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US terror warnings weigh down market sentiment

Fred Tam

ARE we going to see a year-end rally this year? Many investors are sceptical because there are no technical signs at all of even a rebound above the 650 level and we have only one month to go before we wrap up the year.

If one looks at the Table on the weekly performance of Asian bourses, you will see that of the 13 Asian stock indices monitored, the Kuala Lumpur Stock Exchange Composite Index (KLCI), Emas Index, Second Board Index and the Stock Exchange of Singapore (SES) are ranked among Asia's worst performers.

Week on week, the KLCI lost 9.9 points or 1.55 per cent to close at 629.22. Bank Negara Malaysia's announcement of third quarter gross domestic product growth of 5.6 per cent failed to lift the KLSE out of its doldrums as sentiment continues to be weighed down by external factors like US warnings of terrorist attacks on Malaysia. These warnings have deterred both local and foreign investments into the KLSE.

We are instead placed on the back burner while foreign funds bypass us in favour of other bourses like Japan, South Korea, Thailand, Australia and Hong Kong. Even lowly Indonesia is performing better than us in spite of the Bali bombings linked to indigenous extremist group Jemaah Islamiah.

Such is the baffling world of investing. "Hot money" flow in and out of countries when they are least expected to.

One reason why funds are not finding their way into local stocks at this point can be explained by the "over-reaction hypothesis" (ORH). Based on ORH, funds buy into under performing markets and sell out of over-performing markets.

In the year to date, the KLCI and the Emas Index are not anywhere in the ranks of the worst performers, so why buy Malaysia? Instead funds find other oversold global markets like Hong Kong, Australia, Taiwan and the US and Europe.

But this theory does not explain why funds are buying into Thailand, South Korea and even Indonesia as these countries do not fall into the oversold category, which brings us to the next reason why KLSE shares are not sought after vis-à-vis that of neighbouring Thailand, Indonesia and South Korea.

The more plausible reason for the lack of foreign interest in local shares can be traced to the international media's unfounded speculation of a Bali-like attack in Malaysia, Singapore and the Philippines. Recent US warnings about the possibility of terrorist attacks in the region have added to the negative perception of foreign funds with regard to Malaysian, Singapore and Philippine stocks.

We believe these incessant reports and warnings were responsible for both foreign and local selling or avoidance of stocks from these three countries in favour of "safer" destinations like Thailand, South Korea, Australia, Hong Kong and Taiwan.

But how does this explain the continued strength of Indonesian stocks given that the Bali bombings on October 12 came from its own soil? We can explain this anomaly by suggesting that, perhaps, foreign funds are relying on the theory that "lightning doesn't strike twice" or that the Indonesian market is grossly oversold after the Bali incident.

After analysing the patterns of the many South-East Asian stock indices after the Bali bombings, we conclude that US coverage and warnings of

possible terrorist strikes in Malaysia are responsible for the KLCI's fall from 665 on October 29 to 629.22 last week.

The US' action has definitely impacted foreign funds' perception of Malaysia as a safe haven for investment. It is not without good reason that Prime Minister Datuk Seri Dr Mahathir Mohamad was greatly disappointed, to say the least, with the conduct of the US as this is not the way to repay Malaysia for its cooperation extended to Washington in combating terrorism.

Economic sabotage of Malaysia's economy cannot be ruled as the US have so far not produced any proof of such potential threats.

This coverage has put Malaysia as a "high-risk" investment destination. Singapore and the Philippines are not spared from this too. Unless this unfair and irresponsible act is condemned strongly by the Government, it has serious ramifications that could result in a sharp fall in foreign investments into Malaysia.

* The writer is a member of the Society of Technical Analysts, UK.