Reasons of Fluctuations in Stock Prices
Reasons of Fluctuations in Stock Prices
Disclaimer

All information contained in the Companies Guide is for information purposes only. Nothing herein constitutes an offer, solicitation or recommendation to invest or conduct any transaction in any kind of securities listed on Abu Dhabi Securities Exchange (ADX).

ADX is not liable for any claims, losses, or damages of any nature, arising directly or indirectly from use of the data found in this report. ADX endeavors to ensure that the data and other materials found in this report are correct and complete, but does not accept liability or responsibility for any error made or omission in this report.

All materials contained in this guide, including all data, information and content are the property of the Abu Dhabi Securities Exchange (ADX).
Reasons of Fluctuations in Stock Prices

Introduction
Abu Dhabi Securities Market (ADX) is pleased to present this informative and educational booklet to its readers. This is the third of a series of publications published by ADX in 2014, aiming at informing and educating investors, stock traders and those interested in the financial markets.

There are many questions about the nature of share price fluctuations, reasons and the responsible parties. The answers to these questions sometimes have nothing to do with real meaning! Not to mention rumors in finding unrealistic explanations! As a result, we named this booklet:

“Reasons of Fluctuations in Stock Prices in the Financial Market”

Therefore, in this context, we will equip this version with the required explanations and clarifications about reasons that lead to fluctuations in the prices of ordinary shares in the financial markets. This do not include all securities because stock shares are the prevailing instruments in the local and regional markets.

Finally, we would like to remind our readers that the content of this booklet, or any other brochure and publication issued by the relevant departments in ADX, is for information purposes only and does not constitute an investment advice. ADX is not responsible for the contents of this publication.
Supply and Demand: the Basis of Price Fluctuations

By nature, share prices (and other securities) change in the stock markets on a regular basis. There are no static financial markets and if we assume their presence, we do not need them. Static markets, if they were found, do not achieve the objectives of stock traders and listed companies in the market and do not contribute to the economic growth, especially in relation to attracting investment.

Many investors are wondering about the reasons for the rise and fall of share prices in the financial markets from one day to another, sometimes from one moment to another. These questions are followed by analyzes and interpretations that may be objective and true, but they may also be improvisational, imaginative and far from reality, making it a breeding ground for rumors which may negatively affect the investment decision. This, in turn, may expose investors in the financial market to heavy losses.

Therefore, we must know and understand the answer of the important question, “Why Share prices fluctuate?” The correct answer will contribute to the protection of investors and enable them to take precautions and maintain the investment.

Accordingly, there is no one specific reason that causes share prices fluctuations. It is difficult as well to accurately measure and determine all reasons due to the large overlapping elements in the movement of markets. Sometimes, unexpected developments or news may come suddenly and theoretically raise share prices. At the same time, the investor may receive news or any other development that theoretically lead to a price drop. Ups and downs in share prices clearly make the investment decision very difficult and challenging.

In general, the share price depends on the supply and demand along with many other factors that affect the price. By and large, the increase in supply leads to a decline in the share price and vice versa.

Reasons of fluctuations in share prices in the financial market can be classified in three main categories in addition other secondary factors. This document will cover them all.

The impact of these factors varies. Some factors are theoretically and practically important while others have a secondary effect. In addition, it must be noted that it is difficult to review all influences of share prices in a given market, but we will look at the common causes herein.

The following is a review of the most important factors that influence the movement of prices in the market:

- Economic factors.
- Factors related to the company and its sector.
- Factors related to investors and stock traders in the market.
- Other factors.
First: Economic Factors

Naturally, financial markets are directly affected by the general economic situation. If the economy is stable and enjoys a high rate of GDP, low rates of unemployment, high income per capita, etc., this - at least in theory - leads to a high performance by the companies (not necessarily every company), and thus more activity in financial market.

Strategists in the financial sector looks at the current levels of economic indicators but along with the future prospects for these indicators. Hereunder, we will review some economic indicators that may affect share prices in the financial market: provided for potential investors.

Interest Rates:

Interest rates (for those who deal with it) have a significant impact on price movements in the financial market. If banks offer high interest rates (such as those occurred in the seventies when the interest rate exceeded 10%, for example), many investors will opt for the banking sector as an investment option rather than financial markets because of the guaranteed high interest rates. Theoretically, this is expected to lead to a lack of demand for stock shares and an increase in the supply with aim of resorting to banks. This move, in turn, will lead to deflation and vice versa.

In contrast, high interest rates on loans provided to companies, aiming at developing their business, will have a negative impact on the earnings of these companies and their dividends because of the high cost of investment. Thus, it may reduce the demand for the shares of these companies, eventually leading to a decline in share prices.

Inflation:

Inflation is defined as an increase in the overall levels of prices. The price level is the weighted average of prices for various goods and services in the economy.

Simple example: thirty years ago, AED 5000 had a purchasing value of goods and services much more than what can be done to purchase the same goods and services these days because of inflation and gradual loss of worth compared to its previous value. The increase in inflation has a material impact on share prices in the financial market.

The increase in inflation and increase in prices may decrease the appetite of consumers to purchase goods and services, especially non-essential ones, leading to a decline in the productivity of manufacturers and, thus, lower profits. This, in turn, may dampen the enthusiasm of investors to buy shares of these companies, if they are listed financial market, and causes a drop in share prices.

On the other hand, there is a positive relationship between inflation and interest rates according to economic theories. Later on, we will discuss how high interest rates lead to lower share prices.

Currency value

The economic literature tells us that the currency value in the industrialized world has a relationship with price fluctuations in the financial markets. If the value of a currency goes up in a certain industrialized country, it means that the importers of its products will pay more to buy goods and services, which reduces their imports. This leads to a reduction in the sales of exporting companies and, therefore, a drop in share price.
Second: Factors Relating to the Company

The company and its shares are the center of the investment decision. In general, the good performance of a company in a natural environment attracts investment and increases the demand for its shares. Likewise, if it performed poorly with expectations of a continued weakness, the demand for its shares will decline and therefore its share price goes down, depending on the circumstances and data of each company.

Thus, the issue here is principally about the company and its performance. The mature investor does not usually accept the purchase in a weak and losing company, because it does not achieve his objectives in acquiring good assets and getting profits via the company's dividends. Successful companies with expectations of a continued success attract investors because of their sense of confidence and security. This accompanied with an inherited expectation that successful companies are going to achieve investment objectives in far-reaching and short-term investments, especially in relation to dividends or the company’s profits when trading if it was done in a correct and successful way.

Most of other factors, whether economic, political, technological, etc., relate to the extent of its impact on the company itself. If we assume that some sudden economic or political developments did not affect a particular company, the share price of this company will not be affected substantially due to those factors. For example, weapon manufacturers and telecommunications companies may achieve profits even during wars and conflicts. At the same time, one external factor may affect the company's share price if that actor is directly related to the nature of the company.

For example, a share price of a certain company operating in the field of technology may go down, even if it is a good company, especially when another competing company win a new patent that is expected to improve its products and promote its sales. Such news may adversely affect the level of products and sales of the company indirectly and thus decrease its share price. We can imagine this example by comparing Nokia Corporation with Apple Inc.
To clarify the aforementioned factors, changes in the share price of any company depend on several things, including:

- The company’s strength, efficiency, professionalism, commitment to governance, management’s success, reputation, quality of products and services along with other factors related to confidence.
- Financial statements, achieved earnings, regular and irregular dividends.
- Periodic and non-periodic disclosures of the company’s data and news are directly related to the rise in share price with good news or their decline with bad news.
- The company’s news materially affect its share price in the financial market, whether up or down. An imperative example of the news: mergers and acquisitions, new products, new contracts, changes in management, layoffs, financial and non-financial scandals.
- The company’s history and future outlook. A good history of the company is one of the most important factors for a good future. However, this is not the case always, especially for companies that change their products frequently. For example, products produced regularly by a company specialized in mobile phones compared with a company that produces milk and dairy products.
- The number of shares, shareholders, tradable shares and acquisition conditions all have a fundamental impact on the supply and demand movement and thus share prices. The increase in the number of the company’s shares, investor base, tradable shares and easy acquisition procedures will reasonably drive an increase in trading volume, and therefore supply and demand movement.
- There is a hypothesis that when the company buys its shares, share prices go up in the financial market due to decrease in the number of shares offered for trading. At the same time, when the company buys its shares, this may give comfortable with good impression among investors because the company’s purchase of its shares means the company’s confidence in this share.
- Insider trading, such as a sudden sell-off by the director of the company, chairman, members of the board of directors or chief financial officer. Their movement is an indication of their desire to get rid of shares early before the expected decline in its price because of bad results, alarming other investors to sell off their shares quickly. This may leads to an increase in the supply and a drop in the price.
- In the other hand, a purchase of more shares by the company’s insiders gives an impression that the company is in a good standing. This, in turn, encourages other investors to come in, pushing the share price up due to the strong demand.
- Opinions expressed by financial analysts affect the company’s share price, whether up or down. If analysts felt that the fair value of the shares is in excess of its current tradable price and issued a recommendation for investors to go and buy, this will increase the demand for the company’s shares and upsurge the price in the financial market. On the other hand, the negative recommendations of analysts will lead to a sell off, leading to an increase in the supply and a drop in the share price.
- On the other hand, different opinions and assumptions issued by analysts may result in a confusion in the company’s share price and leads to a misperception among individual investors.

Opinions expressed by financial analysts may be issued late after new developments and urgent news from the company or outside the market where traders will deal immediately with these developments, whether positively or negatively. The share price, therefore, rises or falls before the issuance of reports by financial analysts.

Furthermore, opinions expressed by financial analysts should be taken with a grain of salt. Every so often, some analysts have an interest in raising or decreasing the share price of a particular company to achieve a personal or corporate interest.

As a result, financial analysts must be licensed. They
Third: Factors Related to Stock Traders and Stakeholders in the Financial Market

The Behavior of stock traders and stakeholders in the market trading transactions has a significant impact on share prices, particularly in the case of lack of awareness among some stock traders in the market or if there is some negative factors. Deep negative results in many cases.

• In some markets, the existence of a listed company within a certain indicator relates directly to the share price. Most indicators in the financial market depend on a sample of companies in the market, not all companies, such as the US Dow Jones or the German DAX. The entries there contain only 30 companies.

• We should also note that there are investment funds that mainly depend on indexes. If the fund management decided to rely on a particular index, so to add a new listed company instead of another company, they should be buying large amounts of the new company’s shares in exchange for the issuance or re-issuance of units. This purchase will raise the demand for the company’s shares and thereby increase the share price.

• Usually, the share price is affected when the so-called corporate actions is effected. For example, the share price falls when the company distribute its profits in the form of bonus shares. Here, we must note that there is also an increase in the company’s shares. The share price also decreases when the company increases its capital by using the principle of priority subscription rights. Again, number of shares will increase.

• The share price is also negatively affected by cases of corruption, lawsuits, and sanctions against the company or defamation by regulators. This will cause a decline in the company’s share price in the financial market.

• The share price may also be affected by developments that happen in the sector in which the company operates, regardless of its performance. The increase or decrease in the share price of companies operating in the same sector, such as the technology sector or the real estate sector, may result in a simultaneous increase or decrease in the share price of this company. This analysis is based on real-world cases and may not be related to the performance of the company.

should be monitored by a regulatory authority and investment banks in order to protect investors from dishonest analysts.
Aspects of the Behavior of Some Stock Traders:

Rumors

Rumors are widespread practices in the area of trading in stock shares. Stakeholders usually spread rumors in various forms and types for the purpose of influencing a certain price, up or down. These spread and effectiveness of these rumors are caused mainly by the use of modern means of communication such as mobile phones, electronic forums, SMS, Facebook and others.

Naturally, the victims of these rumors are mostly ordinary investors who wish to achieve quick profits and accept news as they hear without validation. Following rumors without enough investigation has deep negative results in many cases.

Emotions and Personal Qualities

Emotions and personal qualities of the individual investor play a significant role, especially with small investors, in the trading transactions and causes ups or downs in share prices. Often, the effect of these things is not significant in changing share prices, but it may be so more often, especially in markets dominated by individual investors.

For example, the fear of loss plays an instrumental role the sell-offs. Greed also has its hand in the postponement of buying, selling or resorting to buying on margin even if the company is not licensed. Still, greed has a role in unjustified borrowings from banks.

Some traders are optimistic, opt for a particular company just because it has achieved profits in the past, and believe that this will continue. Pessimism also has a role in avoiding certain companies based on non-objective reasons.

Opinions of relatives and friends, even if they have no experience, affect the investment decision of some stock traders.

Decision-making is also affected by personal qualities of individual investors, such as nervousness, anger, postponement of decisive decisions, overconfidence and fear of risk taking.

The abovementioned factors have a limited effect on the supply and demand movement, and, therefore the price fluctuations.
Brokers

Brokers are expected to abide by laws and regulations and represent ethics of their profession, such as caring for the customer’s benefit, transparency, honesty, stay away from rumors and fake trading, etc.

However, some brokers may disregard the aforementioned qualities and recommend certain transactions to investors based on non-objective and non-professional reasons. Derived solely by a desire to achieve more commissions for the company, these dishonest brokers lure investors and encourage them to do more trading transactions.

Brokerage firms normally achieve profits from taking a specific percentage of transactions performed under their supervision.

Theoretically, trading transactions shall not occur without the approval of the investor. However, they occur every now and then without his approval. On the other hand, companies licensed to do financial analysis and share prices evaluation may sometimes issue inaccurate financial analyses drafted mainly in order to increase trading on shares of a specific company, especially if there is a relationship between the two companies (the two are owned by one owner, for example).

All of these practices have an impact in supporting the supply or demand for shares and, thereby, increasing the price volatility.

Stock Exchange Speculations

Speculations are an integral part of the financial markets. Their impact vary from one market to another, from one investor (speculator) to another and from one environment to another. Dealing with speculations depends on laws and regulations and their applications as well as the knowledge, awareness and experience of speculators and sometimes other qualities such as emotions and greed. Legal speculations are not prohibited in the markets. It is difficult to prevent the investor (speculator) from quick trading transactions if they are done within the framework of laws, rules and regulations. Nevertheless, there are some questions about the speculation when proved to have a negative impact on the rising or falling of share price, if it aimed at causing confusion in the market or intended to cause damage to small-scale investors in return for quick profits.

The key mission of stock markets is to convert savings into investments, harness funds, especially surpluses, to contribute to the support of listed companies, broaden the investor bases, regulate trading transactions, increase companies’ capital operations, protect investors through corporate governance and disclosures, monitoring of listed companies, etc.

Speculations with a negative effect contradicts with the principles of objectivity that form the basis of financial markets. In general, speculation has a significant impact on price fluctuations in the financial markets, but they vary from market to another.

On the other hand, continuing monitoring leads to regulating and minimizing speculations, separating the wheat from the chaff, exercising deterrent penalties against violators, attracting institutional investment, raising awareness among investors and speculators alike.

Fourth: Other Factors

Many other incalculable factors influence the movement of share prices. They include natural disasters, such as earthquakes, volcanoes and hurricanes. The massive earthquake that occurred in Japan a few years ago is still a representative example in this regard.

Also, wars, political crises, strikes have an impact on the performance of listed companies and share price in the stock markets.
Reasons of Fluctuations in Stock Prices