



## **STOCK MARKET TERRAIN: TREAD CAREFULLY, BULLS AND BEARS ON THE PROWL.**

Just like a spot of adventure, the stock market presents a scenario of risks and opportunities; risk in the sense of uncertainties masking the odd of losing hard earned income and opportunities in the sense of inherent possibility of capital gain. It is commonplace to hear stock market expressions like ‘the bull laid siege in the market today...’, “The bears still rally around on the Exchange...”, “The lemmings are in full control of market activities as band-wagon effects....” On the whole, the metaphoric use of animate objects to dramatically capture market behaviours is revealing and interesting. However, so much as their use enhances simplicity in understanding the basics of stock market; it also fronts the possibility of misuse and misinterpretation.

### **What are bull and bear markets?**

The use of "bull" and "bear" to describe market conditions evolved from the manner in which each animal attacks its opponents. That is, a bull thrusts its horns up into the air while a bear robs its paws down. These actions are metaphors for the movement of a market. An upward **trend** captures a bull market; and a downward trend is considered a bear market.

What constitutes a trend is a set of market conditions mirroring the long term movement of security prices. A market condition in which the prices of securities are falling or are expected to fall typifies a bearish tendency. Although figures vary, analysts' consensus puts a plunge of **15-20 per cent** or more in major market indices as a signal of entry into a bear market. Bearish tendency is reaction to general economic downturn which amplifies pessimism and fear resulting in a downward trend that investors believe will hop into the long run, which, in turn, perpetuates the spiral.

Conversely, a stock market situation in which share prices are upward bound or are expected to leap is pictured as a bull market. Bull markets are characterized by optimism, well-built investor confidence and expectations that strong results will continue. Bullish trend is a reflection of buoyant economic activities translating to growing GDP.

So much as 'bullish and bearish trends' are decipherable from market indexes, none of these trends lasts forever. The market is often described as being in constant flux with the bulls and the bears striving to take control. What is difficult is to consistently predict the direction of the market since market sentiments alongside fundamentals dictate market trends.

## Understanding the Bull and Bear Signs

Though a bit more specific than throwing a dart, marked direction of stock prices might be inadequate in defining a bull or bear market condition. There are some accompanying

characteristics of the bull and bear markets that investors should be aware of. The nature of these factors which are couched in three broad dimensions sheds appreciable light on what typifies either bull or bear markets. These are supply and demand for securities, investor psychology and the state of key macroeconomic variables like interest rate, GDP growth rate, unemployment rate etc. Below are some prominent signs (**market tops**) heralding the coming of a bearish market:

- Increasing interest rate coinciding with economic recession.
- Corporate earnings reports coming in below expectation. Since the businesses whose stocks are traded on the exchanges are inexorably linked to the whole economy, the stock market and the economy are strongly connected. A bear market is associated with the troughs of economic cycle as most businesses feel the pinch of weakening consumer spending.
- Over-valued P/E – Market indexes rise too much from **normal valuation** levels resulting in overvalued P/E. This implied that the major market indexes would have to fall for the traditional valuation to be restored.
- Stock market action termed ‘churning’ with high volume transactions but no much change in prices or great irregularities in prices [some share prices up sharply, some down sharply] with a lot of day-to-day volatility .
- Low quality stocks lacking strengths in fundamentals start to appreciate in price.
- Excessive speculation and investors frantic search for shelter in blue-chips
- Excessive enthusiasm resulting in strong investor confidence. This is underlined by uniformity in bullish forecasts by business analyst, brokers and industry watchers who are in the main bullish. Any downturn is dismissed as temporary.

On the other end of the continuum, an investor should be able to recognize market bottoms. This is the level where all sellers have dumped their shares. It is at this level

that the market stabilizes and starts its rebound. This is the most profitable phase of the market and it pays to recognise it. The end of a bearish momentum is signaled by **market bottom** signs which include:

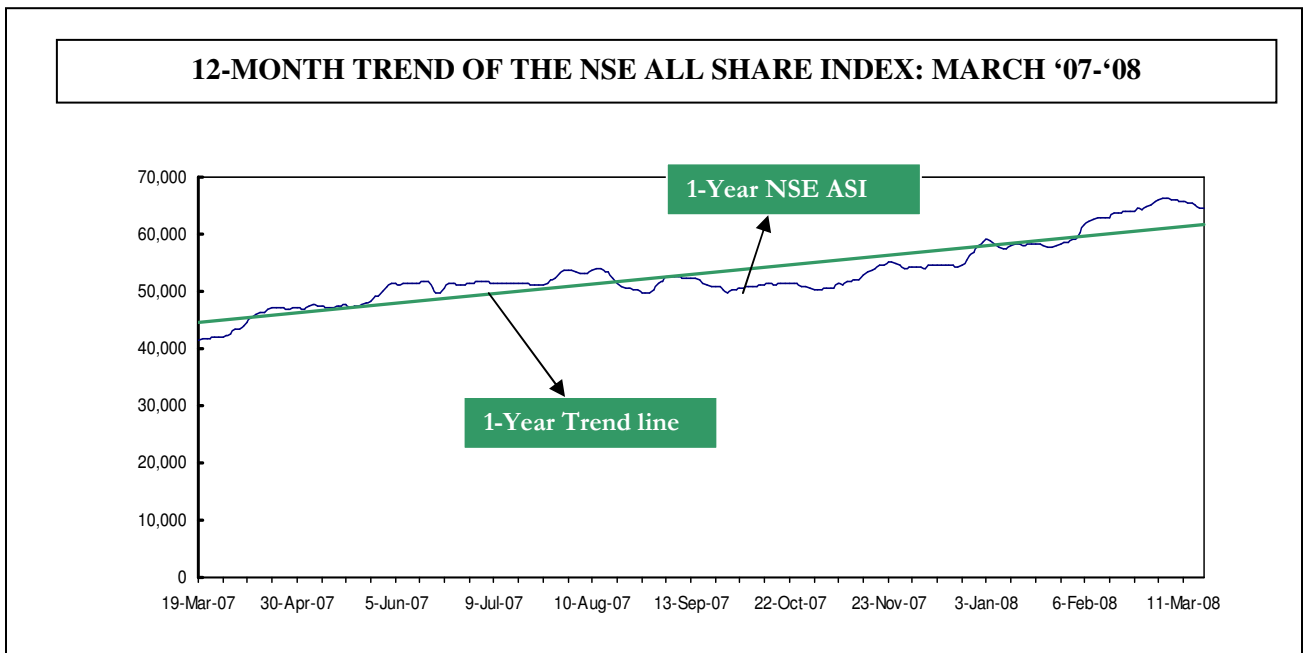
- Increase in market price with increasing volume on successive days of rally
- Extreme pessimism, eroded confidence and gloomy forecasts for the market and businesses. The stock market seems to start up before the bad news stops. At that point the market will be acting ‘contrary to the obvious’.
- Widespread low market turnover with low price earnings translating into higher yields. But then some key stocks exhibit rally potential with volume traded gradually increasing on successive rally and falling on dips.
- Low price earnings ratio reflecting undervaluation of stocks

The list is not exhaustive. Spotting the signs of a bullish or bearish trend requires a keen watch on the long term trend established in market indicators not just the market’s knee-jerk reaction to a particular event. Small movements would only represent a short-term trend or a market correction. Thus, most analysts agree that a decided reversal in the market should be ascertained by the degree of change in market indexes. If major indexes have changed by at least 15-20%, investors can be quite certain the market has taken a different direction. If the new trend does continue it is because investors perceive a change in both market and economic conditions and are thus making decisions accordingly.

## **The Nigerian Stock Market: Bullish or Bearish?**

The Nigerian stock market in recent years caught the fancy of the investing public. The three metrics highlighted above are adopted here to gauge the direction of the Nigerian stock market. From the perspective of demand and supply of securities, the Nigeria stock

market exhibits uptrend behaviour. In a span of a year, the NSE All-Share Index which tracks market returns, appreciated by **55.2 per cent** hitting a high of 66,482.68 points at the close of trading on 7 March 2008. The Market Capitalisation of the current 216 listed equities also skyrocketed by 130% in the same period. This is a reflection of a northward movement in share prices. Analysis of this movement on 104 randomly selected equities revealed that substantial **87 per cent** added more than **20 per cent** returns to shareholders value measured from price appreciation alone. It is surprising to know that the top 5 equities posted an average return of **1698.7 per cent** in just a year! These equities are **AFROIL, ALUMACO, COSTAIN, SCOA and MORISON**. The import of this on the investment climate in Nigeria is that, an investor who channeled N1million in March 2007 on any of the above equities will be worth more than N17million by March 2008!



Further, a peep at the general economic condition points to the same direction. In the past 3 years, the economy has grown by 7% annually with major macroeconomic indicators heading northward just as the projection for next year stands at 11 per cent. Besides, the growing confidence of the international community in the potential

investment returns also spurred the influx of massive foreign capital into the economy. On the flank of market sentiment, investors exude favorable disposition that the current trend will leap into the future. In fact, some analysts submit that the '*resistance and support levels*' of equity prices have drifted upward setting another platform for maximum high and minimum low price gyrations.

## Taming the Bears and the Bulls

To some investors, recognizing the appropriate entry and exit points in stock market is the money spinning time-tested strategy in stock trading and investing. **The basic idea behind stock speculation is to buy low and sell high.** The spread translates into profit. Hence, speculators, who are out to reap from capital appreciation make entry decisions in a bear market when stock prices are low and exit in a bull market when stock prices are high. Alternatively, a well thought-out timing strategy might dictate an entry at the spot of a bullish rally before the trend is strongly established. However, knowing the best time to buy and sell is not that simple. Here are some strategies used by investors to win big by taming the excessiveness of bears and bulls.

### Contrarian Strategy

Unfortunately, most investors are too emotional reflecting their herding instinct unconsciously forcing them to drift with the trend. They sell in a bear market and buy in a bull market. This is contrary to the contrarian strategy of drifting against the tide. This position (**the contrarian strategy**) is made strong by the law of mean reversion. If the market is upward bound at the moment, for the long term averages to be maintained, the market must perform below this average for the same period of time in the future. This, coupled with historical evidence of stock markets performance cycles, partly explains the

lurking sentiment by some investors that the Nigerian stock market might well be heading for ebbing tide in a future not too distance.

### **Odd-Lot Trading**

A softer version of the contrarian strategy mostly adopted by sophisticated investors is **odd-lot trading**. Essentially, fringe investors as a group more often than not trail an established momentum. Hence at the sight of excessive buying spree in the market, investors who understand the nuts and bolts of market pulse, sense this as a signal of the end of a bullish course. It is noteworthy that market is always bullish just before the dawn of a downswing. The same strategy holds sway with profound bearishness.

### **Up-or-Down –by Half Rule**

Just as some investors might adopt the ‘**up-or-down-by-half**’ principle in timing the execution of their investment decisions, a bearish or bullish run does not necessarily connote a substantial swing in all share prices. So, adopting this principle in spotting an entry point in a bearish market and exit point in a bullish market might not prove too potent when applied to some selected stocks that have the in-built fundamentals to defy market swings.

In sum, the list of timing strategies potentially capable of helping investors exploit the opportunities presented by both bearish and bullish trends is inexhaustive. The pertinent issue is the ability to consistently adapt a blend of strategies and read if multiple strategies point to the same direction. Though both the bear and the bulls are wild in the investment terrain, taming them to reap enormous investment fortune is a story that can be told by living men.

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