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Tactical Portfolio Adjustments and Profitability of Member Firms of the Nairobi Securities Exchange, Kenya

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ABSTRACT

Tactical portfolio adjustments within the Portfolio hedging aims to reduce the risks linked to market volatility, safeguarding investments from potential losses. It enables firms to maintain a well-balanced portfolio by employing strategies that offset unfavorable price movements in specific assets or market segments. As a result, the profitability of brokerage firms depends on how effectively they manage these risks. Member firms of the Nairobi Securities Exchange (NSE) are essential in enabling securities trading within Kenya's capital markets. However, despite their important role in the country's financial sector, challenges in managing portfolio risks have impeded their growth. The current study was undertaken to assess the effect of tactical portfolio adjustments on profitability of member firms of the Nairobi Securities Exchange. The study was anchored on modern portfolio theory. A descriptive research design was adopted to systematically capture and analyze the phenomenon. The target population comprised member firms of the Nairobi Securities Exchange. Data was collected using a questionnaire and analysis was aided by SPSS. The study utilized both descriptive and inferential methods for data analysis. The results revealed that tactical portfolio adjustments ($r = 0.735$, $p = 0.000$) had strong and positive relationships with profitability. The coefficient of determination was ($R^2 = 0.540$), indicating that tactical portfolio adjustments explained 54% of the variation in profitability. This demonstrates that profitability is to a great extent determined by tactical portfolio adjustments. The study concludes that tactical portfolio adjustments play a central role in stabilizing earnings and enhancing financial resilience among firms at the Nairobi Securities Exchange. It is recommended that member firms of the Nairobi Securities Exchange deepen the integration of portfolio hedging into their investment strategies to balance risks with sustainable returns and profitability.

Key Words: Portfolio hedging, Profitability, Member firms of the Nairobi Securities Exchange, Tactical portfolio adjustments.

1. INTRODUCTION

Portfolio hedging serves as a protective mechanism that shields investments from adverse market movements, thereby reducing both risk exposure and the likelihood of significant financial losses (Syahputra, 2023). Through the careful balancing of exposures across different risk factors, firms are able to cushion themselves against the disruptive effects of volatility and broader economic uncertainties. Hedging practices often extend to diversification, where investments are spread across multiple asset classes, sectors, or geographic regions to ensure that risk is not concentrated in one area. As Martinsuo and Vuorinen (2022) note, the central objective of diversification is to establish a portfolio that is more stable and resilient, capable of preserving value and maintaining performance even when markets fluctuate. Within this broader framework, portfolio hedging also incorporates tactical portfolio adjustments, which allow institutions to realign asset allocations in response to evolving market conditions while maintaining the long-term stability of the investment strategy. Tactical portfolio adjustments involve strategically shifting the asset allocation of a portfolio in response to short-term market opportunities or evolving economic conditions (Ruano & Barros, 2022).

Unlike long-term strategic allocation, which emphasizes stability and consistency, tactical adjustments are dynamic and flexible, allowing institutions to take advantage of temporary dislocations or emerging trends in the market. These adjustments may be driven by factors such as shifts in interest rates, inflation expectations, regulatory changes, or sector-specific developments that temporarily alter the risk-return landscape. By reallocating resources in line with these conditions, institutions are able to capture additional returns, protect against short-term risks, and enhance overall performance. While the objective is not to overhaul the long-term investment strategy, tactical adjustments provide a mechanism for aligning portfolios with prevailing market realities, thereby ensuring responsiveness, agility, and resilience in uncertain environments.

Member firms of the Nairobi Securities Exchange (NSE) execute buy and sell orders, managing investment portfolios, and delivering advisory services to both institutional and individual investors. These firms play an essential role in sustaining market liquidity while ensuring adherence to regulatory requirements. Beyond these core functions, they also provide a diverse range of financial products and services tailored to the evolving needs of investors within Kenya’s expanding economy. Despite their importance, NSE member firms continue to grapple with profitability challenges, which have been compounded by rising capital requirements alongside increasing regulatory and reporting complexities. Evidence from audited financial statements illustrates this concern: in 2022, ABSA Securities Limited posted losses of Kshs. 10.363 million; SBG Securities recorded a dramatic 91% decline in profitability, falling from Kshs. 153.9 million in 2023 to Kshs. 14.7 million in 2024; and in 2023, both Francis Drummond & Co. Ltd and Geghis Capital Limited reported losses of Kshs. 1 million and Kshs. 13.957 million, respectively. Collectively, these outcomes underscore weak profitability across NSE member firms.

Nonetheless, research on the relationship between portfolio hedging strategies and profitability among NSE member firms remains limited. For instance, Muema (2023) explored firm-specific factors and their influence on financial performance within commercial and services firms listed on the NSE, while Ngetich and Mbuva (2023) investigated the effect of inflation on securities market performance, establishing that inflation exerted a negligible influence on market returns. However, such studies have not adequately addressed how tactical portfolio adjustments shape profitability in the context of NSE member firms. To fill this gap, the present study examined the effect of tactical portfolio adjustments on the profitability of Nairobi Securities Exchange member firms.

2. OBJECTIVE OF THE STUDY

The objective of the study was to examine the effect of tactical portfolio adjustments on profitability of member firms of the Nairobi Securities Exchange.

3. LITERATURE REVIEW

Tactical portfolio adjustments represent a dynamic approach to portfolio management applied within portfolio hedging, where asset allocations are actively modified to respond to short-term changes in market conditions (Kanuri, Malm, & Malhlotra, 2021). This approach entails altering the portfolio structure in order to seize emerging opportunities or mitigate risks arising from factors such as interest rate shifts, inflationary pressures, or geopolitical events. Unlike strategic asset allocation, which is typically long-term and relatively stable, tactical adjustments emphasize exploiting short-lived market inefficiencies or imbalances to enhance returns or reduce exposure to adverse developments. Through timely modifications in asset exposure—such as increasing investment in one class while reducing another—investors strive to optimize the overall risk-return profile of the portfolio and insulate it from short-term fluctuations in the market environment (Vaskikari, 2020).

Liquidity considerations form an integral part of tactical portfolio adjustments, requiring modifications in asset allocation based on an investor’s liquidity requirements or expectations regarding market liquidity conditions. Liquidity denotes the ease and speed with which an asset can be converted into cash without causing a significant impact on its price (Lorini, 2023). During times of economic uncertainty or heightened market turbulence, liquidity often becomes constrained, making it harder to liquidate holdings swiftly at favorable valuations. Tactical liquidity adjustments therefore involve shifting the balance between liquid and less liquid assets, such as increasing positions in cash reserves, government securities, or large-cap equities to enhance accessibility, or reducing them when liquidity

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risks are lower. For instance, if liquidity tightening is anticipated, investors may deliberately move toward highly liquid assets to ensure sufficient cash availability when required (Kanuri et al., 2021).

Interest rate sensitivity plays a significant role in tactical portfolio management, particularly in the context of fixed-income securities like bonds. Because fluctuations in interest rates directly influence bond prices, tactical adjustments seek to realign portfolio holdings in anticipation of rate changes (Freitas & Bertini Junior, 2021). In scenarios where rising interest rates are projected, investors might scale back their exposure to long-term bonds or other rate-sensitive investments, as these are more likely to suffer price declines. On the other hand, when falling interest rates are expected, tactical strategies may include increasing allocations to long-duration bonds, which typically benefit from a declining interest rate environment. These adjustments are crucial in ensuring the portfolio remains resilient under shifting monetary conditions. Volatility, understood as the degree of price variability in financial assets, is another key factor influencing tactical portfolio adjustments (Peláez, 2021). Periods of elevated volatility often bring about rapid price swings, which simultaneously present potential risks and opportunities for investors. Managing volatility through tactical reallocation involves adjusting exposure to higher-risk or lower-risk assets depending on prevailing conditions. For example, during phases of high volatility, investors may scale down positions in riskier assets such as speculative equities or commodities, and instead expand their exposure to safer, lower-volatility holdings, including government bonds or dividend-oriented equities (Vaskikari, 2020). By doing so, investors aim to stabilize portfolio performance while navigating unpredictable markets. Modern Portfolio Theory (MPT), pioneered by Harry Markowitz in 1952, transformed portfolio management by introducing a quantitative framework for optimizing investments. At its core, MPT posits that investors can construct portfolios that either maximize returns for a given level of risk or minimize risk for a desired return. A central tenet of the theory is diversification, where combining assets with varying risk profiles reduces the overall portfolio risk (Liu, 2024). Rather than focusing solely on the individual risks of assets, MPT emphasizes the role of correlations among asset returns in shaping portfolio risk exposure. A key contribution of MPT is the concept of the efficient frontier, which identifies the set of portfolios that deliver the highest expected return for a given level of risk or the lowest possible risk for a given expected return (Maqbool & Husnain, 2022). This framework enables investors to allocate capital strategically across asset classes such as equities, bonds, and alternative investments. Underpinning the theory is the assumption that investors are rational and risk-averse, preferring lower risk when returns are equal and making deliberate trade-offs between risk and reward (Liu, 2024). Building on these principles, MPT underlies portfolio hedging strategies aimed at strengthening the risk–return balance. One such approach is tactical portfolio adjustment, which allows investors to make short-term reallocations in response to changing market conditions, such as shifting asset weights to capitalize on anticipated economic or market trends (Maqbool & Husnain, 2022). Figure 1 represents the relationship between tactical portfolio adjustments and profitability of the member firms of the Nairobi Securities Exchange.

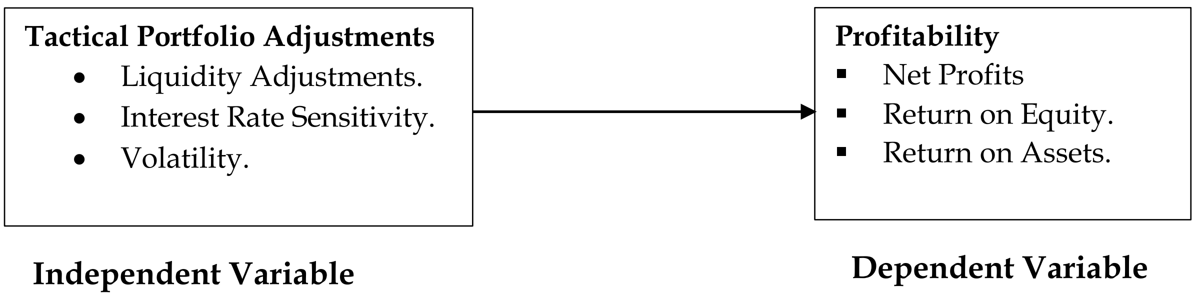

Figure 1: Conceptual Framework

The review of empirical studies related to tactical portfolio adjustments has been conducted. Muema (2023) aimed to examine the impact of firm-specific factors on the financial performance of commercial and services firms listed on the Nairobi Securities Exchange. The study covered a ten-year period from 2012 to 2021 and utilized secondary data. A descriptive research design was adopted, and panel data techniques were employed to conduct descriptive and diagnostic tests, as well as regression analysis. The findings revealed that leverage affected financial performance through its impact on the firm's capital structure, while firm age and asset tangibility contributed to enhanced stability

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and operational efficiency. Additionally, liquidity was found to be vital in ensuring firms could meet short-term obligations, and firm size was associated with economies of scale and increased market power.

Matara (2023) capital structure, profitability, size and value of non-financial firms listed at the Nairobi Securities Exchange. Prais-Winsten panel regression was applied for the inferential analysis. The study found a positive and statistically significant relationship between equity ratio and firm value ($R^2 = 0.3590$, $p < 0.05$), while the relationship between debt ratio and firm value was negative and significant ($R^2 = 0.3590$, $p < 0.05$). Additionally, the study revealed that profitability does not mediate the relationship between capital structure and firm value ($R^2 = 0.0302$, $p > 0.05$). Regarding moderation, firm size was found to have no moderating effect on the relationship between capital structure and firm value ($R^2 = 0.5248$, $p > 0.05$). However, when considered together, capital structure, profitability, and firm size collectively influenced firm value ($R^2 = 0.5461$, $p < 0.05$).

Maranga, Ngali, and Wepukhulu (2022) conducted a study on the product diversification and profitability of listed commercial banks in Kenya. The study finds a strong link between product diversity; bancassurance, financial securities, real estate, and trade finance and profitability (ROA) in commercial banks listed on the Nairobi Stock Exchange. Increased product variety is associated with higher profitability, with all study factors showing a positive impact on the profitability of Kenya's publicly traded banks. The aspects of volatility and interest rate sensitivity within portfolio adjustments were overlooked thus limiting the comprehensiveness of the study. The reviewed studies offer valuable insights into factors such as firm-specific characteristics, capital structure, and diversification in relation to financial performance; however, they did not adequately address the critical aspects of tactical portfolio adjustments that shape profitability in volatile market environments. Important elements such as tactical liquidity adjustments, which respond to shifting liquidity needs under changing conditions, were overlooked. Similarly, the role of interest rate sensitivity, which determines how portfolios are realigned in anticipation of rate fluctuations, was not considered. The current study addresses these gaps by examining portfolio hedging, with particular focus on tactical portfolio adjustments, and their effect on profitability.

4. RESEARCH METHODOLOGY

The study adopted a descriptive research design, which systematically describes a phenomenon, situation, or population. It was well-suited for examining tactical portfolio adjustments and profitability, as it enabled the collection of detailed information on how different practices were applied and the profitability outcomes associated with them. By providing a snapshot of prevailing practices, the design highlighted relationships without altering any variables. The target population comprised the 17 member firms of the Nairobi Securities Exchange, with each firm serving as the unit of analysis. The unit of observation were 51 risk managers, investment managers, and finance managers drawn from these firms. The study utilized questionnaires as the primary method of data collection. The study employed both descriptive and inferential methods for data analysis, which was aided by the Statistical Package for Social Sciences (SPSS). The regression analysis was conducted based on the following model:

$Y= \beta_0 + \beta_1 X_1 + \varepsilon$;

Where;

Y= Profitability

β_0 represents the constant

β_1 represents beta coefficient

X_1 represents tactical portfolio adjustments

ε represents error of margin

5. RESULTS

This findings and discussions on tactical portfolio adjustments and profitability of the member firms of the Nairobi Securities Exchange are presented in this section. They comprise the descriptive and inferential findings of the study.

5.1 Descriptive Findings and Discussions

The study sought to analyze the effect of tactical portfolio adjustments on profitability of member firms of the Nairobi Securities Exchange. The findings are presented in Tables 1 and 2:

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Table 1: Effect of Tactical Portfolio Adjustments on Profitability of Member Firms of the Nairobi Securities Exchange

	N	SA	A	N	D	SD	Mean	Std. Dev.
We adjust our investment portfolio tactically based on market trends.	46	41.3%	45.7%	8.7%	4.3%	0%	4.24	0.794
Tactical portfolio adjustments help in responding quickly to market volatility.	46	30.4%	58.7%	6.5%	4.3%	0%	4.15	0.729
Liquidity adjustments are essential for managing portfolio risk during market fluctuations.	46	26.1%	43.5%	19.6%	4.3%	6.5%	3.78	1.094
Our portfolio is highly sensitive to fluctuations in interest rates.	46	32.6%	30.4%	17.4%	8.7%	10.9%	3.65	1.320

According to the findings, 41.3% of the respondents agreed while 45.7% also concurred, hence 87% at least agreed (Mean = 4.24; Std. Dev. = 0.794), that they adjust their investment portfolio tactically based on market trends. This outcome implies that tactical repositioning enables firms to capture short-term alpha opportunities while mitigating downside risks, thereby sustaining profitability through active reallocation of capital in line with prevailing market dynamics. Moreover, 89.1% of the respondents in total agreed (Mean = 4.15; Std. Dev. = 0.729) that tactical portfolio adjustments help in responding quickly to market volatility. The finding underscores the importance of agility in portfolio management, where rapid adjustments allow firms to exploit arbitrage windows, preserve capital, and protect earnings against sharp drawdowns.

Although 43.5% of the respondents agreed, 19.6% had differing views (Mean = 3.78; Std. Dev. = 1.094) that liquidity adjustments are essential for managing portfolio risk during market fluctuations. This mixed perspective indicates that while liquidity management enhances the ability to meet margin calls, reallocate assets, and reduce exposure to illiquid positions, its effect on profitability is contingent on prevailing market depth and transaction costs. 30.4% of the respondents agreed that their portfolios are highly sensitive to fluctuations in interest rates. This finding reflects the reality that interest rate volatility directly affects the cost of capital, discount rates, and asset valuations. Increased sensitivity can compress net interest margins and reduce earnings, particularly for leveraged positions, thereby undermining profitability unless adequately hedged through duration management or interest rate derivatives.

Table 2: Profitability

	N	SA	A	N	D	SD	Mean	Std. Dev.
Over the past five years, our return on assets has shown consistent growth.	46	47.8%	37%	6.5%	8.7%	0%	4.24	0.923
The increase in our company's profit margins can be attributed to effective portfolio management.	46	39.1%	50%	10.9%	0%	0%	4.28	0.655
Our company has achieved steady returns on equity over the last five years.	46	37%	43.5%	15.2%	2.2%	2.2%	4.11	0.900
The profitability informed by the ability to adapt to market changes.	46	54.3%	34.8%	6.5%	2.2%	2.2%	4.37	0.878

The findings indicated that 47.8% of the respondents strongly agreed while 37% concurred thus 84.8% at least agreed (Mean=4.24; Std. Dev.=0.923) that over the past five years, the firms' return on assets has shown consistent growth.

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89.1% of the respondents agreed (Mean=4.28; Std. Dev.=0.655) that the increase in company's profit margins can be attributed to effective portfolio management. Moreover, the findings show that 80.5% of the respondents admitted (Mean=4.11; Std. Dev.=0.900) that their respective firms have achieved steady returns on equity over the last five years. It was established that 54.3% of the respondents strongly agreed while 34.8% also agreed hence 89.1% at least agreed (Mean=4.37; Std. Dev.=0.878) that the profitability informed by the ability to adapt to market changes. Overall, the findings demonstrate that the profitability of member firms listed on the Nairobi Securities Exchange is influenced by the tactical portfolio adjustments. The results further indicated that tactical portfolio adjustments positively affect profitability, as they enable firms to realign their investment positions in response to changing market conditions, thereby optimizing short-term gains while managing exposure to volatility.

5.2 Inferential Findings and Discussions

Inferential analysis was carried out to determine the relationship between tactical portfolio adjustments and profitability of the member firms of the Nairobi Securities Exchange. This section presents both the correlation analysis and regression analysis findings, followed by their discussions.

5.2.1 Correlation Analysis

Correlation analysis was performed, and the results are summarized in Table 3:

Table 3: Correlation Analysis Results

		Profitability
Tactical Portfolio Adjustments	Pearson Correlation	.735**
	Sig. (2-tailed)	.000
	N	46

The findings show a significant relationship between tactical portfolio adjustments and the profitability of member firms of the Nairobi Securities Exchange (0.735**; p=0.000) at a 1% significance level. This highlights that effective tactical portfolio adjustments directly influence the profitability. Liquidity adjustments preserve net profit margin by ensuring funds are readily available to exploit investment opportunities without incurring costly financing. Interest rate sensitivity management protects return on equity by shielding firms from rising borrowing costs and valuation shocks, maintaining stable shareholder returns. Volatility alignment boosts return on assets by optimizing risk-adjusted allocation, ensuring that asset bases generate consistent earnings across market cycles.

5.5.2 Regression Analysis

The regression analysis was performed to determine the relationship between the tactical portfolio adjustments and profitability of member firms of Nairobi Securities. The findings are presented in Tables 4, 5 and 6:

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.735[a]	.540	.530	.29800

a. Predictors: (Constant), Tactical Portfolio Adjustments

The model summary shows that coefficient of determination was R^2=0.540, indicating that the tactical portfolio adjustments accounted for 54% variation in profitability. Therefore tactical portfolio adjustments affected the profitability of member firms of Nairobi Securities Exchange.

Table 5: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.593	1	4.593	51.715	.000[b]
	Residual	3.907	44	.089		
	Total	8.500	45			

a. Dependent Variable: Profitability

b. Predictors: (Constant), Tactical Portfolio Adjustments

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The Analysis of Variance (ANOVA) results show that F-value=51.715 was significant (p=0.000). This means that the overall model was significant. As such, tactical portfolio adjustments affected the profitability of member firms of Nairobi Securities Exchange.

Table 6: Regression Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.560	.239		10.705	.000
Tactical Portfolio Adjustments	.427	.059	.735	7.191	.000

a. Dependent Variable: Profitability

The model was interpreted as $Y=2.560 + 0.427X_1 + \varepsilon$. One-unit change in tactical portfolio adjustments results in a 0.427-unit change in profitability of member firms of Nairobi Securities Exchange. These results indicate that profitability was predicted by variations in tactical portfolio adjustments. The t-value was significant ($t=7.191$; $p=0.000<0.05$) at a 95% confidence level. This result tactical portfolio adjustments have an effect on the profitability.

6. CONCLUSION

In conclusion, tactical portfolio adjustments provide member firms of Nairobi Securities Exchange with the flexibility to respond quickly to shifting market conditions, thereby sustaining profitability. By reallocating capital during volatile periods, firms are able to protect net profit margins while also preserving liquidity through timely exits from vulnerable positions. Liquidity adjustments further contribute to profitability by allowing firms to honor financial obligations, meet margin calls, and redeploy resources where returns are higher, though transaction costs and market depth remain critical considerations. Interest rate sensitivity is another pivotal factor, as fluctuations directly influence borrowing costs, discount rates, and asset valuations; firms that effectively hedge such exposures maintain healthier returns on assets and protect earnings stability. Moreover, managing volatility through swift tactical shifts safeguards return on equity by preventing deep losses during market downturns and capturing short-term opportunities that improve overall portfolio performance. Ultimately, tactical portfolio adjustments ensure that profitability is not only preserved but also optimized by aligning investment decisions with evolving financial conditions.

7. RECOMMENDATION

Member firms of the Nairobi Securities Exchange should embed tactical portfolio adjustments into their portfolio management practices. This includes timely capital reallocation during volatility, dynamic liquidity management to meet obligations and seize high-return opportunities, and active hedging against interest rate shifts to stabilize returns. By adopting real-time risk analytics and swift tactical responses, firms can protect and optimize profitability in changing market conditions.

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