Title: Return Volatility and the Pricing of Equities at the Nairobi Securities Exchange

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Abstract

The study is an empirical test of asset pricing theory, which postulates that volatility is priced if a positive relationship exists between asset returns and their volatility. The asset under study is the Nairobi Securities Exchange 20-Share Index (NSE-20), which is assumed to be a well-diversified portfolio. Data from daily values of the NSE-20 were collected over a 15 year period from January 1999 to December 2013, and from these data, monthly returns were computed. Two models of the Auto-Regressive Conditional Heteroscedasticity-in-Mean (ARCH-M) family allowed the study to specify volatility conditionally. The study finds that monthly NSE-20 returns are not normally distributed and exhibit volatility clustering. A positive and significant relationship between risk and returns is found; indicating that volatility is priced. The study hopes to be useful to portfolio managers when carrying out a forward-looking valuation of a well-diversified portfolio of Kenyan stocks as well as other similar stocks based on market characteristics.