A STUDY ON INVESTOR'S DECISION TO INVEST IN CAPITAL MARKET IN BOOM AND RECESSION ECONOMIC ERA - A REVIEW OF LITERATURE

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Abstract

Investment decision have become significant for investors as the process involves taking a huge risk to earn excess return based on the investments made in the capital market. Stock market is well known for its volatility and unpredictability of price movements. Hence, the investors should be careful enough while investing their money in stock market especially during the boom and recession period. This paper is investigated to know the investors behaviour while investing in capital market during boom and recession period. The main objective of this study is to find out how the factors impact on investors decision in capital market in boom and recession period. The study founded that investors tend to take advantage during the boom period by investing in capital market, whereas, during recession period their confidence did shook a little but it was backed up with the support of Government and Central Bank who took counter cyclical measures to overcome the recession period.

Keywords: - Boom, Recession, Investors Behaviour, Capital market, Investment.

Introduction

Investment decision have become significant for investors as the process involves taking a huge risk to earn excess return based on the investments made in the capital market. Stock market is well known for its volatility and unpredictability of price movements. Hence, the investors should be careful enough while investing their money in stock market especially during the boom and recession period. The boom and recession cycle is the alternating phases of economic growth and decline. In boom phase, growth is positive, if Gross Domestic Product (GDP) growth remains healthy it can stay in this phase for long years. Boom period accompanies a bull market where investors often have faith that the uptrend in the market price will continue over the long term. Generally, in this scenario country's economy is strong and employment levels are high. An investor would like to take advantage of rising prices by buying stocks early in the trend if possible, and then selling them when they have reached their peak. In case of loss during boom period it should be minor and temporary. The recession or bust period accompanies a bear market with negative GDP, which in turn it leads to increase in unemployment rate and a crash in stock market. Investors don't feel confident enough during crash period as the share prices tends to move downwards. Investors sell their positions, and buy safe-haven investments that traditionally don't lose value, such as bonds, gold. As companies lay off workers, consumers lose their jobs and stop buying anything but necessities. The bust cycle eventually stops on its own, that happens when prices are so low that those investors who still have cash start buying again. This can take a long time, and even lead to a depression. During recession period, Confidence can be restored more quickly by central bank monetary policy and government fiscal policy.

Objectives of the study

1. To explore the factor impact on investor's in Boom and Recession economic era.
2. To analyse the profitability in Boom and Recession economic era.

Investors Decision to Invest in Capital Market

Mrunal Chetanbhai Joshi, Yashika Batra (2017) stated in their paper on factors affecting investment decision in stock market about the perception of investors how they are focusing on various sectors and variables related to investment in stock market by using convenience sampling method. A descriptive research design was used for the study to find the factors like Price Earnings Ratio, Earnings Per Share are given top most importance as compared to market share, company's prestige and liquidity. If industrial factors are considered Government policies and growth rate of industry are of even more important. In addition to that, Global Economic condition and FII flow are also a part of Macroeconomic environment, which is considered as crucial factors for investors while investing in capital market.

Jeet Singh, Preeti Yadav (2016) in their paper on factors influencing investors decisions in investing in Equity shares in Jaipur and Moradabad with special reference to Gender, has found in their study that whether male or female they need to look into all the avenues while investing their funds with the help of Fundamental, Technical and Financial Analysis. As some of the investments are risky and some or not, hence they should decide about their investment preference as per their age.

Kim, Nofsinger (2007) examined individual investors behaviour during Bull and Bear markets by using market level data and discovered that investors own risky and high book to market stocks, frequent in trading activity, lack of investment decisions and buy current winners. Moreover, these characteristics appear to differ on the basis of Ups and Downs in the market. They also found that investors are more persuaded to hold high book to market stocks in a Bull market, whereas, in a Bear market investors display their preference towards holding the stocks which are having a high beta.

Blake, Wohar (2006) has found in their paper on the movements of stock prices depend on number of factors. The decomposition of factors is very sensitive based on the assumption of the presence of permanent changes in either real dividend growth or excess stake return.

Docking, Koch (2005) examined the sensitivity of investor reaction to market direction and volatility towards dividend change announcements and found there was a greater change in stock price whether the nature of the news (good or bad) goes against the gain of the recent market direction during volatile times.

Udegbunam, Eriki (2001) revealed from their study on Inflation and Stock price behaviour in Nigerian Stock Market that it provides a strong support for the proposition on inflation which exerts a significant negative influence on the behaviour of the stock prices. The study was also focused on the level of economic activity which was measured by interest rate, GDP, financial deregulation and money stock.

Yartey (2008) conducted a study on the determinants of stock market development in emerging economies and to check if South African economy is different. From their study it was revealed that Macroeconomic factors like Income level, Gross Domestic Investment, Banking sector development, Private capital flows and Stock market liquidity are the major determinants of stock market development in the emerging market countries. Apart from that, some of the other important determinants of stock market development such as political risk, Law & Order, Bureaucratic quality will lead to the enhancement of sustainability in external finance.

Joshi (2013) examined the factors affecting Indian Stock Market and found some major factors like flow of Foreign Institutional Investors, Political stability, growth of Gross Domestic Product, Inflation, Liquidity & different Interest rate and Global level factor are responsible in creating the Up – Down movement in Indian stock market.

Amit, Dr. Prashantha (2016) conducted a study on stock market analysis and investment decision making in North Karnataka region and found that investors take their investment decisions based on three sources of guidance i.e., Self-analysis, Brokers or Friends and the Experts who have a special knowledge about stock market. Investors based on level of education i.e., Graduates and Post Graduates depends on self-analysis and advice from brokers. Whereas, investors from Agricultural background depends on media, brokers and experts' opinion. Investors from business and employees prefer self-analysis, friends and brokers advice to invest in stock market. To conclude, investors do not depend majorly on only one source of stock market analysis in taking decision towards their investment.

Investors Decision to Invest in Capital Market in Boom Period

Saurabh Ghosh (2004) investigated on boom and slump periods in the Indian IPO market. The paper was mainly concentrated on the two key variables i.e., IPO volume and Initial returns. The study also analysed the firm specific characteristics and their influence on the timing of a company getting listed in the hot and cold market. The IPO volume series was auto correlated over the entire period, especially during the boom period. It was found that there was no significant relation between IPO volume and initial returns during hot and cold periods. However, some of the other characteristics would have influenced the likelihood of IPO's during hot and cold periods are industry classification, age, size and under-pricing of new issues. It also recognized that more established firms have greater likelihood to get listed on the capital market to raise large amounts and under-price more during the slump period.

Alejandro Izquierdo, Randall Romero-Aguilar, Ernesto Talvi (2008) conducted a study on the role of external factors during Boom and Busts in Latin America to test the relevance of external factors in average quarterly GDP growth for 1990 – 2006 in the seven largest Latin American countries (LAC7). It was found that the relationship between LAC7, Gross Domestic Product, and several external factors account for a significant share of variance in LAC7, GDP growth and external shocks produce significant responses. Considering the external factor 'Tailwind' the recent share of LAC7 growth performance can be explained, and also evaluated the impact of drop in external financial conditions. To conclude, the relevance of policy evaluation is emphasized on growth performance, the strength or weakness of macroeconomic fundamentals and the impact of domestic macro and micro policies on growth can only be properly appraised by first filtering out the effects of external factors.

Kenneth J. Singleton (2013) in his paper on investor flows and the 2008 Boom/Bust in oil prices argues that informational frictions and the associated speculative activity may induce prices to drift away from fundamental values and may result in price booms and busts. Based on the new evidence it was found that economically and statistically significant effects of investor flows on future prices after controlling for returns in the United States and emerging economy stock markets. The large impact of investor flows was on future prices based on intermediate term, growth rates of index positions and managed money spread positions. Besides, these effects were through risk or informational channels distinct from changes in convenience yield. To conclude, hedge fund trading in spread position in futures impacted the shape of term structure of oil future prices.

Hammami, Haifa, Boujelbene, Younes (2015) examined the paper on investor herding behaviour and its effect on stock market boom and bust cycle to test the presence of investor herding behaviour in the Tunisian stock market with a combination of herding behaviour of investors, economic and financial fundamentals, the explanatory factors of the occurrence of the probability of stock market booms and busts can be explored. It was found that herding behaviour was intensely existed both in boom and bust of stock market. To conclude, investor herding behaviour contributes to an increase in the probability of stock market booms and also the economic and financial fundamentals lead to the emergency of Tunisian stock market boom – bust cycles.

James R. Brown, Steven M. Fazzari, Bruce C. Petersen (2009) investigated a paper on financing innovation and growth cash flow, external equity and the 1990s R&D Boom. By financing R&D created a strong channel to link the finance and economic growth but there was no direct evidence of financial effects to show the impact on aggregate R&D. U.S firms financed R&D from volatile sources cash flow and stock issues. Dynamic R&D models were constructed for high tech firms and found significant effects of cash flow and external equity for young firms than mature firms. The financial coefficients of young firms are huge enough that supply shifts can explain most of the dramatic 1990s R&D boom in which it shows a significant connection between finance, innovation and growth.

Muhammad Shahbaz, Ijaz Ur Rehman, Talat Afza (2015) explored the determinants of macroeconomic in stock market development of an emerging market (Pakistan) for the period of 1974 – 2010. By applying Vector Error – Correction model Granger Causality approach to investigate the direction of causality between the variables and discovered they are co-integrated for long run relationship. The causality analysis confirms that stock market development is a Granger cause of economic growth, investment, financial development, inflation and trade openness. It also showcases the importance of trade openness while formulating a comprehensive financial policy.

F. T. Kolapo, Adaramola (2012) examined the impact of the Nigerian capital market on its economic growth over the period 1990-2010. The performance of the stock market is a boost for economic growth and development. The study reveals that the Nigerian capital market and economic growth are co-integrated by applying Johansen co-integration and Granger causality tests. The causality test suggests there is a bidirectional causation between the GDP and value of transactions and unidirectional causality from market capitalisation to GDP and not vice versa. By using a two tailed test the F test is significant at 5% level. However, there is no "Reverse causation" from GDP to market capitalisation. Moreover, there is independence "No causation" between the GDP and Total New Issues as well as GDP and Total Listed Equities and Government Stocks. This clearly shows that there is a comparative positive impact on capital market which plays on economic growth of the country. To conclude, the regulatory authority should initiate policies that would encourage more companies to access the market and be more proactive to check sharp practices which damage the market integrity and investors' confidence.

Peter Blair Henry (2000) conducted a study on stock market liberalisations will lead to private investment booms by considering a sample of 11 developing countries who have liberalised their stock markets. In the first year of liberalising, 9 countries experienced growth rate of private investment which went above the non-liberalisation median. And in second and third years after liberalisation the numbers were 10 out of 11 and 8 out of 11 respectively. The exceed in the sample mean by 22 percentage points indicates that the mean growth rate of private investment in the three years are immediately following the stock market liberalisation. The evidence from the study showcase that capital account liberalisation has no effect on investment.

Julius Enqvist, Michael Graham, Jussi Nikkinen (2014) examined the impact of working capital management on firm profitability in different business cycles from Finland. It was found that the relationship between working capital and profitability was more pronounced in economic downturns relative to economic booms. In addition to that, the significance of efficient inventory management and account receivables conversion periods increased during the period of economic downturns. To conclude, the active working capital management matters on firm profitability in different business cycles, so it should be included in firm's financial planning.

Enrico C Perotti, Pieter Van Oijen (2001) investigated a paper on privatisation, political risk and stock market development in emerging economy. It was found that major political test will gradually resolve the uncertainty over political commitment to a market-oriented policy as well as regulatory and private property rights through a sustained privatisation program. The study shows there is a progress in privatisation which is correlated with improvement in perceived political risk. It also showcases that the changes in political risk is generated to have a strong effect on local stock market development and excess returns in emerging economies. To conclude, the resolution of political risk is resulted from the success of privatisation which has been an important source for the rapid growth of stock markets in emerging economies.

Investors Decision to Invest in Capital Market in Recession Period

Matthew Rognlie, Andrei Shleifer, Alp Simsek (2018) explored a study on investment hangover and the great recession. Over building of durable capital such as housing requires a reallocation of productive resources to other sectors, which is facilitated by a reduction in the interest rate. The restriction of Monetary policy on over building lead to a demand driven recession with limited reallocation and low output. Usually investment in other capital at first declines due to low demand, later it booms gradually and motivate to an asymmetric recovery in which the overbuilt sector is left behind. Here, welfare can be improved by ex-post policies that trigger the investment (including in overbuilt capital) and ex-ante policies that restrict investment.

Julijana Angelovska (2017) investigated the reaction of investors to annual earnings during recession period in Macedonian stock exchange. Event methodology was employed and found investors did not react to firm specific positive earnings announcement. Even the returns in an event window showed a conventional as the day before to two days after a firm specific public earnings announcement was not abnormal as well as there was no abnormal change in volume of trade. To conclude, the recession did not impact on the investor psychology as such that fear did not ease by the good news and good financial results.

P. K. Mishra (2012) examined the performance of Indian capital market in terms of market size, market liquidity, market turnover, market volatility and market efficiency over the period 2008-2011. However, the Indian capital market revealed the greater degree of volatility and weak form of inefficiency during the crisis. It was found that there was an increase in market size, market liquidity and reasonable market turnover. Hence, the planners, policy makers and regulators should come up with prudential norms and implement fair market practices to make the national economy more resilient to cross broader contagions.

Suresh, Anil (2010) examined the various aspects of current financial crisis and its impact on Indian capital market in the arena of financial innovations and global best practices and their policy implications. It was found that there was a financial stability in India during the crisis by the persistence of prudential policies which prevent institutions from taking outrageous risks and financial markets from becoming extremely volatile and chaotic which boosted the investors' confidence.

Cristiana Tudor (2011) investigated a paper on casual relationships and short term interaction mechanisms among six Central and Eastern European (CEE) stock markets and the USA stock exchange, with special reference to the effects of the 2007-2009 global crisis. The study included daily observations for six CEE stock indexes and also for the US market covering the period from January 2006-March 2009, which was later divided in to two sub periods corresponding to the pre-crisis and crisis period. It showed the relationship among CEE stock markets are time varying. The linkages to stock market was limited before the crisis but it became significantly stronger during the crisis. The study also revealed it is best to diversify the risk by investing in different CEE markets as it was limited during the financial turmoil. Russian market played a leading role in the CEE region before the crisis. Besides, the CEE markets were significant before the crisis which was influenced by innovations in the USA market. Hence it explains why they were heavily affected during the crisis and managed to spread immediately in the region.

Rajiv Kumar, Pankaj Vashisht (2009) examined the impact of global economic crisis in India and its policy responses. The study showcases that India's financial sector was not affected by the global financial crisis during the first round of its effects. But then in the second round of its effects has affected India through three distinct channels i.e., financial markets, trade flows and exchange rates. The reverse of capital inflows created a credit crunch in domestic markets along with a slump in export demand which led to decline in gross domestic product by more than 2 percentage points in the fiscal year 2008-2009. In line with efforts taken by Governments and Central Banks all over the world, the Government and the Reserve Bank of India (RBI) took aggressive countercyclical measures, dramatically the monetary policy was loosening up and instruction of fiscal stimulus boosted domestic demand. However, it was seen that there was very limited fiscal manoeuvrability and the limited friction of monetary policy, policy measures to restore the Indian Gross Domestic Product growth back to its potential rate of 8.9% must focus on addressing the structural constraints that are holding down private investment demand.

Felicia Omowunmi Olokoyo (2014) investigated a paper on attitude of investors towards capital and money market investments before and after financial crisis. It was found that there was a change in the attitude of investors as they switched funds from capital market securities in favour of money market instruments which guaranteed them a fixed interest income. Even though capital market was gradually recovering were having very less confidence in the market. Hence, the Nigerian stock exchange should strive to regain and retain common investors' confidence in the primary market through improvement in their corporate performance.

Marcel Fratzscher (2012) conducted a study on capital flows, push versus pull factor and the global financial crisis. The causes of the 2008 collapse and subsequent surge in global capital flows remain an open and highly controversial issue. It was found that key crisis events as well as changes to global liquidity and risk have exerted a long effect on capital flows both during the crisis and recovery. Moreover, these effects have been highly heterogeneous across countries, with a large part of this heterogeneity can be explained by the differences in quality of domestic institutions, country risk and the strength of domestic macroeconomic fundamentals. To conclude, push factors were dominant in accounting for the dynamics of global capital flows in 2009 and 2010 in particular for emerging markets.

Claudio Raddatz, Sergio L. Schmukler (2012) analysed a paper on how investors and managers behave and transmit shocks across the countries. It also shows the volatility of mutual fund investments in quantitatively led by both the underlying investors and fund managers based on injections into/ redemption out of each fund and managerial changes in country weights and cash. Here both of them responded to country crisis and returns and adjusted their investments substantially. The behaviour of investors and fund managers tends to be procyclical, reducing their exposure to countries during bad times and increasing it when conditions improve managers actively change country weights over time, but there is significant short run pass through from returns to country weights. The capital flows from mutual funds didn't seem to have a stabilising role and yet expose countries in their portfolios to foreign shucks.

Joern Block, Philipp Sandner (2009) analysed the effect of the current financial crisis on venture capital investments in US Internet start-ups by using regression analysis. During financial crisis period there was 20% decrease in the average amounts of funds raised per funding round. However, these effects can be seen in later funding rounds. The firms in later financing rounds need capital to survive but they cannot avoid the deduction influenced by financial crisis, while on the contrary the firms which seek initial funding postpone their funding and expansion plans till capital market is stabilised. Besides, the firms in later phases of the venture cycle are more likely to be negatively affected by the weak IPO market than firms seeking initial funding. To conclude, the financial crisis can lead to a dreadful funding gap in the financing of technological development and innovation.

Conclusion

Investors can protect their investment in capital market during boom and recession era by rebalancing their investment portfolio once or twice in a year by purchasing the shares at low price and selling them at high. Investors need to study the causes of both the boom and recession era as it will have a large influence on investor investments, so it's better to take some time to think what market is doing while making an investment decision. As the saying goes, "the best time to invest in the market was yesterday; the second best is today." Investors should continue to remain invested in quality stocks and good mutual funds and persist with systematic investment while being cautious of the valuations in pockets of mid and small caps.

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