table>

Please explain ________________________________

______________________________
12. In making portfolio choice different investment vehicles may generate varying returns in context of your market what do you consider as:
   a. High return investment vehicles ............................................
   b. Low return investment vehicles ............................................

13. Who is charged with making portfolio choice
   a) Committee headed by research analyst □
   b) Committee headed by research analyst □
   c) Research analyst □
   d) Fund manager □
   e) Other(s) specify and rank  □

14. When making portfolio choice to invest in bonds what do you consider as important

<table>
<thead>
<tr>
<th></th>
<th>Unimportant</th>
<th>Less Important</th>
<th>Fairly Important</th>
<th>Important</th>
<th>Very Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate</td>
<td>□</td>
<td>□</td>
<td>□</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Inflation rate</td>
<td>□</td>
<td>□</td>
<td>□</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Tax rate</td>
<td>□</td>
<td>□</td>
<td>□</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Any other</td>
<td>□</td>
<td>□</td>
<td>□</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>

16. When making portfolio choice with regard to stock what factors do you consider as important. List them in order of importance.
   a.  
   b.  
   c.  

Thank you for completing this questionnaire
APPENDIX III

FUND MANAGERS REGISTERED BY CAPITAL MARKET AUTHORITY
AS AT 30/9/2006

1. AIG Global Investment Co. (EA) Ltd
   ICEA Building 2nd floor
   P.O. Box 67262 – 00200
   Nairobi.

2. Old Mutual Asset Managers (K) Ltd
   Old Mutual Building Mara Road, Upper Hill
   P.O. Box 1189 – 00400

3. Old Mutual Investment Services Ltd
   Old Mutual Building, Corner of Mara/hospital road
   P.O. Box 30059 -00100
   Nairobi.

4. African Alliance (K) Management Ltd
   Kenya Re Towers 4th Floor
   P.O. Box 27639 – 00506
   Nairobi.

5. Stanbic Investment Management Services Ltd
   Stanbic Building, Kenyatta Avenue
   P.O. Box 305 – 00100
   Nairobi.

6. Zimele Asset Management Co. Ltd
   Unipen House
   Hurlingham Shopping Centre
P.O. Box 76528 – 00508
Nairobi.

7. Aureos Kenya Managers
   Norfolk Towers Kijabe Street 1st floor
   P.O. Box 43233 – 00100
   Nairobi.

8. ICEA Investment Services Ltd
   ICEA Building 14th Floor
   P.O. Box 46143 – 00100
   Nairobi.

9. Co-op Trust Investment Services Ltd
   Co-operative House Mezanine
   P.O. Box 48231 – 00100
   Nairobi.

10. Standard Chartered Investment Services Ltd
    Stanbank House, Moi Avenue
    P.O. Box 3003 – 00100
    Nairobi.
    Tel: 32093703/32093000

11. Amana Capital ltd
    Barclays Plaza Ground Floor Loita Street
    P.O. Box 9480 – 00100
    Nairobi.
    Tel: 313356/312144

12. Genesis (k) Management Ltd
    Lonrho House 12th Floor
    P.O. Box 79217
    Nairobi.
13. British – American Asset Managers Limited
   Britak Centre – Upper hill
   P.O. Box 30375 – 00100
   Nairobi.

14. Old Mutual Asset Managers (EA) Ltd
   Old Mutual Building Corner of Mara/Hospital Road
   P.O. Box 30059 – 00100
   Nairobi.

15. Investeq Capital Limited
   Milimani Road
   P.O. Box 56977 – 00200
   Nairobi.
   Tel: 2730980/1
**APPENDIX IV**

**Ranking of consideration and importance of Factors influencing portfolio choice amongst investment companies**

<table>
<thead>
<tr>
<th></th>
<th>AIG</th>
<th>BRITAK</th>
<th>OM(K)</th>
<th>OM</th>
<th>AFR</th>
<th>SIMS</th>
<th>ZAM</th>
<th>AKM</th>
<th>CO-OP</th>
<th>GM</th>
<th>RIMS</th>
<th>ICEA</th>
<th>AVERAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>C</td>
<td>I</td>
<td>C</td>
<td>I</td>
<td>C</td>
<td>I</td>
<td>C</td>
<td>I</td>
<td>C</td>
<td>I</td>
<td>C</td>
<td>C</td>
<td></td>
</tr>
<tr>
<td>1. Investment objective</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
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<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5.000</td>
</tr>
<tr>
<td>2. Risk tolerance</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>4</td>
<td>4</td>
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<td>4.244</td>
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<td>3. Liquidity measurement</td>
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<td>5</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>4.423</td>
</tr>
<tr>
<td>4. Regulatory framework</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td>3.750</td>
</tr>
<tr>
<td>5. Time horizon</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>4.250</td>
</tr>
<tr>
<td>6. Ability to rebalance</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>4.800</td>
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<tr>
<td>7. Personnel availability</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>3</td>
<td>2.857</td>
</tr>
<tr>
<td>Standard deviation</td>
<td>0.79</td>
<td>0.95</td>
<td>1.1</td>
<td>0.69</td>
<td>1.21</td>
<td>1.46</td>
<td>1.35</td>
<td>0.9</td>
<td>1.21</td>
<td>0.95</td>
<td>0.79</td>
<td>0.79</td>
<td>0.730</td>
</tr>
<tr>
<td>Correlation co-efficient</td>
<td>0.881</td>
<td>0.761</td>
<td>0.669</td>
<td>0.570</td>
<td>1.000</td>
<td>0.923</td>
<td>0.801</td>
<td>0.167</td>
<td>0</td>
<td>0.623</td>
<td>0.083</td>
<td>-0.331</td>
<td>0.829</td>
</tr>
</tbody>
</table>

I – represents grading of importance of factors influencing portfolio choice

C – represents grading of consideration of factors influencing portfolio choice