Title: EFFECTS OF DEMOGRAPHIC CHANGES ON EQUITY RETURNS: THE KENYAN CONTEXT

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ABSTRACT

Modigliani's Life Cycle Hypothesis (LCH) predicts that demographic variables should play a significant role in affecting asset prices through consumption patterns. Understanding this relationship is particularly important given the demographic changes expected in the next few decades. The asset under study is the Nairobi Securities Exchange 20-Share Index (NSE-20) with the assumption that it is well diversified. The Johansen cointegration approach and Vector error correction model are employed to determine if there is a long run and short term relationship between the stock market returns and the demographic variables. The study covers a period of 50 years from 1964 to 2013 to capture the movements in the low frequency demographic variables. The analysis shows that there is a significant long and short run relationship between demographic changes and equity returns. This will be a useful insight in influencing investors to factor in long run relationships in their decision making.