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Right time to hold, collect quality index-linked stocks

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MALAYSIAN stocks suffered another round of weakness this week as foreign funds continued to unload stocks despite news that only US$546 million was repatriated out of this country since September 1. The Kuala Lumpur Stock Exchange (KLSE) Composite Index (KLCI) lost a total of 19.47 points or 2.55 per cent to close the week at 745.32, but not before testing a low of 730.64 on Thursday.

Not even Prime Minister Datuk Seri Dr Mahathir Mohamad's remarks on Thursday that our stock market would "shortly begin its upward march once again", could shore up market confidence. Analysts and players instead reacted to the Government's firm stand on maintaining the present exit levy structure on portfolio capital repatriation.

Reports of renewed foreign funds selling on the lack of any announcement of relaxation on Malaysia's selective capital controls were responsible for this week's rout on the stock market. But is there any reason to be overly concerned about Malaysia's adherence to its present policy of fixed exchange rates and exit levy structure on portfolio capital repatriation to the extent that one should sell shares in line with foreign funds?

With the sharp fall of 32 points in just two days on Wednesday and Thursday, few would blame an investor of reducing his stock positions. If one is following his heart, one could have sold out. But if one sits back and ask oneself whether Malaysia is now worse off or better than before exchange controls were implemented on September 1 1998, one would think twice about selling.

People tend to forget the facts - that only US$456 million was repatriated since September 1. Observers had expected a massive pullout of some US$5 billion, but that didn't happen. One possible explaination on why the KLCI lost some ground inspite of this small amount being repatriated can be attributed to what some would refer to as "stragglers selling". This is where foreign as well as local funds had refrained from selling two weeks ago in anticipation of the Government supporting the market on September 1. But when this did not happen, they decided to unload, triggering sharp falls.

It was reported Templeton and other funds were heavy sellers in the past three days. But one must understand that while some foreign funds may find Malaysia unattractive, there are others which think otherwise. There are many in fact who view Malaysia's policies as pragmatic (in the face of an "unfriendly" world).

Those of us who are Malaysians or have resided in Malaysia for a while will understand that the Government's policies since September 1 1998 were implemented in the best interest of Malaysian businesses and the population. It was done so for overall national security. If Malaysia had adopted IMF-style prescriptions, it may stil be out of a recession as claimed by the IMF, but at what cost?

One of the costs could well be massive selling of strategic assets to foreign capital, which could lead to national instability and upheaval. Countries like Thailand and South Korea, which have been aid-receivers from the IMF and are in the process of economic recovery, are now facing growing disenchantment over foreign control of some of their strategic assets. Thai Deputy Premier Dr Supachai Panitchpakdi is even reserving his judgement on whether the Thai decision in seeking IMF aid was the right thing to do. As a result of the "financial earthquake", he said, there has been a sea of change in the ownership of assets and businesses with foreign ownership increasing substantially.

As well, the Indonesian economy is still as lethargic despite having adopted IMF prescriptions.

Malaysia's stand on selective capital controls was another reason for this week's price fall. Dr Mahathir's announcement on Thursday that Malaysia is not about to let the ringgit float should not be viewed that Malaysia is anti-free markets. Here again we believe that others have misread our intentions.

Malaysia is standing firm on selective capital controls more out of its fear of a repetition of the currency crisis of 1997/98 than anything else. The Malaysian Government understands its vulnerability to new attacks even if the worst is behind her. Just on Thursday, there were rumours that the Thai baht's 11-month low was a result of a new attack by foreign speculators.

Until there is a new international financial architecture or "safety net" to stabilise exchange rates, a recurrence of hedge funds attacks cannot be ruled out. Malaysia's insistence on maintaining stable exchange rates should be welcomed by businesses as our Prime Minister had rightly pointed out on Thursday that "currency fluctuations merely increase the costs of doing business by having to `hedge' against adverse movements".

Foreign fund selling this week was also linked to their disappointment that profits made from the stock market that are repatriated within 12 months will be taxed at 30 per cent. The rate of tax is reduced to 10 per cent if profits are taken out of the country after that. But their selling should be viewed as an over-reaction over this rule as after all taxes on profits or otherwise known as "capital gains" tax had all along been practised by developed countries and yet this has not been an issue.

People tend to forget that Malaysia's fundamentals have been strengthening since last September. Continuing strong economic numbers show that the country is on track is unravelling itself out of its worst ever economic quagmire left behind by currency speculators in 1997/98.

Techinically speaking, the KLCI had corrected 50 per cent of its upmove from 667 to 803. The KLCI has now filled its "up-gap" registered on August 12, the day before the announcement of Malaysia's reinstatement into the Morgan Stanley Composite Index next February. Coincidentally, the current pattern is very similar to the pattern in the month of September last year (see lower chart). Notice in the lower chart that the KLCI also bottomed out after filling its "up-gap".

In September last year, it took 23 sessions before the KLCI embarked on a new rally. As at yesterday, we have already weathered 18 sessions of consolidation. If history repeats itself, then the current consolidation should give way to a new rally by September 10 at the lastest. In anticipation of this new uptrend, we would call on investors to continue to "hold" or "accumulate" quality index-linked stocks at this point but not to "sell".

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