What really contributed to the moving mood of the market—flavour or fear?

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A booming market does lead to a feel-good syndrome. Its fallout also propels inflation and interest rates. Capital markets, nowadays have evolved as highly "liquid institutions" wherein individual investors can transact at will. It is evident that many investors do not buy stocks for "keeps" but rather to resell them in the very near future in the hope of making gain. In real world, the investor is not faced with risk but rather uncertainty- different from probability. According to Keynes, the individual investors tend to conform to the behaviour of the majority or the average. Thus stock market can be subject to waves of optimistic or pessimistic sentiment when no solid basis exists for such sentiment, and movement of stock prices are caused largely by changes in the perception of ignorant speculators. Several research reports indicate that the earning growth momentum of India Inc will be sustained despite the fuel price hike and other factors. But the fear of failure due to collapse of the stock market, insider trading scandals and the surge of corporate bankruptcies evident and even common in developed countries could not be ruled out. At Enron, Worldcom, Tyco, and too many other companies, highly incentivised executive, who embraced shareholder primacy rhetoric looted their companies and lied about corporate profits and assets to keep the stock price up long enough for them to sell their shares. In the face of such abuses, the general perceptions that share value is the only right way to measure corporate performance and the only acceptable goal for corporate executives and directors ringed suddenly pathetically, hollow. That's why the finance minister of India once cautioned: "The Government is not against the speculators but manipulators". But what do the bulls and bears do when international events rather than domestic concerns sway the market?

Movements in share prices can reveal much about how well companies are performing. Over the past two years, markets have experienced a sustained bull run, with the sensex rushing from one high to the next. On October 4, it reached its all time closing high of 8800 though it has been case of ups and downs since then. It is possible to make money on the stock market by guessing which way share price are likely to move in future. Not quite the playground of novices, but who can resist the lure of a quick buck. Its seeming invincibility has attracted the most unlikely players, from students to housewives. Possibility of a future rise in US interest rates, the weakening of the rupee and rising fuel price prompted investors to take a cautious view of the market. Evidently, during first fortnight of October 2005, the market mood remained bearish on fears that rising Fed rates leading to a rising dollar may result in a diversion of FII investments from emerging markets, including India. It is estimated that the sensex remains volatile till the current corporate results season ends, as investors are likely to make a comparative performance study of more companies. There is substantial documented evidence on both over and under reaction to earnings announcement. Some even argue that the market underutilises financial statement information. Researcher find a surprising increase in share prices on the announcement of a price sensitive information such as winning a significant customer order, listing of Indian companies on overseas stock exchanges, merger and acquisition, etc.

How Investment Ratios Help Individual Investors Ascertain Risk Before Investing in a Company?

There are some ratios primarily of interest to prospective investors and are known as investment ratios. Firstly, the P/E (i.e. market price per share divided by earnings per share) ratio tells that the market price is X times the earnings attributable to shareholders including those distributed as dividends and those retained by the business. It means that it would take X years to repay investors at the prevailing share price. It is of course difficult to determine a normal range of P/E variation. On historical evidence in Britain and the USA, a P/E ratio of between six and thirteen might be considered a normal

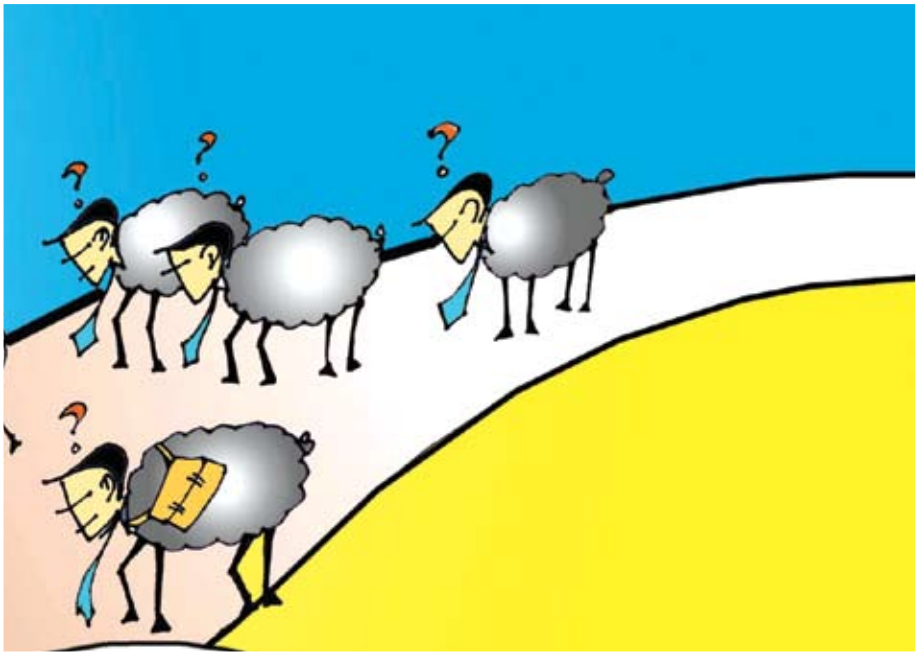
range which both allows for cyclical fluctuation in the real economy and for moderate inflation. Thus, high or low P/E ratio can only be judged in relation to other companies in the same sector of the market. Any abnormal rise implies expectations are on steeper trajectory than the real economy and an increasing disconnection between current realities and market prices. Secondly, the capital-gearing ratio helps to calculate the proportion of the entity financed out of borrowings. This may be put in the form of borrowings divided by shareholders fund plus borrowings. If a company, therefore, finances itself from a high level of borrowings, there is obviously a higher risk of investing in it. This arises out of two main factors: 1. The higher the borrowings, the more interest the company has to pay and that may affect the company's ability to pay as ordinary dividend. 2. If the company cannot find the cash to repay its borrowings, the ordinary shareholders may not get any money back if the company goes into liquidation. A company that has financed itself out of a high proportion of borrowings is known as high-geared company and is potentially a higher risk investment, as it has to earn sufficient profit to cover the interest payments and the preference dividend before it can pay out any ordinary dividend. Thirdly, the dividend yield measures the rate of return an investor gets by comparing the cost of the shares with the dividend receivable (or paid). For example, if an investor buys 100 numbers of $ I ordinary shares at a market rate of $2 per share; and the dividend was 10 per cent, his yield would be 5%. As ratio analysis is all about extraction of data from accounting statement and conversion into statistics and these statistics are used to compare the current year's performance with previous years, or with similar entities, the reliability of data and its classification and measurement play a crucial role in the process of investment decision.

Can the Movement in Prices be Fully Attributed to the Announcement of Events?

The announcement of events such as earnings, stock splits, capital expenditure, divestitures and takeovers usually affects the movement in prices. The relevance of the information could be judged based on the market activity associated with a particular event. In general, the security prices seemed to adjust to new information within a day of the event announcement. Three analysts of the aggregate stock market reported that there is little correlation between the greatest aggregate market movement and public release of important information. More recently, Haugen and Baker in the analysis of determinants of returns in five countries conclude: "None of the factors related to sensitivities to macroeconomic variables seem to be important determinant of expected stock returns". The predictability of stock returns reflect the psychological factors, social movements, noise trading, and fashions or fads of irrational investors in a speculative market.

Does Stock Price Synchronism Depend On Countries' Economic Characteristics?

In general, high-income countries have asynchronous stock price. In contrast, low-income economies have higher degrees of price synchronicity. Firms in low-income countries might have more correlated fundamentals since such economies tend to be small, un-diversified, subject to unstable macroeconomic policy, and characterized by inter-corporate equity cross-holdings. Moreover, low-income economies usually provide poor and uncertain protection of private property rights. Evidently, the variables like, market size, country size, economic diversification, macroeconomic policy stability, and inter-corporate earnings correlation are at best, only vaguely related to stock price asynchronicity. Rather, the measures of development that are most closely related to stock price synchronicity are the measures of integrity of the government, the efficiency of the judicial system and the rule of law. However, studies have found that price synchronicity is positively correlated with both GDP growth variance and earnings co-movement. Again, greater economic and industrial diversity is not consistently correlated with less stock price synchronicity. Through legislation, licensing requirements and nationalisation, Government can inhibit the growth and development of business. In these environments, political events or even rumours about political events, may cause large market-wide stock price swings and generate high levels of stock price synchronicity. Finally, stock returns are more synchronous in emerging economies than in developed economies. In other words, stock markets in emerging economies may be less useful as processors of economic information than stock markets in advanced economies. The function of an efficient stock market is to process information and thereby guide capital towards its best economic use.



A soaring stock price helps a company grow, by raising bond ratings and bringing in more money from additional share offerings. A lamenting stock price unsettles creditors and raises the dilution cost of each dollar of new equity.

Does Market Movement Consider Discounted Present Value of Future EVA?

Economic Value Added (EVA) is defined as net operating profits after tax, minus the required rate of return on capital employed. The top line was growing, the bottom line was growing, but the stock price was going nowhere, may be, due to a negative EVA. The most widely used new matrix, EVA, is a residual income measure which shows whether the firm in one year earns more than its weighted average cost of capital. It is assumed that the market price incorporates expectations of future earnings. When the programme began, Harnishfeger had a negative EVA and a share price of $18. Thereafter, year after year, the company's EVA grew until it was substantially positive, and over the three years, the stock reached $40 a share. Again, many British companies with negative EVA have positive Market Value Added (MVA). MVA reveals how well each company has performed over the long term in using its resources to create value. Thus, several major British companies have poor current profit records but better prospects, which already influence the price. Shell is in bottom position on the EVA as the company yet shell is at the top of the MVA table because the market can make judgements about "the true value of reserves" which enter into its price. When the market as a whole is rising strongly, even fairly average companies that struggle to create EVA can create positive market value. Evidently, the BSE index has risen unsteadily but strongly in past some time barring a few exceptions during which ordinary share prices have risen sharply. Indeed, this is part of current economic problem in both Britain and the United States where the stock market has risen in a way that eases the creation of MVA on the long upswing. But the ever-present threat is one of unsustainability and instability when the bubble bursts resulting in a massive and sudden destruction of MVA.

Does Magical Market Suggest that Investors Value Governance Improvements?

Given the importance of the relation between the quality of governance mechanisms and the credibility of the financial reporting system, it is surprising that we know so little about the nature and extent of this relation. Empirical evidence indicates that weak corporate governance is associated with financial reporting fraud but little is known about the actions that fraud firms take to improve their weak governance after fraud detection and perhaps more importantly, how effectively these actions restore investor trust. Regulators, perhaps in view of the recent flurry of highly publicized financial reporting frauds (e.g., Enron) are considering or have enacted rules intended to strengthen the quality of corporate governance. Impliedly, stronger governance is associated with more credible financial reporting. Edward D. Breen, CEO of Tyco believed that there is a net benefit to improving to his firms' governance mechanisms. Perhaps in the form of a positive stock price reaction. Some firms accursed of fraud are using a recovery strategy that includes governance improvement. Several studies find that the inclusion of larger proportions of outside members on the board of directors significantly reduces the likelihood of financial reporting fraud. However, the fraud firms that take actions to improve governance have superior stock price performance, even after controlling

for earnings performance.

Do Changes in Weather Influence Price Fluctuations?

In finding a correlation between weather cycles and financial cycles, Smith's great discovery was that human psychology was the bridge between weather and solar cycles and the markets. Smith says that "weather cycles affect health, health affects mental attitudes and mental attitudes affect business." Dr. William F. Petersen writes: "Practically every passing atmosphere disturbance involves period of stimulation for the individual – if frequent, the individual may become lax, if sufficiently frequent and severe, the individual becomes over-stimulated, fatigued; the inadequate individual may succumb." An empirical research found a series of definite cycles that controlled the New York barometer's fluctuations – much as one would expect to find in the stock market itself. Among them: 1. Whenever the barometer in New York is above 30.05 and rising, it is normally bullish for the NYSE composite, at least in the very short term. In fact any reading above 30.05 generally means the market is stable and will not suffer any serious decline. 2. A reading of below 30.05 and falling is typically bearish for the NYSE over the very near term. The more prolonged and pronounced the decline in barometric pressure, the more significant the drops in the overall stock market tend to be. The important thing of Smith's findings to emphasize is that there is definite correlation between weather and financial cycles, the former leading the latter. Finally, changes in the weather have measurable impacts on human psychology, which in turn influence price fluctuations in trade and commerce.

What Did John M Keynes Think About Stock Market Movement?

Keynes' in his philosophy pictures the stock market as a 'casino' guided by "animal spirit". He argues that investors are guided by short-run speculative motives. They are not interested in assessing the present value of future dividends and holding an investment for a significant period, but rather in estimating the short-run price movements. In his analogy of the stock market as a "beauty contest", Keynes noted that the goal of the investor is often to pick the girl that other would consider prettiest rather than choosing the one he/she thinks is the prettiest. Thus, stock market can be subject to waves of optimistic or pessimistic sentiment when no solid basis exists for such sentiment, and movements in stock prices are caused largely by changes in the perception of ignorant speculators. It is evident that many investors do not buy stocks for "keeps" but rather to resell them in the very near future in the hope of making gain. And if we agree, we will have to concede to Keynes' observations such as 'casino', 'animal spirits', 'musical chair', 'beauty contest' etc., made in the thirties seem to fit in very well with the stock market behaviour of today. ❐