

13/11/1999

Futures premium over cash augurs well for market

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THE benchmark Kuala Lumpur Stock Exchange Composite Index (KLCI) jumped more than 20 points early Wednesday after getting a whiff of an impending general elections when Prime Minister Datuk Seri Dr Mahathir Mohamad skipped a trip to South Africa for the Commonwealth Heads of Government Meeting (CHOGM).

The Prime Minister's official call for Malaysia's 10th general elections on Wednesday ended months of speculation, but came as a shocker for even on the day before, analysts and diplomats had said polls were more likely in 2000.

Responding to news of the dissolution of Parliament, Malaysian stocks came alive and were bought up briskly, lifting the KLCI by more than 20 points early Wednesday before profit-taking pared its gains to 13.27 points to close at 728.81.

Fresh bouts of profit-taking and position squaring on Thursday and Friday continued to cap further anticipated rallies, weakening the KLCI further to close the week at 721.52.

Investors' initial euphoria had turned cautious by the weekend due to uncertainties over whether the ruling coalition will be able to retain two-thirds majority in the coming general elections.

Week-on-week, the KLCI was dealt almost unchanged, higher by a mere 0.17 of a point to close at 721.52. This lethargy was against a backdrop of strong closes in Singapore and Hong Kong, which saw hefty gains of 74 points or 3.5 per cent to 2,185 and 579 points or 4.3 per cent to 14,189 respectively.

With the market easing back after only a day of gains, investors are beginning to feel the many uncertainties that comes with the holding of elections. To buy or not to buy now - that's the big question.

If one were to pose this million ringgit question to investors, the majority of them would prefer to stay aside. "We would rather wait for the outcome of the general elections before committing any further" would invariably be their reply.

Here are some possible reasons which do not favour buying right now. The first is the expected mud-slinging from both sides, all of which are going to irk investors; worst still, what if there are riots?

The second is the often feared outcome, that the ruling coalition may just win by less than two-thirds. How would the market react? What about the fear of an Opposition win, although it would be by a very long shot. The market would plunge.

Third is the unlikely entry of foreign funds into the market until after the elections. If so, where are the funds to boost the market right now? The conventional wisdom, therefore, is to stay aside until after the elections.

There are other investors, however, who think a little differently from the majority. These investors will tell us that perhaps the best time to be picking up stocks is the trading day after November 20, the nomination day for all candidates.

"But first, one will have to scrutinise the candidates from both sides before buying. Who the victor will be as well as the percentage majority they will command will be much clearer once the line-up of the contestants are known," said Madam Khoo (not her real name), a retail investor who came by our office yesterday.

"But why not buy only after the election results are announced, when the political haze has lifted and the economic road ahead of us is clear enough not to fall into an abyss?" we asked Madam Khoo.

"Where is the 'super-profits' to be gained when we buy when everyone is buying?" she snapped back. "People tend to forget that there are just as valid reasons, if not more, for buying now."

What are they?

"For one, buying support for local funds may be present during this transition period to boost the ruling coalition's chances of winning. Two, disagreements among the Opposition coalition over whether they should pursue certain ethnic sensitive policies are seen to be a factor which could weaken their chances of winning.

"Three, there will not be much broker force-selling pressure as force-selling from the high volume day of October 29 is already over by November 9 except, of course, Wednesday's high volume day.

"If prices do not rally soon, squaring of contra positions by November 18 could still be a reason for immediate weakness. One option may be to buy after next Thursday, the force-selling day.

"People tend to forget that Malaysia's fundamentals have been improving since selective capital controls were implemented from September 1 last year.

"They still are. For example, this week, there is news that Malaysia's foreign reserves in the last half of October rose and industrial production figures for September was higher by 19 per cent. Manufacturing output was 5.9 per cent higher in September as well when compared to August and 25 per cent higher year-on-year.

"What about the positive results from Public Bank, Maybank, Pacific Bank? Doesn't this trend reflect an economic recovery for our nation? And just yesterday, Standard and Poor's was reported to have upgraded the country's ratings to BBB because of Malaysia's stronger-than-expected economic recovery."

From this point on, Madam Khoo sounded even more confident about buying now and began to shrug off the "wait-for-the-nomination-day-before-buying" kind of tone. She had put on her chartist hat. Leaning forward, she talked about market sentiment.

"Yet another reason for buying now is because I am a contrarian. As a contrarian, I would want to 'buy' when everyone is selling or staying aside, and 'sell' when everyone is buying.

"I am buying now because the charts show that we are in a Wave 5 move up to test the 1,000 level in the next couple of months in line with the regional uptrend. And I am buying now because I am a long-term investor who is not concerned about short-term fluctuations.

"Last but not least, I am buying because there is a 17-point premium on November futures over cash as at Friday's close. The KLCI was at 721.52, while Kloffe's November futures was at 738.60. And when futures trade at a premium over cash, the immediate cash market is expected to be bullish." And this despite the fact that all technical indicators we are monitoring are still in bearish territory? we asked.

"I am afraid so, because technical indicators are useless when a market is in Wave 4," she shot back.

With that, she ended our short conversation, murmured something to herself, picked up her cellphone, dialled a number and shortly after was heard speaking into the mouth-piece: "Buy 10 lots November futures at market." That was just after 5pm, Friday.

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