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Poised for another rally this week?

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THE past week has been a rather turbulent one for the Malaysian capital markets as the nation tried to digest the political uncertainty which arose when Prime Minister Datuk Seri Dr. Mahathir Mohamad dropped a bombshell of sorts by announcing his resignation over the previous weekend.

Sentiment, the main driver of market prices, took a negative turn upon the news and the bond market retraced some gains made during the month.

Still, prices stabilised by the end of the week as the announced transition plan reassured a concerned public that the current economic policies will remain pretty much intact.

In retrospect, a smooth transition plan may later prove to be the impetus that boosts the market as it addresses the niggling issue of succession head on, an admirable first for a South-East Asian nation.

Another issue that capped the topside on the bond market this week was the financial year-end and half-year financial reporting period for the majority of banks.

Some banks were seen liquidating some of their portfolio ahead of the financial reporting period and this limited the upside potential of the bonds as it was met with some resistance.

Fundamentally, this is an opportune time to enter the bond market. The uncertainty in the equity markets, especially with the re-emergence of corporate governance issues in the US with the Worldcom debacle, is not leaving many choices for the discerning investor.

Many also have the opinion that the policies adopted by Dr. Mahathir will carry on in the near future which should imply that the soft interest rate stance will remain in place.

We expect the current low interest rate regime to remain in place as the Government concentrates on microeconomic measures to fine-tune the economy, while pressures from the world stage is dimmed (as the US Federal Reserve itself appears to be playing a cautionary stance with a higher interest rate environment, until fundamentals turn for the better).

For the bond investor, this bodes well as the funding costs continue to be maintained at its attractive lows and worries over an interest rate increase seem unwarranted.

On the trading front, with most players seen liquidating part of their positions on profit-taking, yields across all tenors moved slightly higher.

Main action was concentrated on Malaysian Government Securities (MGS). Yields on the 10-year MGS 1/01 rose to 4.00 per cent (98.70) while the yields on the five-year MGS 1/89 increased to 3.28 per cent (115.75).

The two-year benchmark MGS 2/99 was trading at 104.40-104.41 (3.02 per cent) while the new three-year benchmark MGS 1/94 bond was trading at 105.10-15 (3.06 per cent).

The spread between the five- and three-year MGS stood at 19 basis points (bps), whereas the spread between the 10-year and the five-year closed at 72bps.

The September futures contract closed at 111.96, 39 points lower last Friday with an open interest of 1454, whereas the December contract closed at 111.62.

In view of the correction, investors now appear to be faced with rather attractive investment opportunities especially with reference to corporate

bonds.

The liquid AAA PLUS bonds are seen to be at their best values since their issue date as the yields have moved slightly higher on slight liquidation.

Investors who missed out on the issue at the primary levels are now able to participate in the PLUS issue given its more attractive yields.

This is evident in the longer tenors, which are actually trading above the IRS curve.

The IRS curve is usually associated with AA-rated issues as it is reflective of the rating of most banks, who are the active quoters of IRS in the Malaysian market.

Investors could earn up to 34bps clean by buying 10-year PLUS bonds and swapping it out through the IRS if they wish to assume the respective credit risks.

Generally, however, corporate bond activity took a backseat to Govvies as the clouds of uncertainty continued its overhang over the market.

Spreads - the yield difference against comparable maturity Govvies - widened about 5-10bps across the board.

As the month of June saw bonds rallying, this would be a good time for many investors who missed the boat earlier to buy now.

Undoubtedly, investment risks will remain, but investors and traders will always remain and will be back in the market - if only because other investment avenues are equally limited.

Many funds would perhaps feel more comfortable tolerating the lower yields afforded by bonds instead of braving the vagaries of the stock market given the current scenario.

As an act of endorsement to the Malaysian Government, International rating agencies - Standard and Poor's (S&P) and Moody's - have viewed Malaysian credit in a more positive light with a view to upgrade its ratings.

Last Friday, S&P reaffirmed Malaysia's long term credit rating to positive while Moody's looked to upgrade its rating on the Malaysian sovereign bonds.

The question of succession was not an issue as the plan is viewed to be transparent and allows for a smooth transition.

Even US Ambassador Marie Huhtala stated that "Continuity is the watchword here... We know Datuk Seri Abdullah Ahmad Badawi well and we're quite comfortable", as she was speaking to business people in Singapore.

Last week bond investors were faced with two decisive events, namely the succession issue and the liquidation ahead of the year-end/half-year end.

Both issues were faced in the positive as bond prices managed to stabilise eventually highlighting the importance of fundamentals in a market otherwise driven largely by sentiment.

With all the positive news splurged on the bond market and prices having retraced from their lows, this week could prove to be an exciting week as we begin a new month and ... potentially look forward to another bond market rally.