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SOCIETY FOR SCIENCE AND EDUCATION

Stock Market Volatility, Melt Down and Investor Apathy: What Future for the Nigerian Stock Market?

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ABSTRACT
The world global financial crises in 2008 which impacted negatively on the Nigeria financial market in 2009 leading to severe financial assets impairment following a crash in the stock market prices as well as the current melt down have created a lot of doubts and apathy in the minds of investors and on their future behaviour towards the stock market. The purpose of this paper is to examine the factors responsible for stock market instability, bubbles, crash and melt down as well as the current apathy on the part of investors in the Nigerian stock market. The paper observes that stock market bubbles and crashes arise from market inefficiencies due sometimes to government misdirected macroeconomic policies, mispricing and misallocation of resources and the negative effects of globalization which expose some developing countries to the influence of economic and financial crises in various countries. The paper demystifies the theoretical fundamentals and behavioural factors that pollute the minds of investors leading to apathy. Finally the paper highlights policy implications and is concluded with recommendations on the way forward for the Nigerian stock market and Nigerian investors.

Key Words: ''Stock market'', ''Volatility'', ''Meltdown'' ''Investor apathy''.

INTRODUCTION

In the last two decades, there have been significant developments in the economies of various countries that have brought about stock market volatility, bubbles and in extreme cases crashes or meltdown to the detriment of many investors. Such developments include liberalization in financial markets, global market linkages, integration between highly developed, emerging markets and with the less developed countries ((Sabri: 2002)). There have also been a growing awareness and sophistication on the part of investors, rapid expansion on the number of listed companies, rapid growth in size by market capitalization, the impact of information communication technology (ICT) and the dynamics of globalization.

Notwithstanding the advantages of liberalization, diversification opportunities that could help to moderate risk return profile and liquidity, the resulting international stock market linkages, integration and globalization are found to be associated with several challenges. They subject international stock markets to the mechanism of price volatility transmission and contagion effects that have spiralled instability and global financial crises (Sabri: 2002).

Following the indigenization decree of late 1970s and the commercialization of public enterprises in 1988 as well as the recapitalization of banks in 2004 added to the growing financial education and sophistication amongst Nigerian investors, there has been a boost in

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public awareness and interest in investing in the Nigerian stock market which hitherto appeared to have been a preserve for corporate institutions, highly enlightened net worth individual and foreign investors (Asekome and Agbonkhese: 2015).

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In Nigeria, efforts made by the Federal Government of Nigeria through macroeconomic policy adjustment such as the bale out of some commercial banks through the injection of over N60 billion to assist the adversely affected banks, the introduction of various financial stimuli to boost the real sector especially the small and medium enterprises with N200 billion Commercial Agricultural Loan Scheme, strengthening Corporate Governance Code of Conduct in financial institutions, the Agricultural Transformation Agenda as well as various other confidence building policies had impacted significantly as there was evidence of gradual recovery of the activities in the Nigerian stock market between 2011 and 2013 as the stock market capitalization rose from about N4.9 trillion in 2009 to about N12 trillion in 2013.(Asekome and Agbonkhese:2014).

Unfortunately, the due to political uncertainty, the sudden drop in oil prices and declining corporate earnings and unfavourably business environment, the stock market capitalization dropped from N9.757 trillion to N8.649 trillion and thus lost about N1.2billion while the All Shares index declined from 28,370 to 25,145 during the first quarter of 2015. Since the first quarter of 2015, there has been a continuous downward trend on stock prices in Nigeria. Any slight bullish movement is immediately overtaken in a higher downward trend as investors' confidence has been greatly impaired resulting on the current apathy in the Nigerian stock market.

The purpose of this paper is to examine the factors responsible for stock market instability, bubbles and melt down as well as the current apathy on the part of investors in the Nigerian stock market.

LITERATURE REVIEW

Some of the overriding assumptions in the theory of stock market that investors have a behavioural rationality and that they are risk adverse have in recent times faced several challenges as prices have tended to either excessively move upwards in bullish trend (bubble) or move downwards in bearish trend (meltdown). In traditional efficient markets theories, bubbles, crashes or meltdown ought not to have been common as price movements are random and reflect fundamental factors such as information on company factors, industry and macroeconomic factors based on the intrinsic or economic value of financial assets. In efficient markets, studies by various authors have indicated that there is a positive relationship between fundamental factors and price responses (Lie and McConnell:1998, Comment and Jarrel(1991). Similar studies specifically indicated that there is a positive relationship between earnings per share and movement of stock prices and that some macroeconomic variables such as manufacturer index, currency exchange rate, money supply and balance of trade had positive influence on stock market prices. The extent to which these factors impacted on stock prices depended on the country's financial system development and behavioural influences (Kwon and Shin:1999, Dellas and Hess: 2001).

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The efficient market hypothesis further assumes rapid adjustment of security prices to the inflow of relevant new information (Reilly, 1989), that all relevant available public information influence the prices of traded securities (Samuels and Wilkes, 1980), that there is a rapid response to any relevant new information (Brockington, 1980). Reilly (1979) described an efficient capital market as one where (i) there is a large number of profit maximizing participants, (ii) new information regarding securities adjusts security prices rapidly to reflect the effect of the new information. Thus an efficient market is one in which security prices adjust rapidly to the infusion of new information and in which current stock prices fully reflect all available information including the risk involved (Keilly, 1979 and Fama, 1970).

CHALLENGES TO TRADITIONAL ASSET PRICING MODELS

Evidence from researches in the world financial markets have revealed that traditional assets pricing models have often failed to correctly predict the overriding influence of mass phenomena arising from psychological aspects of human behaviour as the ''systematic cognitive biases in the intuitive judgement of market risks''(Fenzl, Brudermann, Malik and Petzmann(2013)p.405. Such behavioural factors are discussed below.

Extreme variations of stock prices not consistent with the fundamentals of the random walk hypothesis negate the basic principles of market efficiency and are therefore not compatible with the models that successive stock prices are not serially correlated. Such situations are usually triggered off by investor behaviour rather than market fundamentals. For example, rather than being rational, noise trading, herd behaviour and bandwagon effect usually over shadow market fundamentals (Bailey, 2005). This portrays market inefficiency which in extreme cases leads to stock market price distortions, eventual meltdown or outright collapse. Another non-fundamental factor that may lead to stock market volatility and inefficiency is style investing in new fashionable businesses such as ICT which resulted in the dot-com bubbles of the early 1990s (Barbers and Shleifer, 2003). Apart from fundamental and behavioural factors, some macroeconomic variables such as government monetary policy thrusts as well as global stock market co- integration and behavioural contagion could negatively impact on stock market returns as well as investor behaviour especially in developing countries like Nigeria where stock market maturity, depth, breadth and efficiency are still at low ebbs.

HERD BEHAVIOUR

The concept of herd behaviour arises in market inefficiency when people tend to follow a pattern not consistent with fundamentals but rather because they follow bandwagon behaviour even among professional Fund Managers (Prechter and Parker:2007, Menkhoff and Hikiforow (2009). Herd behaviour gives rise to a decreasing variance in mass phenomenon and increasing social contagion resulting in stock market prices either going upward or going down and thus grossly negating the random walk hypothesis and in extreme negative cases resulting to investor apathy.

CONTAGION EFFECTS

Market contagion has been identified as a major cause of financial market speculative bubble arising from rumour, hear-say, above average profit expectation that are usually transmitted through social behaviour and interactions (Shiller 2008).

Due to the contagion effects of market linkages, volatility or irrational price movements are easily transmitted to other stock markets through increasing investment risk across the global economics.

OVER REACTION MODEL

This is a situation where investor response to changes in stock price movement is over demonstrated out of tune with fundamental. Such factors include perceived adverse information, political or legislative factors, noise trading, bandwagon and herding behaviour etc. especially in times of economic down term. The negative impact of these factors are more damaging during stock market bearish trends that eventually leads to stock market crash or investor apathy (Titman and Wei: (1999), Kane et al (2002) and Seyhun (1990). Veronesi (1999) posited that overreaction can be more in bad times even to good news and there could be more of under reaction to good news in bad times (Sabri: 2002).

Thus some of the major causes of stock market anomalies including investor apathy have been identified in several studies as behavioural factors that are not in tune with fundamentals (Asekome and Agbonkhese: 2015, Fenzl et al :2013, Shleifer:2000, Prechter and Parker:2007). These factors could vary and their impact also depends on the level of financial system development in the country.

STOCK MARKET BUBBLE

The most remarkable evidence of stock market bubble was witnessed in Nigeria between 2007 and 2008, manifested by a rapid growth in market capitalization by 1154% and an unprecedented rise in the All Shares Index by over 300%. Suddenly due the melt down arising from the contagion effect of the World financial crisis arising from the United States mortgage markets, the Nigeria stock market index declined by 71.2% (Onyuike-Okereke, 2010). The Nigeria stock market that had hitherto grew its equity capitalization from ₦2.01 trillion in 2005 to ₦12.64 trillion in March 2008 suffered a sharp decline ₦4.5 trillion in March, 2009. Asekome and Agbonkhese(2014) noted that macroeconomic policy measures and global exogenous factors contributed greatly to the bubble and eventual melt dawn. They opined that the former was traceable to the call on banks in 2004 to increase their minimum capital base to 25 billion naira which led to most banks approaching the capital market to source funds coinciding with the period when the price of crude oil was going up arising from the Middle East war in Iraq which contributed greatly to high foreign exchange earnings with attendant nationwide liquidity in the economy (Asekome and Agbonkhese(2014). They added that the national general elections that followed, spurred the economy with the ejection of huge cash usually associated with election periods (2006-2007), increased government spending, access to liquidity for banks, individuals and corporate organizations. The successful political transition coupled with the stronger banks that emerged after the consolidation, (2006-2007), rising crude oil prices at the international markets, accumulation of huge external reserves according to Asekome and Agbonkese (2014), all combined to boost investor confidence and public perception of the country's capital market that climaxed with unprecedented growth evidenced from a market capitalization from N5.12 trillion at the end of year 2006, to N12.640 trillion when the Nigerian All Share Index rose from 33,358 to 66,371.(CBN:2013)

THE BUBBLE BURST

At the peak of the bubble and responding to the contagion effect of the global financial crisis, there was massive divestment by foreign investors who proactively traded off their investments for cash. Unfortunately, prices of crude oil suddenly nose-dived crashing from about $150 to less than $50 per barrel as a result of the global financial meltdown. Banks that were massively involved in stock margin loans were exposed to huge portfolio of non-performing loans. An attempt to quickly sell off to reduce their losses further depressed the market resulting on investor's apathy towards the market leading to liquidity crunch and a decline of credit to the productive sectors of the economy.

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STOCK MARKET INVESTOR APATHY

Since the beginning of the 17th Century there have been over 45 major crises in various centuries emanating from different sources. These major crisis according to Fenzl, Bruderman, Malik and Pelzmann (2013) include the Dutch Tailing bulb mania from 1636 to 1637, the Mississippi /South Sea bubble in 1720 and the new economy bubble from 1991 – 2000. Others include the Dot-com bubble in 2000.

Friedman and Abraham (2006), noted that bubbles do not repeat often as well as crash as people become cautious and slow to reaction if similar episodes had occurred. They contended that investors' historical losses and their past experience in the stock market go a long way to influence their trading behaviour taking into consideration endogenous market risk premium. They believe that minimal price losses over a long period of time encourage portfolio managers to continue to add more risky portfolios hoping that they could take advantage of rising trends that are expected to follow. Unfortunately this may be unpredictable as slight losses proximal to the point of saturation could instigate a market crash originating from a possible push in risk premium and fall in asset prices.

Stock market bubble resulting in bubble crash and with market depression over a period of time leads to investor apathy in which case investors become uninterested in market participation arising from several factors including the followings.

(i) Severe Losses Especially by Armature Investors.

In Nigeria for example, many individual institutional investors including commercial banks lost millions of money following the 2009 stock market crash. The crash was followed by a long period of market sluggishness, credit crunch, depression and consequently leading to apathy in several months and even years that followed.

(ii) Declining Corporate Performance

The aftermath of a stock market meltdown is most often associated with credit squeeze, a decline in purchasing power and thus affects corporate performance. The rapid transmission of the fundamental information on not too attractive corporate earnings and dividends to anxious investors further amplifies apathy and subsequently drives down stock prices (Osaze 1988, Buttler 2002 and Barett 2002). Such information brings about actions that negate rational stock pricing based rather on mass psychological influences (Bollhorn:1999) and apathy on the part of investors.

(iii) Economic Recession

With trends of recession in the economy, declining corporate earning according to Ekineh (2002) could instigate bearish markets but in some cases downward price movements may not reflect the low dividend payments (LeRoy, Porter and Shiller:1981). Osaze (1985) finds that there is a positive correlation between dividend pay-out and stock price movement in the Nigeria stock market and thus a continuous downward trend in dividend pay-out and drastically dropping stock prices could lead to investor apathy in the market.

As well, institutional or public policy directives hurriedly fashioned and thus unsustainable but intended to remedy economic hardship could lead to irrational stock market price movements not consistent with fundamentals and consequently leading to pessimism and apathy due to loss of confidence in the economy

(iv) Exchange rate

A depreciating currency exchange rate has a negative effect on stock market prices as witnessed in Thailand, Malaysia and South Korea in 1997 and even in Nigeria after the introduction of the structural adjustment programme that resulted to a bearish market(Ekineh:2000) and Otegheri (2010). In Nigeria, the exchange rate has

depreciated by over 200% in the last couple of years currently hovering at over N400 to the United States dollar in the parallel market. This has not been exciting to investors and has no doubt affected market participation.

(v) Mass Psychological Behaviour

In the last one year, there has been a psychological fear or belief that stock prices may continue to fall as a result of the uncertainty and unfriendly macroeconomic environment. Foreign investors who still have a large share of the Nigeria stock market for lack of confidence have resorted to selling their shares for profit taking. Dalton (1988) noted that when a large number of prospective sellers continue to dump their shares, it easily depresses the market as was the case in post 1987 stock market crash in the U.S.A. when traders simply had a psychological loss of confidence after some period of depression. Dalton (1988) and Mulini (1988) find no economic indicators to explain the sudden apathy of traders rather than psychological or mass phenomena.

(vi) Macroeconomic Policy Environment

Prior to the current meltdown and apathy, oil prices in the global market have been on sharp downward trend. Though the 2015 elections were successful there was a complete change of political administration which was preceded by high political tensions and uncertainties leading to a null, and 'wait and see' attitude by both local and foreign investors. The 'wait and see' syndrome following the change in government in the face of dwindling crude oil prices and the post-election null in government activities also constituted one of the major factors affecting the stock market down turn and eventual apathy in the Nigeria.

(vii) The Anticorruption Disposition of the Federal Government Administration The tough stand by the new Federal Government Administration, strict guidelines on the Federal Government Treasury Single Account (TSA), tightening of the procedures on and foreign exchange transactions have impacted seriously on investor dispositions towards the stock market since the middle of 2015 to date. High net worth political bigwigs and chieftains of parastatals and heads of public corporations that were hitherto disposed to surplus funds and flexibility for investment discretions have become conscious of the anti- corruption agencies' watchful eyes hence they have become more careful in their choice of investment outlets. This has impacted on the declining trend of market participation and thus contributing apparently to the stock market apathy in Nigeria.

(viii) Liquidity Constraints

Osaze (2007)p.345 noted that ''there is a close relationship between money supply and stock prices''. He added that increase in money supply enhances the disposable income of investors and vice versa. Thus the tightening on liquidity, the highly depreciated exchange rate, high interest and inflation rates have negative impact on the stock market and the combination of these factors presently in Nigeria has taken a toll on stock market vibrancy and more often than not but apathy.

THE WAY FORWARD

The way forward includes the need to continue to sensitize investors to embrace the reality that the current down turn in the market is temporary and one of the features of stock markets worldwide. This implies educating investors to understand that investing in the stock market involves some patience, some appetite for risk and sometimes medium to long term rather than the extremely low appetite for risk and the extremely high attitude of most investors for short term expectation. On the part of the Government there is the need to explore and introduce growth stimulating policies such as accelerating the pace of critical infrastructure development especially power supply that has been a major constraint to all sectors of the

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economy. Other investor apathy inducing stimulants such as low level of financial literacy and the long standing problem of unclaimed dividends should be adequately and effectively addressed. Confidence building strategies should include straightening regularly supervision, good corporate governance, fair pricing and transparency as well as enacting laws to protect the less educated and vulnerable investors. This could encourage the participation of more local investors and thus reducing the dominance of foreign investors who tend to dump their stocks more easily by being more adversely sensitive to macroeconomic variables in the Nigerian economy.

CONCLUSION

This paper examines the factors responsible for stock market instability, stock market bubble, and meltdown as well as the current apathy on the part of investors in the Nigerian stock market. The paper observes that stock market bubbles and crashes arise from market inefficiencies due sometimes to government misdirected macroeconomic policies, economic recession and global contagion effects. The paper demystifies the theoretical fundamentals and behavioural factors that pollute the minds of investors leading to apathy and highlights policy implications. The paper recommends the way forward strategies to include public enlightenment and urging the federal government and apex regulatory authorities to explore and introduce growth stimulating policies such as accelerating the pace of critical infrastructure development especially power supply that has been a major constraint to all sectors of the economy. Others include strengthening the level of financial literacy of small investors through financial literacy programmes to empower them with basic investment knowledge about the activities in the financial markets as well as confidence building strategies which include straightening regularly supervisors, good corporate governance, fair pricing, resolving the long outstanding issues of unclaimed dividends mostly associated with armature investors, transparency and enacting laws to protect potentially vulnerable investors.

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