An Assessment of select market timing strategies performance in Nairobi Securities Exchange

Judah Ng'ang'a
Strathmore University, Nairobi, Kenya.

Herding behavior among Kenyan traders in the capital markets has been majorly attributed to low levels of income and lack of knowledge in trading principles. This focus of this study was on the latter challenge. The study sought to avail information to traders in NSE regarding the profitability of select market timing strategies. The study evaluated the performance of three market timing strategies namely the relative strength index (RSI), simple moving averages (SMA) and hidden Markov model (HMM). The data considered in this study included the share price of the NSE-20 index over the period 2004-2018 triangulated to the perceptions and opinions of trading experts in Kenyan fund manager firms. The performance of market-timing strategies in this study was determined by a strategy's ability to generate above market returns as well as the accompanying Sharpe ratio. Using Henrikson and Merton market timing model, this study shows that all the market timing strategies have positive market timing strategies, with HMM having the best market timing ability. By accommodating the autoregressive nature of financial prices this study examined the ability of the strategies to time the market using an ARDL model.

The model shows that all the strategies lack the ability to time the market but just like in HM model, HMM performances ranks best among the three strategies. Over the period 2004-2018 the Sharpe ratio of all the market timing strategies exceed that of SBH. The profitability is still the same when the period is split into two halves (2011-2018). The profitability persists when the trading points determined using the market index are used to trade five randomly selected securities. This confirms the profitability of trading based on patterns of historical prices. This negates the principles of EMH Theory but is in harmony with the FMH Theory, this study, therefore, provides support of FMH Theory as a more relevant market theory. In Kenya, this study found that investors are averse to market timing and tend to herd towards buy and hold strategy. Given the low profitability of the SBH strategy in NSE, this study should provoke the traders in NSE to reconsider their approach in determining optimal trading points.

Keywords: Fractal Market Hypothesis; Herding Behavior; Hidden Markov Model, Market Timing.