AN ASSESSMENT OF THE EFFECT OF GENERAL ELECTIONS ON THE STOCK MARKET RETURNS IN KENYA

BY

ZUWENA ZAINABU

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DECLARATION

This research project report is my original work and has not been presented for any degree in any other university.

Signed………………………………………… Date…………………………………………

Zuwena Zainabu

D61/63281/2010

The project report has been submitted for examination with my approval as a university supervisor.

Signed…………………………………….. Date……………………………………….

Dr. Sifunjo E. Kisaka

Lecturer

Department of Finance and Accounting

School of Business

University of Nairobi

DEDICATION

I would first like to thank the Almighty God for helping me spiritually and keeping me in good health to pursue my studies until completion.

This project is dedicated to my husband and my entire family, for the inspiration and courage they gave me.

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I also wish to thank my husband, my family, colleagues and friends, my employer and persons who helped me accomplish my project

ABSTRACT

The main aim of the study was to establish the effect of the general elections on the return of the stock market in Kenya. This is an empirical study that analyzed the stock market returns during electioneering periods in Kenya. The study covered the period between 1997 and 2013. This period is selected because during the competitive general presidential, parliamentary and civic elections were held compared to previous general elections which did not include many political parties. The NSE index performance during this period was analyzed and the performance of the NSE index during election years compared to none election years. Descriptive research design was applied. The population of the study was the 61 listed companies at NSE. The study used secondary data, this constituted of data for the Nairobi Securities indices from 1996 to 2013 and data of each general election in the years 1997, 2002, 2007 and 2013 taken as event date: 27th December 1997, 26th December 2002, 26th December 2007 and 4th March 2013.

From the research findings, it was noted that investors tend to include forward looking expectations, implying that voters incorporated speculative expectations into their assessment of macroeconomic indicators. From the analysis and the research findings, it was noted that stock market returns tend be affected by the presence of election trends. A higher level of policy uncertainty increases the risk of holding assets with returns that depend on economic policies. The study recommends that investors should carefully plan and carry out investments during and after the periods of the general elections as the returns could be affected either positively or negatively during that period. Elections can have important consequences in the stock market; therefore investors can devote a certain portion of money to invest in stocks before and another in stocks after elections. Many investors simply invest in stocks after elections where they presume that the market will be performing well as a result of the new regime.

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APT	Arbitrage Portfolio Theory
CAPM	Capital Assets Pricing Model
CBK	Central Bank of Kenya
DP	Democratic Party
DTS	Directorate of Trade Statistics
EMH	Efficient Market Hypothesis
IFS	International Financial Statistics
KADU	Kenya African Democratic Union
KANU	Kenya Africa National Union
KNBS	Kenya National Bureau of Statistics
MOU	Memorandum Of understanding
MPT	Modern Portfolio Theory
NARC	National Rainbow Coalition
NSE	Nairobi Securities Exchange
ODM	Orange Democratic Party
PBC	Political Business Cycles
PNU	Party of National Unity
TNA	The National Alliance

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Diverse financial literature has established that stock market return can mainly be explained by economic events. But economic news is not the only news that influences stock market movements. Political, environmental and other events are repeatedly considered responsible for such movements. There is empirical and theoretical literature discussing the effects of these other events, especially political cycles on the macro economy, which is specifically of interest in this research paper.

There are two models of politico-economic cycles that analyze the scope for government macroeconomic policies to influence the real side of the economy in a politically profitable way. The ''political business cycles'' (PBC) model stresses the opportunism of policy-makers trying to maximize their popularity and/or their probability of re-election. The PBC model predicts pre-electoral high growth and low employment, increasing inflation before elections, accompanied by postelection recessions, regardless of the political orientation of the government.

The PBC model was enriched with rational expectations (Cukierman and Meltzer, 1986; Person and Tabellini, 1994; Rogoff and Sibert, 1988), placing greater importance on information asymmetry between the government and voters. In this extended model, politicians know their own level of competence, while the voters, who are endowed with rational expectations conditional on the information set

available to them at any given time, discover the level of politicians' competence only after the elections. Based on this set of information, voters are forced to base their judgments on observed economic outcomes. Fotios, Siokis, Aristidou 12, Kalamaria 55133, Thessaloniki, Greece.

This study will focus on the Nairobi Securities Markets, particularly focusing on general elections and its effects on the stock markets in the last four election cycles: 1997-2013, which have always been negatively impacted by each election cycle as per Kithinji and Ngugi (2013).

The main variables will be the Nairobi Securities index which comprises of the 20 most highly capitalized shares of the main market and reflects the general trends of the stock market as well as the election cycles which influence a change in stocks performance. The variables are related in that share prices generally perform poorly close or during election periods

1.1.1 Elections in Kenya

Election in Kenya is done after every five years. When the country got independence in 1963, there were two political parties: Kenya Africa National Union (KANU) and for a brief period Kenya African Democratic Union (KADU), which dissolved itself in 1966. All the elections, except in 2002, when long-serving former President Moi was defeated by the "Rainbow Coalition" have been precipitated with political and land clashes. 20O7/08 was a particularly dark mark on Kenya's history as there was

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widespread political violence culminating in over 1300 Kenyans dead and thousands displaced. The current President, his deputy and a journalist are still being accused by the International Criminal Court for serious crimes against humanity.

This study will focus on elections from 1997 to 2013. In 1992, there were seven presidential candidates, with the frontrunners, being former president Moi of KANU and Kenneth Matiba of Ford Asili, Mwai Kibaki (DP) and Jaramogi Oginga Odinga of Ford Kenya. Moi won the election.

In 1997, there were fifteen presidential candidates with the leading being former president Moi of KANU again and Mwai Kibaki of Democratic Party (DP), the former won the race. In 2002, there were five presidential candidates, with the leading being; former President Kibaki of National Rainbow Coalition (NARC) and Mr. Uhuru Kenyatta of KANU. The former won the election. Between 2002 and 2007 Kenya had 5 years of very positive economic development with four consecutive years of growth above 4 percent.

The disputed 2007/8 elections which caused bloodshed in Kenya and an upheaval in the Nairobi Securities Exchange had two main contenders: Former President Kibaki of Party of National Unity (PNU) and Raila Odinga of Orange Democratic Party (ODM). The dispute was resolved through a power-sharing arrangement negotiated by Mr. Kofi Annan, under the auspices of the Africa Union, whereby Mr. Kibaki became the President while Mr. Odinga became the Prime Minister.

The violent disruption to the free flow of goods, labor and financial services affected all sectors of the economy. The political upheavals like the prolonged differences within the grand coalition resulted in serious damage to the economy, including reduced confidence among investors and damage to social capital. The economy showed signs of recovery in the first quarter of 2009, recording a growth rate of 3.9% compared to a decline of 0.6 percent in the first quarter of 2008.

The 2013 elections were also disputed and were resolved by the Supreme Court, which declared Mr. Uhuru Kenyatta of The National Alliance (TNA), the winner against Mr. Odinga of ODM, in a race of eight presidential candidates. This was the first elections held under Kenya's new constitution which was promulgated in 2010, creating an Independent Electoral & Boundaries Commission.

1.1.2 Stock Market Returns

A stock return is a vital subject in the stock market as it affects the country's economy. According to Zuravicky, 2005 it has emerged that economists are equally perplexed by the stock market just as anyone else and have tried to come up with explanations as to why stock prices keep on changing. The prices in the stock market are affected by reasons which at time could be volatile at the same time complex, and the reasons impact the stocks directly or indirectly.

Rioba (2003) carried a study on the predictability of ordinary stock returns at the Nairobi Securities Exchange (NSE). He argued that neither does efficient market hypothesis nor taxes on their own influence stock prices. The smartness or otherwise of a trader on his own also does not count, implying that competition in capital markets is very unpredictable and complex. Thus the ability to predict stock market return one-period ahead should not be construed to mean market inefficiency.

The information trader's use in generating forecasts depends on the trading style. Quantitative traders estimate expected returns and well-defined odds of success on the basis of historical relationships. Short-term traders measure flow and sentiment to determine price behavior. Longer-term traders, who are often theme based, try to set bounds on risk in an uncertain world through economic logic and scenario analysis.

Werah (2006) did a study to survey the influence of behavioral biases on investor activities at the NSE. The study population composed of both individual and institutional investors at the NSE. Data was collected through questionnaire and analysis was done to establish the influence of herd behaviour, mental accounting, loss aversion, anchoring, over reaction and under reaction, overconfidence, confirmation bias, regret aversion on investor activities at the NSE. The results obtained from the research suggested that the behavior of investors at the NSE were to some extent irrational when considered from the rationality of the investors in their disregard of fundamental estimations as a result of herd behavior, regret aversion, overconfidence and anchoring.

1.1.3   General Elections and Stock Market

Since 2004, the stock market environment has changed in ways that make it more important than ever to seek to understand the relationship between politics and stock market behavior. Studies done, especially in the United States focused on two broad issues; first they provided evidence of the relationship between economics, politics, and the four-year presidential cycle; and second, they included an analysis of stock market performance during the 2008 period. In addition, they introduced a risk measurement for the stock market and argued that the 2008 stock market crash should be considered an anomaly. They concluded that the four year presidential stock market cycle is likely still valid. Political scientists and economists in the world today are more increasingly interested in the interplay between politics and the stock markets; one of the reasons is to test the explanatory power of established politico-economic models. If different parties strategically manipulate the economy to optimally benefit their voter base then at the end of the day, their economic policies will result in producing reactions by stock markets (Person, 2012)

Jones (2002) argues that there are major hypotheses explaining the effects on the U.S. market stock returns. The first effect tests the popular wisdom over time that the stock market prefers Republican Presidential Administration to Democratic Administration .This effect is referred to as the "party "effects. The other effect rests on popular wisdom and holds that the last two years of presidents four year term feature better stock performance than do the first two years

Few would argue that there are not major differences between the two presidential candidates, or that the outcome won't have an effect on Wall Street and the economy over the next four years. However, there is significant disagreement or even confusion about what that potential impact might be. (http://.investech.com)

As a result of infrastructural development and reforms, specifically in the NSE and financial sector in general, the performance of the NSE improved in the last 10 years, culminating in the penetration of securities to the mass market, with the sale of Safaricom shares. According to The World Bank; Kenya's GDP has grown at an average of 4.6% against an average of 4.3% for Sub-Saharan Africa in the last three years (2011-2013)

1.1.4   Stock Market in Kenya

The Stock market plays an important role as indicators, reflecting the performance of the status of the country's economy. Stock market is a place where securities are bought and sold. It is exposed to a high degree of volatility; prices fluctuate within minutes and are determined by the demand and supply of stocks at a given time. Stockbrokers buy and sell securities on behalf of individuals and institutions for some commission. Countries have different authorized body, which regulates the operations of stock exchanges, banks and other financial institutions.

In Kenya the dealing in stocks and shares started in the 1920s when the country was a colony of Britain. The Nairobi Securities Exchange was formed in 1954 as a

voluntary association of stockbrokers registered under the societies act. The first privatization ever to be held in the NSE was done in 1988 when the government sold 20% of its stake in Kenya Commercial Bank. In February 18th 1994 the NSE 20-share index recorded an all record high of 5030 points and was rated by the International Finance Corporation as the best performing market in the world with a return of 179% dollar terms.

In September 2006 live trading on the automated system at the NSE was implemented which was customized to uphold the spirit of the Open Outcry Trading Rules in an automated environment. In the same year trading hours increased to three hours from the usual two hours. In November 2006, a MoU was signed between the Nairobi Stock Exchange and the Ugandan Securities Exchange which allowed cross listing and it allowed listed companies in both exchanges to dual list which is contributing to development of the regional securities market.

In July 2011 the Nairobi Stock Exchange Limited changed its name to Nairobi Securities Exchange Limited and the change of the name was a reflection of the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange service provider (Nairobi Securities Exchange, 2013).

The entry of Safaricom Limited into the NSE brought the trading of shares to the mass market due to both its volume and pricing structure. Many ordinary people were

introduced to the NSE through the floating of Safaricom shares. Other major companies, including KENGEN also floated during the same period.

1.2 Research Problem

Security exchanges all over the world play crucial roles in mobilization of financial resources and providing businesses with cheap and long-term sources of funding. The Nairobi Securities Exchange equally plays a similar role in the Kenyan context.

However, due to the competitive nature of Kenyan elections with its attendant risks, stock prices at the Nairobi Securities Exchange are usually at rock bottom during election periods. Additionally, the situation has been exacerbated by retail investors who sell shares in a panic mode further dampening prices. This is due to lack of knowledge among majority of retail investors who are unable to follow the trend whereby stock prices fall just before and after elections and take advantage to optimize on their investment. This is indeed common in most of Sub Saharan Africa, where democratic values are still in their nascent stages and retail investors lack stock market knowledge.

Modern Portfolio Theory (MPT) indicates the significance of diversification to reduce the total portfolio risk, but it also guides investors on how to effectively diversify by picking assets that tend to have dissimilar price movements. The focus should be on the significance of diversification to reduce the total portfolio risk. The basic

assumption of MPT is that diversification reduces risk while maximizing on stock returns.

CAPM considers a simplified world where all investors aim to maximize economic utility, are rational and risk-averse, are price takers. There are no restrictions in lending or borrowing under the risk free rate of interest and trade without transaction or taxation costs. The securities are all highly divisible into small parcels and have identical investment horizons, options, expected returns, volatilities and correlations of available investments. All investors are assumed to have access to similar information.

Arbitrage is the practice of taking advantage of a state of imbalance in the markets and thereby a risk free profit maximization mechanism. It is the process by which market players take advantage of price differentials of similar assets by selling overpriced assets and buying under priced assets until equilibrium is attained.

The primary hypothesis for an efficient market is that stock prices accurately and quickly reflect all available information in such a way that no one can earn abnormal returns. (Hadi 2006). It is generally believed that securities markets are extremely efficient in reflecting information about individual stocks and about the stock market as a whole. The accepted view is that when information arises, the news spreads very quickly and is incorporated into the prices of securities without delay.

The literature that this study has reviewed takes cognizant to the fact that this subject has been debated and researched by many academicians, mainly in the developed countries. The ideological differences between political parties, which are arguably evident in most industrialized countries, are clearly apparent in Greece, which could be considered as an ideal laboratory to examine the impact of elections on financial markets (Siokis and Kapopoulos, 2003)

Researchers (Stoval (1992) and Atkin (2012)) established that there is a close correlation between general elections and trends in various stock markets. They also established that lack of market knowledge creates a situation where investors buy and sell stocks with other considerations other than knowledge, at times on impulse, resulting in low returns and further discouraging the penetration of the stock market to the mass market.

Pearson (2012) argues that stock markets are known to play a critical role in various countries around the world since they influence the activities of governments and general performance of an economy. Several other studies have been conducted especially in the developed world on how the stock market is affected in the period just before and after general elections. The findings have suggested a mixed reaction towards parties that take leadership in those countries. However, not enough research has been conducted in this area especially in the developing countries. This leaves a wide knowledge gap that this study seeks to fill. This research examines whether movements in the stock market returns in the Nairobi Securities Exchange can be

partly explained by the dynamics of the Kenyan election cycles, especially taking cognizant to the fact that elections in Kenya are high stakes events and regularly conducted every five years .This knowledge gap will be partially mitigated through this study.

This study seeks to determine two research questions; namely the effect of general elections on stock market returns and role of an informed investing community in stabilizing stock market prices.

Data and information generated through this study will among others, create a pool of knowledge that will respond to the research questions as to whether general elections and lack of stock market knowledge among the retail investing community contributes to poor stock market performance during election periods in Kenya, and indeed most of Sub-Saharan Africa.

1.3 Objective of the study.

To assess the effect of general elections on the returns, of the stock market in Kenya.

1.4 Importance of the Study

This study is expected to highlight the great risk posed to the Kenyan economy as a result of non-adherence to proper democratic norms and traditions. This sensitization is likely to gradually lead to better management of elections and the country in general, particularly inclusivity and following due process in all public affairs.

Better management of election cycles could enhance investor confidence, thereby increasing stability and resources within the securities markets, which is likely to enhance the production capacity, employment and create faster socio-economic growth.

This study is also likely to benefit the investing public who would understand the processes of investing in the stock market and the risks that are involved. Market information and circulation would be more accessible to the general public, local institutional investors and all the foreign investor both retail and corporate.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter is a summary of the various literature and studies that have been used to form opinions and observations on elections and stock market return in Kenya. This includes; section 2.2 which discusses theoretical literature, section 2.3 which discusses determinants of stock market, section 2.4 presents the empirical literature, section 2.5 review of local research and 2.6 a summary of literature.

2.2 Theoretical Literature

According to Wyss (2001) in a stock market setting what seems to matter is a list of the following: high growth in earning or an expected growth in earnings while at the same time meeting the goals of earnings, flow of money, price stability and the interest of investors. An ideal stock market is affected negatively by missed earnings, inflation and high interest rates while at the same time indifference of the stock market is dependent upon recessions.

The players in the stock market are considered to be "forward looking" which means that they have a rational expectation forecast of future earnings which matter more than past earnings but that does not mean that current and past earnings are not significant since their trend will be used as estimates for future earnings (North & Caes, 2011).

It has emerged that economists are much perplexed by the stock market just as anyone else and have tried to come up with explanations as to why stocks prices keep on changing and among the factors explored include: change in value of debt, changes in the value of plant and equipment or organizations and change in the value of intangible assets owned by organizations in the value of claims of stakeholders who are not securities holders. The change in value of plant and equipment offer little help in understanding the change in stock value as compared to the change in intangible assets which account for the great changes in stock-market value (Zuravicky, 2005).

Smith (2004) states that the stock market is viewed as a tool that is used to build wealth without having to own a personal company, having to go out and run the company and in the long run dividends are collected as part of profit making for individuals. Stocks are considered as the key if not the main part of an investment portfolio; when one is on the journey to financial freedom, an understanding of the operations of the stock market needs to be gained.

The prices in the stock market are affected by reasons which at time could be volatile at the same time complex, and the reasons impact the stocks directly or indirectly. People should remember that behind every stock there is a company and there are reasons why companies and stocks behave in a certain manner. Some of the reasons stated for stock value change include: internal developments in companies such as mergers and acquisitions, suspension of dividends and the change of the top

executives in companies i.e. hiring and firing: world events is also a factor that affects the value of stock such as war or civil unrest and acts of terrorism (Kaeppel, 2009).

2.2.1 Efficient Market Hypothesis

Fama et al (1969) argued that in an active market that includes many well informed and intelligent investors, securities will be appropriately priced and reflect all available information. If a market is efficient, no information or analysis can be expected to result in outperformance of an appropriate benchmark unless by chance. An 'efficient' market is defined as a market where there are large numbers of rational profit-maximizers actively competing with each other trying to predict future market values of individual securities. Current information is almost freely available to all participants. Competition among the intelligent participants leads to market prices, that reflect the past, current and future information. Therefore, in an efficient market at any point in time the actual price of a security will be as a good estimate of intrinsic value (Fama, 1970).

Key reason for existence of efficient market is the stiff competition among rational investors who try to profit from any new information. As participants compete with each other to arbitrage on mispriced securities, the likelihood of finding such mispriced securities become slimmer and the cost incurred in the efforts to analyze the information outweigh its benefits. If this occurs instantaneously, which is necessary for idealized world of frictionless markets and costless trading, the prices must then reflect all available information and no arbitrage profits can be made as

advanced by Getmansky et al (2003).Thus information available is a key driver of securities prices. Roll (1988) challenged the information content and found evidence that price movements for individual stocks cannot be traced to any specific public announcement.

According to Fama (1970), there are three forms of efficient market hypothesis depending on the amount of information impounded into stock prices as follows: The weak form efficiency asserts that all past market prices and data are fully reflected in securities prices. This implies that the future prices cannot be predicted by analyzing prices from the past. Excess returns cannot be earned in the long run by using investment strategies based on historical share prices or other historical data. In this form of hypothesis share prices, exhibit no serial dependencies, thus no patterns to asset prices. Hence prices must follow a random walk theory where stock price changes have the same distribution and are independent of each other, so the past movement or trend of a stock price or market cannot be used to predict its future movement (Kendall, 1953)

The Semi Strong Efficiency In this form, all relevant publicly available information is fully reflected in securities prices. This implies that share prices adjust to publicly available new information very rapidly and in an unbiased fashion, such that no excess returns can be earned by trading on that information. If there are any adjustments it would suggest that investors had interpreted the information in a biased fashion and hence in an in efficient manner (Kendall, 1953). According to Onyango

(2004), from his conclusion he found out that NSE was subject to semi strong form of EMH.

Strong Form Efficiency, Share prices reflect all information, public and private and no one can earn excess returns. Benard & Thomas (1990), in their study on evidence that stock prices do not fully reflect the implications of current earnings for future NYSE, they concluded that stock prices partially reflect a naïve earning expectation. Future earnings will be equal to earnings for the comparable quarter of the prior year. The study found abnormal returns around subsequent earning announcement hence lack of strong form efficiency.

2.2.2 Political Business Cycle Theory

Another influential theory presented by Nordhaus (1975) postulates that, irrespective of their political orientation, incumbents will pursue policies that maximize their chances of re-election. As a result, they will try to self-servingly attune the business cycle to the timing of elections.

The economy will be stimulated by unsustainable expansionary policies before the elections, and harsh actions aimed at curbing the resultant inflation will have to follow at the beginning of the new term of office. It has to be noted, however, that any policy- induced cycles in real activity will be ephemeral if the economic agents and voters have rational expectations (Alesina, 1987; Rogoff, 1990).

2.2.3 Behavioral Finance Theory

Behavioral Finance Theory is also critical in the study of the relationship between profit warning and stock value. This discipline relates the financial concepts and other social sciences. According to Heesters (2011), behavioral finance concept is based on the argument that investor rationality is relative and they suffer from and form biases that are applied in investment and stock trading choices. The theoretical argument is that irrational investors would make investment decisions not by relying on market fundamentals but by relying on their psychological situations. As such, there would be both emotionally and cognitively driven errors that influence the investment decisions. The net effect of these errors would be market incongruities that may lead to market crash or stock bubbles. These biases influence how they interpret information so that they make less rational decisions.

The emergence of behavioral finance can be attributed to the realization among scholars that both econometric analysis and psychological factors play critical roles in influencing financial markets. In an efficient market however, it is expected that those who follow arbitrage models identify and exploit these biases till the stock prices are fundamentally restored to market equilibrium.

The importance of this theory is that it helps to show how psychological factors influence investment decisions and the subsequent impact these biases have on the financial market. The behavioral finance theory is thus significant in this study as it is

critical of the EMH on the basis that markets maybe actually inefficient due to cognitive and emotional errors attributable to a certain class of investors.

2.3 Predictability of Stock Market Returns

In the empirical literature review examine the predictability of stock returns, market anomalies, political calendar and stock returns.

2.3.1 Predictability of Stock Returns

Studies done on stock market concludes that stock returns can be predicted by means of publicly available information, such as time series data on financial and macroeconomic variables with an important business cycle component. Predicting stock returns include interest rates, monetary growth rates, changes in industrial production, inflation rates, earnings –price ratios, and dividend yields. The predictable components in stock returns reflect time-varying expected returns, in which case predictability of stock returns is, in principle, consistent with an efficient stock market.

2.3.2 Market Anomalies

Market anomalies are empirical results that seem to be inconsistent with maintained theories of asset pricing behavior. (Schwert (2003)). They indicate either market inefficiency or inadequacies in the underlying asset-pricing model. The market anomaly usually relates to structural factors, such as unfair competition, lack of market transparency, regulatory actions or behavioral biases by economic agents. The

anomalies are cross sectional and time series patterns in security returns that are not predicted by a central paradigm or theory. Seasonality refers to regular and repetitive fluctuation in a time series which occurs periodically over a span of less than a year. Among the causes of seasonal variations in time series data include, but is not limited to, changes in climate, investor perceptions, tax-loss-selling and information hypothesis.

Fama (1997) reviewed and synthesized finance literature on long term return anomalies. He observed that anomalies are chance results, He argued that apparent overreaction to information is about as common as under reaction, and that post-event continuation of pre-event abnormal returns is about as frequent as post-event reversal. He concluded that even though much of the literature produces long term return anomalies, the evidence does not suggest that market efficiency should be abandoned.

The famous (EMH) was introduced by Fama (1965) which claims that in an efficient market stock prices always fully reflect available information. If the stock markets are efficient, stock prices are supposed to follow random walk. The random walk hypothesis states that future prices are not predictable on the basis of past prices, that is, stock price changes are unpredictable. The information contained in the past prices is fully and instantaneously reflected in current prices in an efficient market as argued by Fama (1965). Subsequent to the study by Fama (1965) a good number of researches have been conducted to examine the randomness of stock price behavior to conclude about the efficiency of a capital market. More recently one of the popular

areas of research in finance literature is finding out a particular seasonality or pattern in stock returns which demonstrate the inefficiency of the market.

Since the introduction of EMH by Fama (1965) which states that the expected return on a financial asset should be uniformly distributed across different units of time, researchers have documented several calendar anomalies in the stock returns such as January effect, Turn of the month effect and Day of the week effect or Monday effect, Holiday effect and so on.

The existence of the calendar anomalies is a denial of the weak form of efficient market hypothesis which states that stock returns are time invariant which means that there is no short-term seasonal pattern in the stock returns. The existence of seasonal pattern in the stock return infers that a market is inefficient and investors should be able to earn abnormal return. That's why finance researchers have been interested to find out the existence of the calendar anomalies or seasonality in the stock returns in different markets. Among the calendar anomalies day of the week effect is most widely documented anomaly and has been comprehensively investigated by the finance researchers in different markets of different countries considering different securities and indices and different institutional framework. Empirical studies have shown that day of the week anomaly not only present in the financial markets of the developed counties [for example, Gibbons and Hess (1981), Keim and Stambaugh (1984) Jaffe and Westerfield (1985) Lakonishok and Smidt (1988)] but also in the developing markets [for example, Aggarwal and Rivoli (1989), Islam and Gomes

(1999), Choudhry (2000), Aly, *et al.* (2004), Nath and Dalvi (2004), Hossain (2007), Agathee (2008)].

2.3.3 Political Calendar and Stock Returns

Explaining trends and explanations as to why stock markets rise and fall can be a never ending topic which if ventured would result in different views and perspectives from diverse authors and economists. From a casual perspective no one can tell with precision why stocks fall and rise, the markets are complex and the dynamics involved keep on changing. Never the less that does not mean that fairly accurate observations cannot be made on the rise and fall of stock markets, especially if history which is an impartial judge, is used as a guide (Valdez & Molyneux, 2010)

Shortly after the 2002 general elections in Germany, the CEO of Deutsche Telekom was fired and the decision was widely seen as a political measure to ensure the re-election of the current German government. The shares of the telecommunication company had been on the political agenda from the very beginning and the reason behind this was the fact that the privatization of the company had been done to make share holding more popular in Germany thus the shares were labeled, the people's shares since many people who had never bought shares were able now to own shares.

Many commentators eventually concluded that the returns on investing in the company shares had been highly significant in propelling the government then to popularity. IMF (2004) states that the indication here made seems to suggest that

stock market movements may be of key importance for policy marker and hence data on the stock market movements may be useful for testing the economic theory of political business cycles (PBC) thus implying that the popularity of a government is dependent upon the state of the economy.

2.4 Empirical Literature Review

This study entails empirical literature both local and international.

2.4.1 Review of International Research

Empirical evidence on a four year presidential election cycle in the US stock market returns indicated that returns are higher in the third and fourth year of presidency and lower in the first and second year of presidency. The report indicates that stock market returns tend to be high on average during Democratic presidencies than during Republican presidencies, an explanation is given for this as not being business cycle dates nor is concentrated around election dates but on the statistical properties of stock market returns during Democratic presidencies as being different from those during Republican presidencies (IMF, 2004).

The excess return in the stock market is higher under Democratic than Republican presidencies: 9 percent for the value-weighted and 16 percent for the equal-weighted portfolio. The difference comes from higher real stock returns and lower real interest rates, is statistically significant, and is robust in sub samples. The difference in returns is not explained by business-cycle variables related to expected returns, and is not

concentrated around election dates. There is no deference in the riskiness of the stock market across presidencies that could justify a risk premium. The deference in returns through the political cycle is therefore a puzzle. (Pedro Santa-Clara and Rossen Valkanov)

Leblang and Mukkherjee (2005) constructed a model of speculative trading to examine how the mean and volatility of stock prices is affected both by government partisanship and by traders' expectations of electoral victory by the right-wing or left-wing party. The model predicted that a rational expectation of higher inflation under left-wing administrations lowers the volume of stocks traded in the stock market. The decline in trading volume leads to a decrease in the mean and volatility of stock prices not only during the incumbency of left-wing governments, but also when traders expect the left-wing party to win elections. Conversely, expectation of lower inflation under right-wing administrations leads to higher trading volume. This leads to an increase in the mean and volatility of stock prices during the tenure of right-wing governments and when traders anticipate the right-wing party to win elections. Daily and monthly data from U.S. and British equity markets between 1930 and 2000 statistically corroborate the predictions from the formal model.

2.4.2 Review of Local Research

According to a study conducted by DFID (2007) and Aljazeera Media Network (2008) among others political elections in Kenya, as in many african countries are unpredictable, fiercely fought over and at times result in violence and political

instability. It is recommended that the Government should maintain stability after elections as instability brings about drops in stock returns. The unique contribution of this study is that it reduces the lack of conclusiveness in the studies which attempt to link elections to performance of stock markets in sub-Saharan African economies.

A research by Nguthi (2013) to establish the effect of political news on stock returns in Kenya came to the conclusion that Positive abnormal returns were observed after the election date and Negative returns a few days to the election date. Results showed drastic changes in stock prices during elections. Share prices reduce before elections but start rising after elections. The abnormal returns were however not significant.

Ngetich (2012) in his research on 'effects of political news on stock market returns in Kenya' established that the study findings were consistent with previous studies where stock prices were reported to react to political news. Volatility was noticed in stock prices in the short term to the election date with stock prices steeply rising around the election date. On average, the stock prices recorded an ascend movement around the event date and after the election signifying investor confidence in the incoming government. This signifies the confidence of investors in the new constitution dispensation which brought into effect devolved governments after the election date. As opposed to a previous study by Murigi (2008), the average abnormal returns remained positive before and after the event date with continued rise in stock prices after the event date. However, despite the recorded shift in stock returns, the abnormal returns for 17 counters out of the 19 sampled were not statistically

significant, a matter that should be investigated in future studies. The implication of the study findings is that investors should take precautions when purchasing stocks during periods of political uncertainty.

In their study, Ngugi and Kithinji (2013) indicated that the NSE performance was influenced by the political activities and expectations around the election period in the short-term. The study also reveals that the first two years after the general elections the NSE performed better than the last two years before the next general elections. The poor performance before the election could be attributed to investor anxiety and panic associated with pre-election period.

Nyangena & Gekara (2013) in their study sought to obtain the respondents comments on the volatility of the Kenyan stock market compared to other stock markets in East Africa. The findings show that 68% of the respondents felt that Kenyan stock market is highly volatile; 29% thought that it's moderately volatile; and, 3% stated that it's less volatile. This depict that the Kenyan stock market is volatile compared to other stock markets in the region. Volatility is an important factor in the comparison of risk and reward between stocks and other asset classes (Davis and Kutan, 2003).

Guo (2003) conducted a research on effect of elections on share performance at the Nairobi Securities Exchange. The study adopted an event study methodology since the study was concerned with the establishment of the information content of election results announcement on share performance at the NSE. The population of this study

was 56 companies listed in the NSE. The research shows that stock market volatility is positively and significantly related to future stock returns in the consumption-wealth ratio in the forecasting investment opportunity and risks.

Kuria and Kamau (2013) in their study 'A Study of Seasonal Effects on Average Returns of Nairobi Securities Exchange' examined the presence of day of the week effect anomaly in Nairobi Securities Exchange (NSE). Several hypotheses have been formulated; t-test, F-test and the ANOVA analysis model were used in the study. The study examined three types of anomalies namely, day of the week effect, weekend effect and monthly effect. The analysis provides evidence about the presence of the seasonal effect in the NSE. Thus it was established that the stock markets in Kenya are not yet free from seasonal anomalies despite increased use of information technology and numerous regulatory developments.

2.5 Summary of Literature Review

Various Studies, including Altin Hakan (2002) have indicated that there is a correlation between entrenched democratic norms and traditions and stability in the stock markets during election cycles. South Africa gained independence in 1994 and has established itself as a fast maturing democracy in Africa. They have had three smooth transitions, pioneered by their late elder statesman, Mr. Nelson Mandela. The United States of America and other developed democracies also have had a long history of political stability and limited impact of the electoral cycles on the stock markets as well argued in his paper

As observed above, all the elections conducted in Kenya during the last four election cycles have been marked by violence and the results seriously disputed. This will certainly negatively impact the securities markets volatility, and indeed other investment decisions. The critical role of stock markets in wealth creation has been aptly articulated by Pearson (2012) among others. These pooled resources are a great tool for proper allocation of scarce resources to where they will be most productive while creating wealth for investors.

Election results may affect post-election corporate performance either by influencing a country's overall economy, like through changes in government spending either through fiscal changes, or sector-specific decisions such as changes in the regulatory environment after the new administration has been established (Fiorina, 1991).

Prices are the outcomes of volatile human expectations, shifting the supply and demand lines, and causing prices to oscillate. Fluctuations in prices are a natural process of changing expectations, thereby leading to cyclical patterns. Stock markets in the world individually and collectively play a critical role in their economies as they provide an avenue for raising funds, for trading in securities including futures, options and other derivatives which provide opportunities for investors to generate returns (Alesina and Rodrik, 1994). The markets perform a wide range of economic and political functions while offering trading, investment, speculation, hedging, and arbitrage opportunities.

In addition they serve as a mechanism for price discovery and information dissemination while providing vehicles for raising finances for companies. Stock markets are used to implement privatization programs, and they often play an important role in the development of emerging economies (Lee, 1998). The performance of a stock market of an economy is of interest to various parties including investors, capital markets, the stock exchange and government among others. Stock market performance is influenced by a number of factors key among them being the activities of governments and the general performance of the economy. Other factors that affect stock markets performance include, availability of other investment assets, change in composition of investors, and market sentiments among many other factors.

However, the challenge in Kenya and indeed in most of Africa and other places where democracy and the rule of law is not entrenched is that low stock market prices or returns occasioned by the uncertainties of the elections occur every five years. The total costs could run into millions of dollars, especially as most of the major international investors shift their investments to other safer jurisdictions. Apart from the quantitative costs, the greater and more long-term loss is the damage to the image of the country, resulting in lower investor confidence and fewer visits by tourists and other investors.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter highlights the methods and procedures used in carrying out the study. It includes the following; section 3.2 presents survey research design; section 3.3 presents the population and 3.4 presents sampling; section 3.5 presents data and data collection methods instruments used; section 3.6 presents data analysis, Conceptual and analytical model as well as data presentation methods.

3.2 Research Design

Descriptive research design was applied for the study since it describes a phenomenon. By description it means considering such basic questions as what, how, when and where about a given phenomenon. Being a descriptive study, the researcher aimed at finding out the impact of an electioneering calendar on the returns in the stock market.

Descriptive research design deals with clearly defined problems with definite objectives. It was used because it deals with clearly defined problems with definite objectives (Kombo & Tromp, 2006). Descriptive research design is a scientific method which involves observing and describing the behavior of subjects without influencing it in any way (Bryman, 2001).

3.3 Population

The target population in a research study is the total number of individuals in a group or the number of groups that the researchers are intending to work with (Cooper and Schindler 2001). Cooper and Schindler (2001) terms the population as the total collection of the elements about which the researchers are intending to make their inferences from. The population of the study in this was the 62 listed companies at NSE.

3.4 Sampling

According to Adèr, et al., (2008), sampling is that part of the statistical practice that is concerned with the selection of individual observations with an intention to yield some knowledge about a population of concern especially for the purposes of statistical inferences. Each of the observable measures is considered to measure one or more properties of an observable entity that has been enumerated to distinguish the objects.

The sampling technique that was employed in this study was a census with a clear preference on this based on the fact that the population sample is small. In this study, the sample consisted of all the NSE 20-share index as seen in Appendix I. Mugenda (2003), states that a sample of 30% and above is considered representative for a population less 500.

3.5 Data and Data Collection

The study used secondary data; data for the Nairobi Securities indices which were the variables from 1996 to 2013 was used and the data of each general election in the years 1997, 2002, 2007 and 2013 were taken as event date: 27th December 1997, 26th December 2002, 26th December 2007 and 4th March 2013. The composite price index of the NSE-20 share index is a broad value-weighted index comprising the 20 most highly capitalized shares of the main market and reflects the general trends of the stock market.

Data collection is the process of gathering information about a phenomenon using data collection instruments (Sekaran, 2000). Secondary sources of data were used to obtain information for the study. Secondary data were gathered from the NSE Index on a monthly basis for between the years 1997-2013.

3.6 Data Analysis

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 (Mugenda and Mugenda, 2003). The data was thereafter analyzed using a statistical computer package, the SPSS. The coded data was entered into SPSS program hence analyzed. There are normally two main parts in this section as shown below.

3.6.1 Conceptual Model

This takes the form of a mathematical function:

$$Y = f(x1) \tag{1}$$

Returns on Asset NSE-20 share index $= f$ (General elections)

The percentage increase or decrease in the NSE index before and after elections was calculated and a comparison was done from one election period to another. In order to test for stock market reaction to general elections, the study used the market model (MM).

The study also being empirical in nature since it analyzed the stock market returns during electioneering periods in Kenya. The period of study focused on NSE performance for the period between 1997 and 2013 comparing the months and years that there were no elections. This period is selected because during the general election competitive presidential, parliamentary and Civic elections were held compared to previous general elections which did not include many political parties. The NSE index performance during this period was analyzed and the performance of the NSE index during election years compared to none election years.

3.6.2 Analytical Model

The study used the event analysis to examine the market reaction to general elections on stock volatility. Event studies are based on the theoretical framework of efficient capital markets and the notion that security/share prices include all information available to the market. As a result, announcements provide to market participants

information that can be impounded into the market price (Konchitchki and O'Leary, 2011). The event study approach is commonly used when investigating stock price effect on specific types of events. The time for the event study is determined as $t = -1$ years to $t = +1$ years relative to the event date $t = 0$. The study aimed to find out whether the event had any impact on the Price of the NSE-20 share index.

Hence time (t) is given as:

t= -1 years +1 years

Estimation Window   Event Window   Post-event Window

t_1	0	t_1
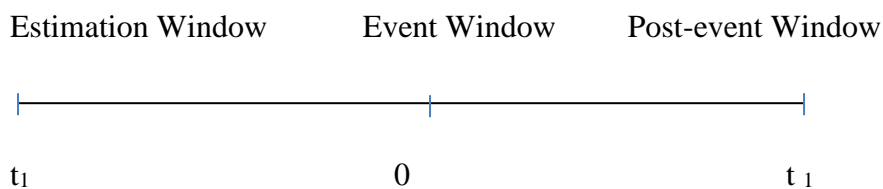
The event of interest in the study was volume of shares traded of the NSE-20 share index and the event window included the date of the General elections. Event Study proceeds as following:

1. Returns on shares traded of the NSE-20 share index are collected from 1 year before General elections and 1 year after General elections, being the event period -1 years to + 1year of 4 General elections.

2. Returns on shares traded of the NSE-20 share index are calculated for NSE 20 share index before and after General elections of the event period for 3 years.

3. A market model analysis was performed; volume of shares traded of the NSE-20 share index being the dependent variable and volume of shares of the NSE-

20 share index at time t-1 is the independent variable before and after General elections. There after a linear regression was conducted.

In identification of event and post-event windows the Abnormal Returns (AR) was used which is calculated by the equation below;

$$AR_{i,t} = R_{AR} - R_{ER}$$

Where R_{AR} is the actual returns on security at time t and R_{ER} is the expected returns on NSE 20-Share Index, 1 year preceding the event. The pooled-variance t-test for differences in means was used to compare significance of differences for the comparative study periods. The average abnormal returns and cumulative abnormal returns were calculated.

3.7 Validity Reliability of Instruments

Joppe (2009) provides the following explanation of what validity is in quantitative research where validity determines whether the research truly measures that which it will intended to measure or how truthful the research results are. In other words, does the research instrument allow you to hit "the bull's eye" of your research object?

Reliability is a measure of the degree to which a research instrument yields consistent results or data after repeated trials (Mugenda & Mugenda, 2003). Kothari (2009) reliability refers to consistency of measurement; the more reliable an instrument is, the more consistent the measure. Reliability is influenced by random error. As random error increases, reliability decreases. Random error is the deviation from a true measurement due to factors that have not effectively been addressed by the

researcher (Mugenda & Mugenda, 2003). The research attempted to minimize random error and hence increase the reliability of the data collected by administering the same instrument twice to the same group of subjects.

Researchers generally determine validity by asking a series of questions, and will often look for the answers in the research of others. Wainer and Braun (2008) describe the validity in quantitative research as "construct validity". The construct is the initial concept, notion, question or hypothesis that determines which data is to be gathered and how it is to be gathered. They also assert that quantitative researchers actively cause or affect the interplay between construct and data in order to validate their investigation, usually by the application of a test or other process. The use of expert opinions, literature searches, and pretest open-ended questions will help to establish content validity.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research objective and research methodology. The method of data collection was secondary research, which essentially involved reviewing data sources for the purpose of establishing the effect of the general elections on the return of the stock market in Kenya. The chapter comprises of sections 4.2 summary of statistics, 4.3 general election and stock market, 4.3.1 results of correlation analysis, 4.3.2 results of event studies, 4.4 discussions, and 4.5 summary.

4.2 Summary of Statistics

The following local institutions formed the main sources of the data : The Statistical Bulletins and the Monthly Economic Reviews of the Nairobi Securities Exchange, Central Bank of Kenya (CBK), the Economic Surveys of the Kenya National Bureau of Statistics (KNBS). For the study period of December 1996 to March 2014, yearly frequency data values were used. In other instances, however, the data was extracted from the relevant publications or documents of the above institutions, and saved in Excel spreadsheet, as well as the SPSS. The main sources of international data were the International Financial Statistics (IFS), and the Directorate of Trade Statistics (DTS). The Library Network that serves the World Bank Group, and the IMF, was the sole source of data from international sources. United Nations data base on social indicators was extensively reliable source of information.

The abnormal returns present the difference between the actual returns and the expected returns over a certain period of time. The formula for calculating abnormal returns was arrived at by using the alpha and the beta in the formula below;

$R_{stock} = \alpha i + \beta R_{mt}$

Expected Return $= \alpha i + \beta R_{stock}$

Abnormal Return $=$ Actual Return $-$ Expected Return

Where;

$R_{mt} =$ market return

$R_{stock} =$ Actual Returns

α and $\beta =$ firm specific constants or parameters

Subtraction of the actual returns from the expected returns gave rise to the abnormal stock returns.

4.3 General Elections and Stock Market

Data collected during this research points to a close correlation between performance of stock returns and general elections.

4.3.1 Results of Correlation Analysis

The research study wanted to establish the relationship effect of the general elections on volatility of the stock market returns in Kenya.

Table 4.1: Relationship between Volatility and Stock Market Returns

	Y	X_1	X_2	X_3
Y	1			
X_1	.371	1		
X_2	.487	0.504	1	
X_3	.337	.209	0.036	1

Source: Author's computations, (2014)

X_1 = Share prices annually

X_2 = Share prices Monthly

X_3 = Share prices Weekly

Y = Stock market Volatility

The relationship between the general elections and return of the stock market indicated a Pearson correlation ratio = (0.337) indicating an effect of the general elections on the return of the stock market in Kenya. The relationship between return of the stock market and X_2 of listed firms showed a positive and significant correlation as evidenced by Pearson correlation ratio = (0.504) hence the researcher concluded that X_1 was correlated with X_2.

The research findings indicated that there was a weak positive relationship (R= 0.036) between the variables. The study also revealed that 11.0% of return of the stock market of the firms can be explained by the independent variables. From this study it is evident that at 95% confidence level, the variables produce statistically significant values (high values, $p < 0.1$) hence when the variables are combined, they can be relied on the relationship effect of the general elections on volatility of the stock

market returns in Kenya. However, when tested individually only the relationship effect of the general elections on volatility of the stock market returns in Kenya.

4.3.2 Results of Event Studies

This part of the study, researched the characteristics of the Nairobi Securities Exchange (NSE) index from January 1996 to December 1998. A comparison of the daily rates of return and volatilities for periods immediately preceding and following election years (1996-1998) and periods prior to and after this electoral season. Volatility was measured by the absolute change in the rate of return. The figure below shows the research findings.

**Figure 4.1: NSE All Share Index of December 1997 General Election**
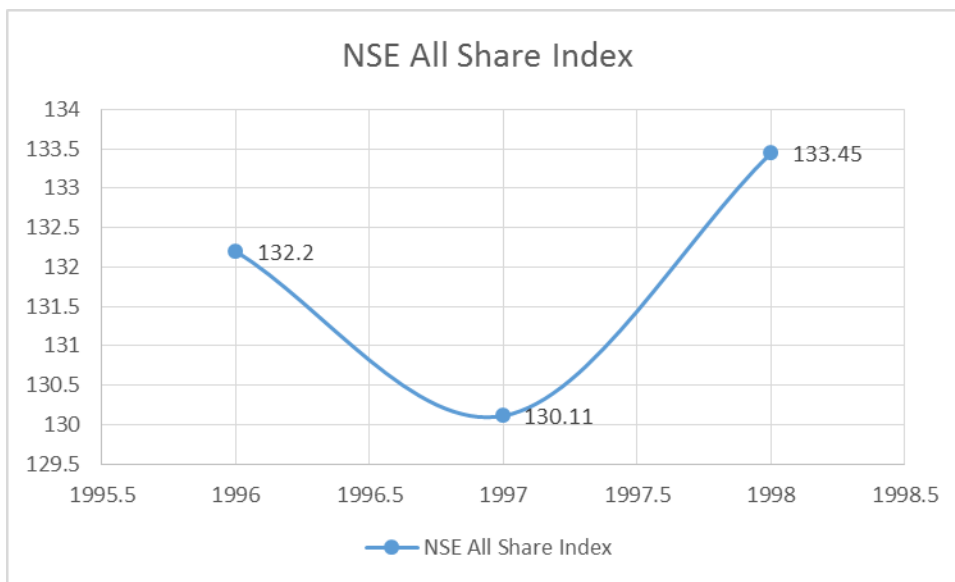
Source: Author's computations, (2014)

In the event period of 11th November 1997 to 27th January 1998 the NSE did not have daily NSE 20 market index. For the research purposes, the monthly NSE index was

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assumed to be the daily NSE market index in the event period. The line graph indicates that the volatility of NSE stock returns was high before and after the general election of 1997. This therefore implies that the volatility of stock returns was higher in 1996 than it was in 1997. This therefore means that the general election most likely had an impact on the stock returns of NSE in 1997.

A comparison of the daily rates of return and volatilities for periods immediately preceeding and following election years (2002-2003) and periods prior to and after this electoral season were also conducted. Volatility was measured by the absolute change in the rate of return. The figure below shows the research findings;

**Figure 4.2: NSE All Share Index of December 2002 General Election**
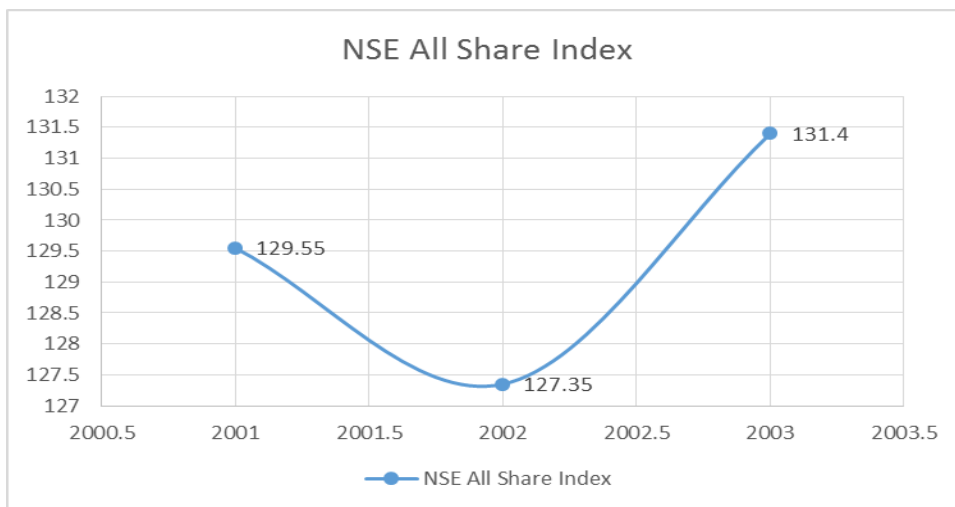
Source: Author's computations, (2014)

From the figure above, NSE all share index, dropped as low as 127.35 on the electioneering year, the optimism that surrounded the election of a National Rainbow coalition (NARC) government was short-lived as immediately after the new

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government took office. The government, however, reduced domestic borrowing, introduced stringent tax collection measures, and went on to inspire local and international investor confidence. These measures led to an economy recovery from a zero growth rate in 2001 to a seven percent growth rate in 2007.

Figure 4.3: NSE All Share Index of December 2007 Election
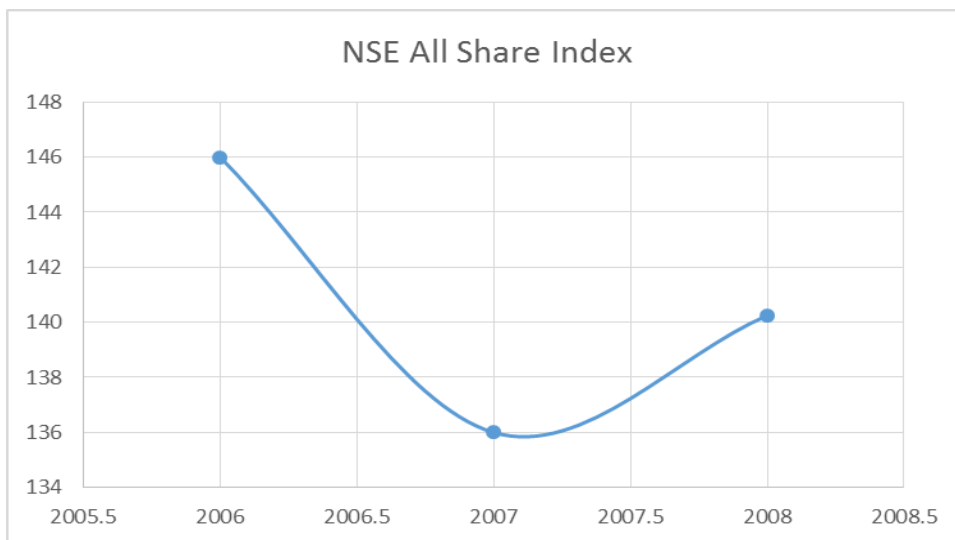
Source: Author's computations, (2014)

From Figure 4.2 above, the market index exhibits a decline from a relative high value in 2006 to an all-time low that was experienced in late 2007. The post-election crisis that followed the December 2007 general election in Kenya, deep-rooted ethnically issue and perceived socio-economic disparities, threatened to nullify the gains made in the 5 years of the NARC. The campaign period only served to excite ethnic tension and made it difficult for businesses to thrive and for the economy to attract or inspire both local and/or international investment. The market index from that point

exhibits a steady growth that may be explained by the positive investor confidence experienced during the coalition government era.

The research findings gives forecasts of the NSE index for a period of 36 months from 2006 to 2008. This is more or less the scenario that has been seen in the Kenyan markets in the past few months until the global slum in October 2008. The high volatilities seen just before elections period, indicate lack of information or uncertainty leads to low stock exchange index.

This part of the study, researched the characteristics of the Nairobi Securities Exchange (NSE) index from March 2012 to March 2014. The figure below shows the research findings;

Figure 4.4: NSE All Share Index of March 2013 Election
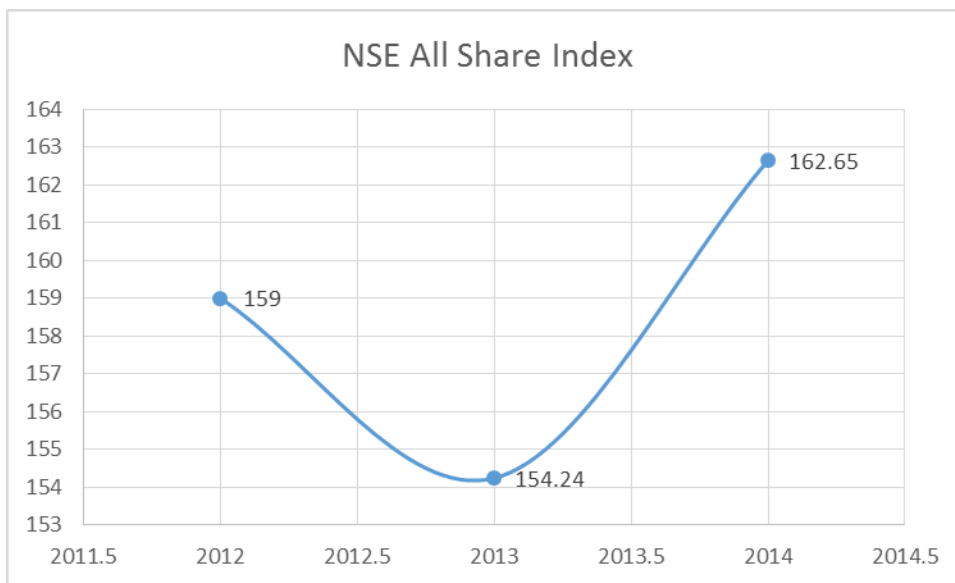
Source: Author's computations, (2014)

The study was based on event study methodology and employed the market model to estimate the expected returns, consequently leading to the computation of abnormal returns. The event day was 4th March 2013. During the event day, the Nairobi Securities Exchange remained closed. The study findings were consistent with previous studies where stock prices were reported to react to political news. Volatility was noticed in stock prices in the short term to the election date with stock prices steeply rising around the election date. On average, the stock prices recorded an ascend movement around the event date and after the election signifying investor confidence in the incoming government. This signifies the confidence of investors in the new constitution dispensation which brought into effect devolved governments after the election date.

As opposed to a previous study by Murigi (2008), the average abnormal returns remained positive before and after the event date with continued rise in stock prices after the event date. However, despite the recorded shift in stock returns, the abnormal returns for 17 counters out of the 19 sampled were not statistically significant, a matter that should be investigated in future studies. The implication of the study findings is that investors should take precautions when purchasing stocks during periods of political uncertainty.

4.4 Discussions

Current literature has highlighted the effects of political elections on the economic performance of a country, with case of Kenyan scenario. As argued by Bratsiotis (2000), voters tend to cast their votes based on the economic parameters such as inflation rates, interest rates, performance of the money markets as well perception on foreign investment. The objective of the policymaker is to maximize his probability of reelection. Voting behavior is retrospective, in that it depends on economic performance under the incumbent in the past. From the analysis, it was noted that investors tend to include forward looking expectations, implying that voters will incorporate speculative expectations into their assessment of macroeconomic indicators.

However it should be noted that the fall in the inflation rate in the post-election environment does not necessarily reflect the degree of institutional development from the election trends. As political budget cycle theory predicts, a lower level of democracy may translate into higher government spending before an election, given greater budgetary discretion and fewer checks on government actions and accountability under these regimes (Bernhard and Leblang, 2002). However, there remains no evidence supporting the notion that such spending produces deleterious economic outcomes following elections. This has been confirmed by the weak correlation analysis in our research.

From the analysis and the research findings, it was noted that interest rates tend be affected heavily by the presence of election trends. A higher level of policy uncertainty increases the risk of holding assets with returns that depend on economic policies. For example, the decision to invest in a government bond is directly affected by the inflation rate since the real rate of return is equal to the nominal return minus the inflation rate. Any increase in the expected variance of inflation also increases the expected variance of the real return. This causes some investors to reallocate their money to other assets that have the same return but a lower level of total risk. As they do so, demand for the bond falls, as does its price. Thus, an increase in inflation risk increases interest rates, which can also have a negative impact on consumption, investment, and growth. Political change strongly correlates to the stock market performance as noted from the research findings. Stock market participants will price their expectations about political change into stock prices prior to an election and adjust their opinion according to the actual political decision making after the election and inauguration took place (Pantzalis *et al.*, 2000). Thus in summary, the research has established some important implications, which investors and other players should consider when seeking to analyze and invest in an economy.

4.5 Summary

Local politics can exert significant influence on a country's income distribution and prosperity hence affect the activities in a stock market as voters in democratic states elect parties which best represent their personal beliefs and interests. Election results may affect post-election corporate performance either by influencing a country's

overall economy, like through changes in government spending either through fiscal changes, or company or sector-specific decisions such as changes in the regulatory environment after the new administration has been established. This study sought to examine the effects of the general elections on the stock market return of companies listed in the Nairobi Securities Exchange.

The study adopted an event study methodology since the study was concerned with the establishment of the information content of election results announcement on share performance at the NSE. The population of this study was all 62 companies listed in the NSE. The study used secondary data to gather information. Data obtained from the NSE covered the period before and after 31st December 1997, 31st December 2002, 27th December 2007 and 4th March, 2013 elections.

Study findings from the market model indicated that the market return is a good predictor of actual stock returns. The results indicated that abnormal returns, actual stock returns, and expected returns before elections were significantly higher than abnormal returns after the elections. Investors should factor in elections effect when making investment decisions. Specifically, investors should buy stocks after elections and sell them when their returns are high, that is, before elections. The Government should maintain stability after elections as economy brings about drops in stock returns.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presented the summary of key data findings, conclusions drawn from the findings highlighted and policy recommendations that were made. The conclusions and recommendations drawn were in quest of addressing research objectives of establishing the effect of the general elections on the return of the stock market in Kenya. They include 5.2 which present the Summary of findings, 5.3 presents the conclusion of the study, 5.4 presents the limitations of study and 5.5 gives us the Recommendations.

5.2 Summary of the Study

Prior to the 1990s, investors thought that the stock market was the magical way to instant riches mainly as a result of lack of knowledge on the operations of stock exchanges.

The Nairobi Securities Exchange is in no doubt affected by the possible change of governments as a result of general elections held in the Kenyan political calendar after every five years. There has been significant downward trends noted of falling of stock value before the general elections and the value of the stocks and their future performance is dependent on the aftermath of the elections and the government that assumes power.

A descriptive research design was applied for the study since it describes a phenomenon. Being a descriptive study, the researcher aimed at finding out the impact of an electioneering calendar on the returns in the stock market. The population of the study in this was the 62 listed companies at NSE. The study used secondary data; data for the Nairobi Securities indices which were the variables from 1996 to 2013.

The trend analysis of actual returns, between years 1997, 2002, 2007 and 2013 which were the election years for Kenya. The figures show a decrease in actual or real returns of stock in year 2007 and an increase in election year 2013. The decrease in year 2007 was affected by the then elections which brought about instability in the country affecting the social and economic pattern of the economy. Trend analysis in market return indicates a decrease in market return in year 2007 and an increase in 2013. The mean market return of year 2007 is less than that of the performance of market of the preceding year 2006. This indicates that the market was more volatile in the election year 2007 compared to the previous years. The fitness of the model used in the study as well as the calculation that derived the alpha and beta coefficients for generation of the abnormal returns.

The data analysis and findings of the abnormal return showed that there was a drastic decline from year 2002 to year 2007 followed by an increase in abnormal returns in year 2013. This changes that caused the drift in abnormal returns can be explained by the election period. In 2007 the post-election violence caused the drop in abnormal

returns compared to the other election years. This further is because abnormal returns are sometimes triggered by events. In finance events can typically be classified as occurrences or information that has not already been priced by the market. The decline in 2007 may be as a result of a decline in the firms' market value which exceeded the expected amount, this therefore is a loss.

5.3 Conclusion

The results revealed Uncontrollable losses mainly from the external environment for instance natural calamity and political instability have an effect on the market value of a firm irrespective of whether it has a weak or a strong shareholders rights. Study findings led to the conclusion that the market return is a good predictor of stock returns. It was concluded that abnormal returns before elections were significantly higher than abnormal returns after the elections. Results led to the conclusion that actual stock returns were significantly higher before elections than after election periods. Finally, results led to the conclusion that the expected returns as well as the market returns were significantly higher before elections than after the elections. From the study conclusions can be made that during periods of increased political uncertainty such as election periods, the stock returns declined. Political uncertainty surrounding elections can affect how corporate investment responds to stock prices.

Kenya is not the only country that experiences this effect, most countries around the world have sensitive stock returns during and the short period after election years compared to periods before election. The poor performance before the election could

be attributed to investor anxiety and panic associated with post-election period. It is therefore with the findings from this study that elections have a real impact on performance of returns in the Nairobi Security Exchange market.

5.4 Limitations of the Study

The paper relied on the use of secondary sources which at times lacks the real control over data quality, which necessitates the careful evaluation on such data sources. This is because not all quantitative data compiled by governments and organizations are error free.

In determining the correlation coefficient between the two markets, the paper entirely dwelt on historical information of realized returns of the two markets. It did not take into consideration the other method which is based on the probability distribution of the future returns of the two markets. The paper does not consider other macro variable affecting the two markets into the analysis (such as the cost factors should under concern, the risk elements need to be identified, as well as the magnitude of prospective returns, etc.)

5.5 Recommendations for Policy

Recommendations are to government policy makers, who formulate and implement laws and policies on management of security exchange. The recommendation is that they should implement policies that reduce capital flights which may lead to huge losses especially to investors making them to draw out from investing in securities exchange which in turn may affect the gross national income of the country.

Finally, would be a recommendation to the Government and other stakeholders to take cognizant to the role peaceful political transitions play in the stability of the securities exchange and other sectors of the economy, and indeed the country's wellbeing in general. To this effect, they should all ensure that elections are conducted transparently and efficiently for the benefit of all.

5.6 Recommendations for Further Research

The study provides recommendation to the investors who should carefully plan and carry out investments during and after the periods of the general elections as the returns could be affected either positively or negatively during that period. Elections can have important consequences in the stock market; therefore investors can devote a certain portion of money to invest in stocks before and another in stocks after elections. Many investors simply invest in stocks after elections where they presume that the market will be performing well as a result of the new regime. However, this is not the best option as expanding ones mindset may lead to discovery of high returns on stocks before the election or even after the election.

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Appendix 1: NSE 20-Share index Constituent Counters

	Company Name	Price per Share(Kshs)
1	Mumias Sugar Company	48.50
2	Express Kenya	9.90
3	Rea Vipingo Ltd	5.0
4	Sasini Tea & Coffee Ltd	5.10
5	CMC Holdings	-
6	Kenya Airways	9.90
7	Safaricom Ltd	6.80
8	Nation Media Group	9.30
9	Barclays Bank of Kenya	10.30
10	Equity Bank	58.80
11	Kenya Commercial Bank	48.80
12	Standard Chartered Bank	58.80
13	Bamburi Cement	16.50
14	British American Tobacco Kenya	90.80
15	KenGen	20.20
16	Centum Investment Company	219.70
17	East African Breweries	19.20
18	EA Cables	48.50
19	Kenya Power & Lighting Company	48.50
20	Athi River Mining Ltd	17.50

Appendix II: Data Collection Check List

NSE All Share Index Year	Share prices Annually	Share prices Monthly	Share prices Weekly
1996			
1997			
1998			
2001			
2002			
2003			
2006			
2007			
2008			
2012			
2013			
2014			