

What Influences Stock Prices?

After a bearish period of almost a year, the stock market is showing some signs that the bear may be loosening its grasp. With positive movements in the Indices and advances once again outnumbering declines, many are speculating as to whether the bear is going into hibernation. Whether the market is bearish or bullish however, there are a number of factors that influence the price of a share.

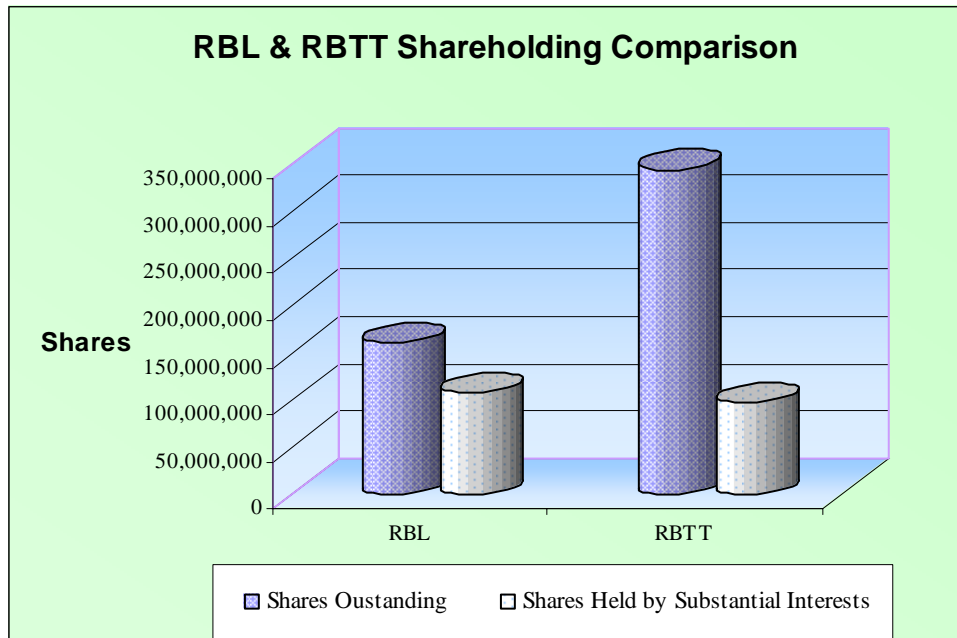
Of course, the most basic driver of share prices is the forces of demand and supply which are of course borne from the investor. When demand outstrips supply, prices will move positively as investors are willing to pay a higher price for a share due to lack of supply. This was most evident in the third week of May when Guardian Holdings Limited shot up over 30 per cent based on the sudden overwhelming demand for the share. Of course, the reverse would also happen when supply is greater than demand. Investors offering the share on the market would have to drop the price of the share in order to meet the price the buyers are willing to pay for the share in question.

The float of shares is another important factor which influences the price of the share. If a Company that is high in demand has a limited amount of shares in the hands of the public, strong demand together with extreme unavailability of the share would result in strong increases in the price of the share.

For example, a very famous question is why is it that Republic Bank Limited's (RBL) price is so much higher than RBTT Financial Holdings Limited (RBTT). Of course, one has to take this pricing into context. Republic Bank Limited has an outstanding share capital of 159,887,876 in comparison to RBTT's 343,504,814. Of this number, approximately 67 per cent is held by substantial interests for RBL compared to 28 per cent for RBTT (See Figure 2). Hence, the shares trading freely on the market are considerably less for RBL in relationship to RBTT.

This is one of the reasons RBL rose to a high of \$113.26 in 2005. The overwhelming demand for the share, together with the lack of availability for the share drove the share to a price at which a great premium had to be paid for the share. Because RBTT has a much bigger float, though demand will cause the price to increase, any profit taking by investors will quicker influence the price of the share as demand and supply factors are faster reflected in this Company's share price due to the liquidity of the share.

Figure 1



General news affecting the Company can also severely impact the price of a share. For example, when news of the sale of sub standard cement produced by Carib Cement Company Limited (CCC) (a subsidiary of Trinidad Cement Limited (TCL)), became public news in Jamaica and there was speculation that the firm could face possible liability claims which could run into hundreds of million of Jamaican dollars, CCC's share price fell by more than 50 per cent. This was exacerbated by the fact that the Minister of Commerce and Technology in Jamaica made public the fact that he intended to review the monopoly CCC enjoyed in the Jamaica market.

The fall came as this news questioned the ability of the Company to be able repay its expansion loan due to the fact that any loss of market share would impact the Company's earnings. The uncertainty surrounding the Company at that point in time caused investors to sell the shares which resulted in the downward movement of the price. Once a press conference was held to explain the course of action to be taken by the Company and the public was reassured that the Company would be able to deal with any lawsuits against them, there was some settling of the price of CCC.

News from key figures in a Company therefore also plays an important role in the price of a share. For example, when Lawrence Duprey announced Angostura's intention to conclude a 300 million Euro deal through their investment in Belvedere, the price climbed from \$5.77 to \$7.50. The rise in price came despite the fact that at that point in time Angostura was already trading at a high price/earnings ratio of 22 as investors speculated on the news of the deal.

Speculative buying also occurs in instances where investors invest in a stock that carries a high risk due to uncertainties surrounding the Company. In our market, this usually occurs with shares that are numerically low in price and investors buy the share in order to make a 'quick' profit in a short period of time. A classic example of this is the

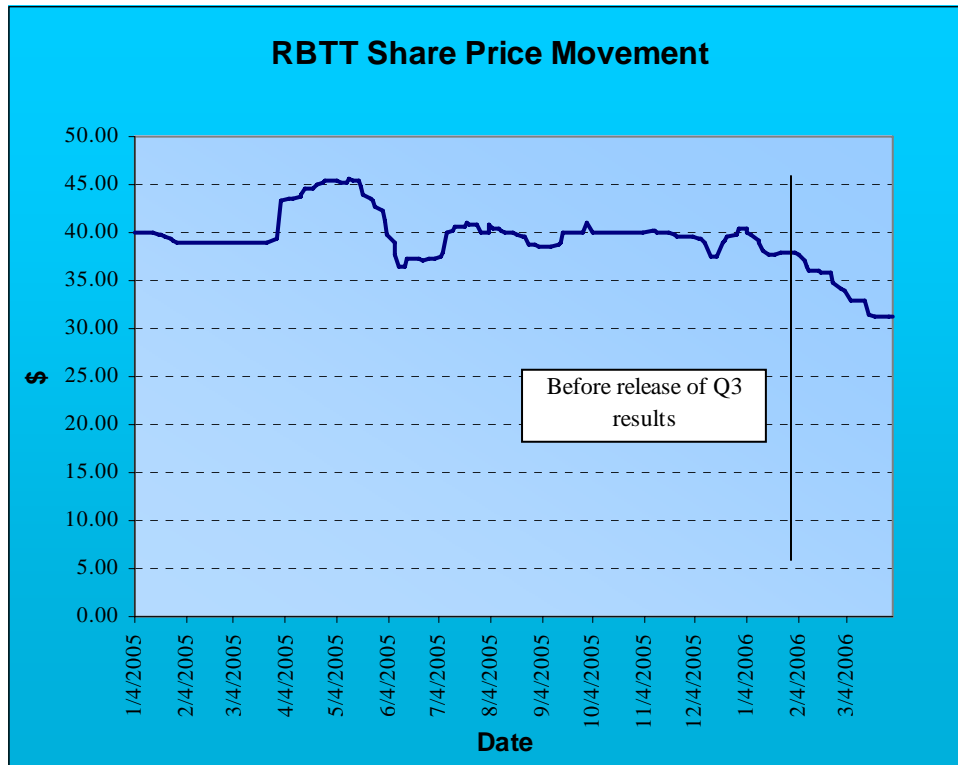
movement of the price of BWIA. In the National Budget of 2005-2006 the Prime Minister outlined his decision to create a new National entity using a restructured BWIA as a basis. Though this Company has historically had problems with its earnings, investors bought the share under speculation that the new entity would be profitable. The share price moved over 185 per cent to 97 cents until it was suspended in November.

Also playing an important role in the price movement of shares is the general sentiment of the market. A depressed market could overreact to disappointing results and even create hesitation with respect to investing in a Company that has produced good results. For example, Guardian's disappointing results together with the depressed state of the market drove the share price down to trade at a multiple of 9.74 where as upon the release of stellar results from Ansa McAl in which its Earnings Per Share grew 45 per cent from \$1.80 to \$2.61, there has been little movement in the share price of this Company. This is despite the fact that a forecasted EPS of \$3.25 places this share at an attractive price/earnings ratio of 12.92.

All of the factors above are basically technical and would result in short term movements in the price of shares as they affect demand and supply. An investor's decision to buy or sell a share is fundamentally governed by the earnings of the Company (both current and expected). A Company producing less than favourable results can see some depression in its share price as investors sell off or sell down their shareholding in the share and vice versa. For example, when RBTT Bank Limited released its third quarter results for its Fiscal Year 2006, the results were not as expected. After two quarters of impressive growth, the disappointing results resulted in the share price moving down breaking through its previous 52 week low of \$36.37 (See Figure 1) as investors reacted to the results at hand. Based on the third quarter results, expectations that the Company's year end results would be flat kept the price of the share down.

The price at which a Company trades would stem from confidence in the underlying earnings potential of the Company. This confidence would be the result of positive past earnings growth of a Company and the future prospects of the Company given the climate in which it operates and the Company's plans for development and expansion. This is because a Company's earnings and expectation of earnings would govern the price/earnings ratio at which it would trade. When a Company's earnings grow, the price/earnings multiple at which it currently trades is reduced leaving room for growth and therefore positive appreciation to a new fundamental price.

Figure 2



It is unequivocal that the movement of share prices is not governed by any one factor. On the technical side, it is really the investor, and his reaction to various factors that influence the movement of a share through his decisions to buy or sell. However, while the technical factors would result in short lived movements in the share price of the Company, the fundamental influence of a Company's share price which comes from the Company's earnings, and its ability to sustain and grow its profits in order to create value for its shareholders, is the basis upon which a Company would find its fundamental and more sustainable trading value.