



INVESTMENT IN STOCKS AND FINANCIAL PERFORMANCE OF INVESTMENT FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE (NSE)

Mwashumbe, C B. ¹, Agong, D.O ², and Kimani E. M³, *

¹MBA Student- Jomo Kenyatta University of Agriculture and Technology

^{2, 3} Lecturers-Jomo Kenyatta University of Agriculture and Technology

Abstract

The financial performance of investment firms listed on the Nairobi Securities Exchange (NSE) is strongly influenced by their stock investment strategies. Poor allocation and exposure to volatility have led to declining profitability and weakened investor confidence. Approximately 60% of NSE-listed investment firms reported profit declines in the past five years, alongside a 12% reduction in foreign investment inflows. Guided by Modern Portfolio Theory (MPT), this study examined the effect of stock investments on the financial performance of NSE-listed firms, measured using Return on Equity (ROE). A descriptive research design and census approach were applied to all five investment firms listed between 2014 and 2023. Secondary data was collected from audited financial reports, NSE records, and Capital Markets Authority publications. Panel regression and diagnostic tests ensured statistical robustness. Results revealed that stock investments significantly and positively influence financial performance, though with notable exposure to volatility risks. The study concludes that well-managed equity portfolios enhance profitability and investor trust. Findings provide practical implications for firms, regulators, and policymakers seeking to strengthen investment practices in emerging markets.

Key Words: Investment in Stocks, Financial Performance, Investment Firm, Nairobi Securities Exchange

1. Introduction

The financial performance of investment firms listed on the Nairobi Securities Exchange (NSE) is a critical indicator of their profitability, operational stability, and overall contribution to economic growth. It not only reflects the firms' internal management efficiency but also signals market confidence and investment attractiveness (Wambui, 2019). Key performance indicators such as Return on Assets (ROA), Return on Equity (ROE), and profit margins are widely used to assess financial health and managerial effectiveness within the investment sector (Gitonga, 2020). Monitoring these metrics enables investors, regulators, and policymakers to evaluate market trends, assess risks, and make informed investment decisions.

In a developing economy like Kenya's, where the capital market serves as a key driver of financial inclusion and private sector growth, the performance of listed investment firms plays a strategic role in shaping the flow of both domestic and foreign capital (Muriuki, 2021). Strong financial performance enhances investor confidence and attracts new capital inflows, which stimulate liquidity, innovation, and competitiveness across the market. Conversely, poor performance can trigger negative investor sentiment, capital flight, and reduced participation in equity markets, factors that can ultimately weaken the country's macroeconomic stability (Kariuki, 2019).

Financial performance is fundamentally shaped by investment strategy, risk exposure, and portfolio management decisions. Inadequate diversification and ineffective risk management mechanisms have been cited as key contributors to declining profitability and rising volatility among investment firms (Mwangi & Muya, 2018). The Nairobi Securities Exchange, being a frontier market, remains highly sensitive to both domestic and global shocks, such as interest rate changes, political instability, and inflation, which amplify the risks associated with stock investments.

Stocks, while offering superior potential for capital appreciation, are inherently volatile and heavily influenced by market dynamics and investor behavior. Equity markets, particularly in emerging economies, tend to experience significant fluctuations in response to shifts in macroeconomic variables and investor sentiment (Maina & Wambui, 2019). For investment firms listed on the NSE, stock investments represent a double-edged sword: they offer opportunities for high returns but also expose firms to systemic risks that can erode profitability.

Effective portfolio management, guided by principles such as diversification and sectoral balance, is therefore crucial to mitigating exposure to market volatility. By strategically allocating resources across industries, regions, and asset classes, firms can reduce unsystematic risks and enhance long-term returns (Mwangi & Muya, 2018). However, empirical evidence suggests that many NSE-listed investment firms continue to underperform despite active participation in the stock market, raising questions about the effectiveness of their portfolio strategies and risk management frameworks.

1.1 Statement of the Problem

Investment firms listed on the Nairobi Securities Exchange (NSE) play a pivotal role in Kenya's capital market by mobilizing savings, channeling investments, and facilitating wealth creation.

However, in the past decade, their financial performance has been marked by inconsistency and declining profitability despite increasing participation in the stock market. Reports from the Capital Markets Authority (CMA) and NSE annual bulletins indicate that between 2018 and 2023, nearly 60% of listed investment firms experienced fluctuating earnings and declining Return on Equity (ROE), largely attributed to exposure to volatile stock investments and weak portfolio diversification practices (CMA, 2023).

While stock investments are expected to enhance profitability through capital appreciation and dividend income, empirical evidence from emerging markets reveals a mixed relationship between equity investments and firm performance. Some studies report a positive correlation between equity intensity and financial performance (Maina & Wambui, 2019; Mutunga & Ochieng, 2020), whereas others document insignificant or even negative relationships due to exposure to high volatility, speculative behavior, and weak governance mechanisms (Kariuki, 2021). These inconsistencies suggest that the link between stock investments and firm performance is not straightforward and may depend on the effectiveness of portfolio management and risk mitigation strategies employed by the firms.

Furthermore, the NSE has undergone significant structural and regulatory transformations aimed at improving transparency, liquidity, and investor protection. However, these reforms have not translated into uniform performance improvements among investment firms. Persistent issues such as limited sectoral diversification, inadequate market research, and overreliance on short-term speculative trading continue to undermine profitability and investor confidence (Mwangi & Muya, 2018). The resulting volatility not only threatens firm-level stability but also weakens the credibility of Kenya's capital markets in attracting long-term investments.

Despite the growing body of literature on financial performance and investment behavior in emerging economies, there remains a scarcity of empirical research focusing specifically on how investments in stocks influence the financial performance of NSE-listed investment firms over time. Most previous studies have either generalized across sectors or failed to account for firm-level variations in portfolio strategies and market exposure. This knowledge gap limits policymakers' and investors' ability to develop evidence-based strategies that enhance stability and performance in Kenya's investment sector.

It is against this background that the present study sought to examine the effect of investments in stocks on the financial performance of investment firms listed on the Nairobi Securities Exchange. By analyzing panel data from 2014 to 2023 and anchoring the investigation on Modern Portfolio Theory, the study aims to provide empirical insights that inform strategic portfolio management, strengthen investment governance, and contribute to the broader discourse on capital market performance in emerging economies.

1.2. Objective of the Study

To assess the effect of investments in stocks on the financial performance of investment firms listed at the Nairobi Securities Exchange.

1.3. Hypothesis of the Study

H₀₁: Investment in stocks have no significant effect on the financial performance of Nairobi Security Exchange listed firms.

2. Theoretical Review

This section reviews key theories relevant to this study.

4.1 Modern Portfolio Theory

Modern Portfolio Theory (MPT), introduced by Harry Markowitz (1952), forms the foundational basis of this study. The theory postulates that investors can maximize returns for a given level of risk, or equivalently, minimize risk for a desired level of return, through diversification of their investment portfolios. The core idea is that combining assets with different levels of risk and return can create an “efficient frontier,” representing the optimal portfolio mix that yields the highest possible expected return at each risk level (Markowitz, 1952). MPT assumes that investors are rational, risk-averse, and make decisions based on expected utility. It distinguishes between systematic risk, which cannot be diversified away (market-related), and unsystematic risk, which is firm- or sector-specific and can be mitigated through diversification. According to the theory, the overall portfolio risk decreases as more uncorrelated assets are added to the portfolio, thereby stabilizing returns over time (Sharpe, 1964).

For investment firms listed on the Nairobi Securities Exchange (NSE), MPT provides a robust framework for structuring portfolios that balance growth potential with volatility exposure. Since the NSE is characterized by moderate liquidity, limited market depth, and sensitivity to macroeconomic fluctuations, portfolio diversification across industries and sectors is essential to achieving sustainable profitability. Through efficient allocation among equities, bonds, and cash equivalents, firms can mitigate exposure to market downturns while capitalizing on high-growth opportunities (Mutunga & Ochieng, 2020).

Empirical evidence strongly supports the applicability of MPT in emerging markets. For instance, Maina and Wambui (2019) found that NSE-listed firms with diversified stock portfolios exhibited greater financial resilience during market shocks compared to those with concentrated holdings. Similarly, Kariuki (2021) observed that excessive exposure to specific equities amplified volatility, leading to reduced returns during economic downturns. Studies in other emerging economies corroborate these findings: Mutunga and Ochieng (2020) reported that firms employing strategic equity diversification achieved superior risk-adjusted returns, while Okafor and Chinedu (2022) found that Nigerian investment companies relying heavily on a single sector experienced higher earnings volatility.

In the context of this study, MPT underscores the need for investment firms to balance their portfolios between high-yield yet volatile assets (such as equities) and stable income-generating assets (such as bonds or money market instruments). The theory suggests that firms optimizing their stock investment strategies through informed diversification and regular portfolio rebalancing are more likely to sustain long-term financial performance.

However, critics of MPT argue that it relies on unrealistic assumptions, such as rational investor behavior, stable correlations among assets, and normally distributed returns, which often do not hold in real-world markets, especially in emerging economies (Fama, 2020). Behavioral biases, market inefficiencies, and sudden macroeconomic shocks frequently distort asset returns in markets like Kenya's. Despite these limitations, MPT remains a useful analytical tool because it provides a structured quantitative basis for balancing risk and return, guiding investment decision-making, and informing empirical analysis.).

2.2 Empirical Review

This section involves reviewing and synthesizing findings from previous studies that focus on real-world evidence, as opposed to purely theoretical discussions.

Maina and Wambui (2019) investigated the effect of stock investments on the financial performance of Kenyan companies listed on the NSE. The study used a descriptive research approach to analyze secondary financial data that was gathered over a period of five years. The study found that diverse portfolios performed better during times of economic stability but were worse during recessions. Businesses with diversified stock investments had higher returns and more financial resilience during periods of stable market conditions. The study however, focused on historical data which disregarded the dynamic nature of emerging countries, limited its ability to predict future market patterns.

Kariuki (2021) assessed how stock market volatility affected the financial performance of businesses listed on the Nairobi Securities Exchange (NSE) in Kenya. The study used a quantitative approach to analyze secondary data from a ten-year period. Businesses that relied heavily on stock investments were shown to be more vulnerable to market swings, which could lead to unpredictable financial outcomes. The study emphasized the need of strategic planning and advanced risk management techniques in lowering these risks. However, because it overlooked significant macroeconomic factors like inflation and interest rates, the study's forecasting accuracy was constrained. However, it was made evident that ongoing market monitoring and adaptable investing strategies are necessary for long-term stability.

Mutunga and Ochieng (2020) conducted a study on the impact of global stocks on Kenyan investment firms' performance. The study used quantitative methodology. Data was collected using secondary methods from financial reports over five years. Researchers applied regression analysis to determine the relationship between global stock investments and financial outcomes. The study found that international stocks improved returns and diversification but were negatively impacted by currency fluctuations and geopolitical risks. The study recommended using financial instruments like derivatives to hedge risks and advised firms to stay informed about global economic trends. The study's reliance on secondary data limited its scope by excluding qualitative factors such as managerial expertise and market strategies.

Wanjiru (2018) investigated how blue-chip stocks could boost Ugandan investment firms' profitability. Employing a quantitative research design, the study examined secondary data from financial statements spanning five years. The study evaluated the connection between financial

performance of the investment firms and blue-chip stock allocations using regression analysis. It was discovered that blue-chip stocks improved businesses' financial resilience during recessions by offering stability and steady returns. The scarcity of these equities in local markets presented a problem, preventing businesses from realizing their full potential.

Mwangi and Muya (2018) conducted a comprehensive study on the effect of growth stocks on the financial performance of South African investment firms. The study used quantities approach and regression analysis to examine financial data over a ten-year period. The analysis found that growth stocks have the most short-term volatility but the best long-term returns, making it challenging for companies to maintain consistent financial performance. It emphasized how important it is to balance growth and income-producing stocks to maintain overall financial stability. Critics to this study argued that it relied on historical data, which may not accurately capture the dynamic nature of financial markets.

2.3 Conceptual framework

The conceptual framework illustrates the hypothesized relationship between investment in stocks and the financial performance of investment firms listed at the Nairobi Securities Exchange (NSE). The study is grounded in Modern Portfolio Theory (Markowitz, 1952), which posits that investors can achieve optimal returns for a given level of risk through diversification of assets. In this study, investment in stocks constitutes the independent variable, while financial performance, measured by Return on Equity (ROE), serves as the dependent variable. The framework assumes that the proportion of total investments allocated to equities directly influences firm profitability and financial stability. Firms that effectively manage their stock portfolios through diversification, risk assessment, and periodic rebalancing are expected to exhibit superior financial performance relative to those with poorly structured portfolios or excessive exposure to volatile stocks.



Independent Variable

Stocks

Investment in stocks refers to the proportion of total investment funds allocated to equity securities. It is operationalized as the ratio of the amount invested in stocks to total investment. This variable captures the firm's exposure to equity markets and reflects its strategic orientation toward capital growth and dividend income. Stock investments provide opportunities for capital appreciation and steady income through dividends; however, they also expose firms to market volatility and valuation risks. According to Modern Portfolio Theory, diversification across sectors and industries mitigates unsystematic risk, enabling firms to optimize returns while minimizing losses (Markowitz, 1952). Empirical studies have established both positive and negative relationships

Dependent Variable

between stock investment and firm performance. Maina and Wambui (2019) found that diversified stock portfolios enhanced resilience and profitability among NSE-listed firms, while Kariuki (2021) cautioned that overconcentration in specific stocks heightened exposure to volatility and reduced returns. Therefore, the effectiveness of stock investment as a performance driver depends on the firm's ability to balance risk and reward through strategic portfolio management.

Financial Performance of Investment Firms

Financial performance refers to a firm's ability to generate sustainable returns from its investment activities. In this study, it is measured using Return on Equity (ROE), defined as the ratio of net income to shareholders' equity. ROE serves as a key indicator of how efficiently management utilizes shareholders' funds to generate profits. A higher ROE indicates effective asset utilization and strategic investment allocation, whereas a lower ROE signals inefficiencies in resource deployment or excessive exposure to unproductive investments. Studies such as Muriuki (2021) and Kipkemoi and Kiprotich (2020) affirm that firms with optimized asset allocation and prudent equity management tend to report higher profitability and investor confidence. Within the context of the NSE, financial performance is influenced not only by internal management decisions but also by external factors such as economic cycles, policy shifts, and investor sentiment. Therefore, analyzing the relationship between stock investment levels and ROE provides critical insights into how investment strategies shape firm profitability in a volatile market environment.

3. Methodology

This section covers research design, population of the study, sample and sampling techniques, data collection instruments, collection procedures, data processing and analysis.

3.1 Research Design

This study adopted a descriptive research design, suitable for examining the relationship between stock investment levels and financial performance among investment firms listed on the Nairobi Securities Exchange (NSE). The design enables both quantitative analysis and interpretive insight, aligning with the study's dual goals of empirical validation and strategic relevance.

3.2 Population of the Study

The population for this study consisted of all the five investment firms that were listed on the Nairobi Securities Exchange (NSE) between 2014 and 2023.

3.3 Data Collection Instruments

This study utilized secondary data which was collected using a secondary data collection sheet. Data was sourced from financial statements, annual reports, and relevant economic reviews of firms listed on the Nairobi Securities Exchange (NSE). Additional sources included company financial reports from the NSE and Capital Markets Authority (CMA), published research papers and dissertations, government reports and policy documents related to investment performance, and stock market data from the NSE website.

3.4 Census Technique

This study used a census technique to gather information from all investment businesses listed on the Nairobi Securities Exchange (NSE). Given the small number of NSE-listed companies, a census is both realistic and doable. It allows for a complete review of financial performance patterns across the industry, improving analysis accuracy and increasing the validity of the study's findings. Furthermore, this approach avoids sampling bias, guaranteeing that the findings are representative of the entire population.

3.5 Data Processing and Analysis

After data collection, the study used a structured method to process data and analysis. The first steps in data processing was data cleaning and validation, during which errors, missing numbers, and inconsistencies will be found and fixed. After cleaning, the data was normalized and grouped for effective analysis. To enhance accuracy and clarity, SPSS and Microsoft Excel were used for statistical computations, data visualization, and trend analysis. Both descriptive and inferential statistical techniques were used in the analysis.

The following regression model was applied.

$$Y = \alpha + \beta_1 X_{it} + \varepsilon_{it} \dots\dots\dots \text{Equation 1}$$

Where:

Y represents financial performance

α represents the intercept

β_1 represents regression coefficient of independent variable

X_1 represents Investment in bonds

it represents firm i in time t

ε represents Error term

3.6 Research Findings and Discussion

This section presents the findings from data analysis and interpretation to investigate the relationship between portfolio and financial performance of Investment firms listed at Nairobi Securities Exchange.

4. Descriptive Statistics

Descriptive statistics were used to summarize the regression panel data and identify underlying patterns. These statistics comprised dispersion measures like standard deviation, minimum and maximum values, central tendency indicators like the mean, and distributional metrics like skewness and kurtosis. Table 1 depicts the descriptive statistics results

Table 1: Descriptive Statistics results

Variable	Minimum	Maximum	Mean	Std. Dev	Skewness	Kurtosis
Investment in Stocks	0.3396	0.3946	0.3470	0.0171	-0.1020	1.7240
Investment in Real Estate	0.2258	0.2323	0.2272	0.0024	0.0510	2.3657
Cash Equivalents	0.1462	0.1483	0.1467	0.0006	0.0392	2.2336
Investment in Bonds	0.2709	0.2911	0.2781	0.0041	-0.1884	2.0526
N	50					

The descriptive statistics revealed that investment in stocks among NSE-listed investment firms ranged between 33.96% and 39.46%, with a mean allocation of 34.7%. This indicates that, on average, firms allocated more than one-third of their total investment portfolio to equities, reflecting a moderate-to-aggressive investment stance. The low standard deviation (0.0171) suggests that firms maintained relatively consistent stock investment policies over time, possibly guided by long-term strategic objectives rather than short-term speculation. The negative skewness (-0.102) implies that a few firms invested less than the average proportion, while the kurtosis value (1.724), being lower than 3, indicates a relatively flat distribution, signifying stable investment patterns without extreme deviations. These results are consistent with Modern Portfolio Theory (Markowitz, 1952), which advocates diversification to balance risk and return. The moderate yet stable allocation of equities observed in this study reflects firms' attempts to achieve an optimal trade-off between profitability and volatility. Similar findings were reported by Maina and Wambui (2019), who observed that firms maintaining diversified and moderately weighted stock portfolios achieved improved financial resilience and sustained growth. Likewise, Mutunga and Ochieng (2020) emphasized that firms investing consistently in equities, while managing risk exposure, tend to outperform those with erratic or overly concentrated stock positions. The findings therefore imply that NSE-listed investment firms generally adhere to prudent portfolio management practices, aligning with the strategic principles recommended in prior empirical literature.

Although this section focuses on investment proportions, the observed stability in stock investment allocation has direct implications for the financial performance of investment firms. The consistency in equity exposure suggests disciplined portfolio management, which enhances predictability in returns and strengthens investor confidence. This observation aligns with Kipkemoi and Kiprotich (2020), who found that disciplined investment behavior and stable asset allocation strategies positively influence Return on Equity (ROE) among NSE-listed firms. Similarly, Muriuki (2021) demonstrated that maintaining a balanced mix of equity and fixed-income investments reduces income volatility and supports long-term profitability. Moreover, the moderate stock exposure observed in this study supports the argument by Kariuki (2021) that excessive concentration in equities can increase vulnerability to market downturns, whereas a balanced allocation promotes sustainable returns. Consequently, the findings indicate that the financial performance of investment firms in the NSE is likely enhanced by prudent management

of stock investments, consistent with the Modern Portfolio Theory framework and prior empirical studies emphasizing diversification as a key determinant of profitability.

4.1 Correlation Analysis

Pearson correlation analysis was performed to examine the direction and strength of the linear relationships between stock and financial performance (ROE). The results are presented in Table 2

Table 2: Pearson Correlation Matrix

	ROE	Stocks
ROE	1	
Sig. (2-tailed)	,	
N	50	
Stocks	.594	1
Sig. (2-tailed)	.000	,
N	50	50

The positive and significant correlation coefficient ($r = 0.594$, $p < 0.01$) between investment in stocks and Return on Equity (ROE) indicates that higher equity allocations are strongly associated with improved financial performance among NSE-listed firms. This finding aligns with Maina and Wambui (2019), who found that firms maintaining well-diversified stock portfolios experienced enhanced profitability due to capital appreciation and dividend income. Similarly, Mutunga and Ochieng (2020) reported a positive association between equity investments and firm performance in emerging markets, emphasizing that strategic portfolio diversification minimizes unsystematic risk and stabilizes returns. The result also supports the Modern Portfolio Theory (Markowitz, 1952), which asserts that optimal asset allocation enhances returns for a given level of risk. Conversely, it contrasts with Kariuki (2021), who observed that excessive concentration in equities exposed firms to heightened volatility. Therefore, this study reinforces the view that prudently managed stock investments are a major determinant of profitability among investment firms listed on the Nairobi Securities Exchange.

4.2 Regression Analysis for Effect of Investment in Stocks on Return on Equity

To evaluate the relationship between investment in stocks and financial performance, panel regression analysis was conducted. The analysis aimed to determine whether investment in stocks significantly influences return on equity (ROE). The findings are shown in Table 3

Table 3: Regression Results for Investment in Stocks on ROE

ROE-Stocks	Coef.	St. Err.	T-value	P-value
Investment in stocks	0.462	0.089	5.230	0.000
Constant	0.102	0.025	4.080	0.000
R-squared	0.353			
F-test	27.356			
Prob > F	0.000			
Number of observations	50			

The regression analysis established that investment in stocks exerts a positive and statistically significant influence on Return on Equity (ROE), with a coefficient of 0.462 and a p-value of 0.000, confirming significance at the 1% level. This implies that as firms increase their proportion of investment in equities, their profitability tends to rise correspondingly. The R-squared value of 0.353 indicates that stock investments explain 35.3% of the variability in financial performance among NSE-listed firms.

These results are consistent with findings by Davis and Thompson (2021), who emphasized that equity investments significantly enhance firm value and shareholder returns in developing capital markets when guided by data-driven portfolio strategies. Similarly, Kim and Lee (2019) found that diversified equity portfolios contribute positively to firm profitability by optimizing risk-return trade-offs, particularly in volatile markets. In addition, O'Connor and Brown (2019) reported that firms adopting strategic equity allocation frameworks outperformed peers that relied heavily on short-term speculative investments.

The observed positive relationship also aligns with Fama (2020), who argued that well-informed participation in efficient stock markets enables firms to capture long-term value through price appreciation and dividend flows. Collectively, these findings reinforce the proposition that prudent stock investment strategies, grounded in sound financial analysis and diversification principles, are vital drivers of profitability and sustainable performance among investment firms listed on the Nairobi Securities Exchange.

5. Summary of the Findings

The findings align with Modern Portfolio Theory, affirming that diversified and strategically managed equity portfolios enhance firm-level returns. Investment firms that actively rebalance and optimize their stock holdings demonstrate superior financial outcomes, validating the role of portfolio management as a core driver of profitability. From a governance perspective, the results highlight the need for board-level oversight of investment strategy. Firms with clear asset allocation policies and performance benchmarks tend to outperform, suggesting that strategic clarity and execution discipline are critical. In the Kenyan context, these insights are particularly relevant given the NSE's evolving regulatory framework and the push for institutional transparency. Investment firms that leverage data-driven equity strategies not only improve shareholder value but also contribute to market stability and investor confidence.

6. Conclusion of the Study

This study examined the relationship between stock investment strategies and financial performance among investment firms listed on the Nairobi Securities Exchange (NSE). The findings revealed a strong, statistically significant correlation between equity investment intensity and Return on Equity (ROE). Anchored in Modern Portfolio Theory and supported by empirical evidence, the results affirm that strategic equity allocation is not merely a financial tactic but a core driver of institutional performance. Investment firms that actively manage their stock portfolios balance risk, timing and diversification consistently outperform their peers. In the Kenyan context, where capital markets are maturing and regulatory oversight is tightening, these

insights carry weight. They underscore the need for data-driven investment governance, robust portfolio analytics, and executive-level accountability in asset management.

7.Recommendations of the study

The study recommends that NSE-listed firms put a greater focus on investment in stocks. The findings demonstrated that investing in equities had a statistically significant and favorable effect on financial performance, particularly the Return on Equity (ROE). Stocks have the potential for capital gains and dividend income, which can contribute significantly to firm profitability. It is therefore advised that Firms should therefore strengthen their equity analysis and adopt dynamic stock selection strategies that align with both market trends and firm risk tolerance. Diversifying stock holdings across industries and geographies can help reduce market-specific risks and increase long-term return potential.

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