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Futures fall in line

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AT THE BEGINNING OF THE MONTH, prior to Budget 2004, both the KLCI and the spot month futures contract broke the 750-psychological resistance level. Otherwise, for the most part of the month, the KLCI and spot month futures contract were tightly traded in the 735-748 range. The market seems to be taking a breather and consolidating at these levels - after all, the journey from the 600 level since mid-second quarter has been a rather steep climb.

What caused the rush? The end of the war in Iraq, demise of the SARS epidemic, KLCI playing catch-up with others in the region, better-than-expected corporate results and lately, the statistical figures from the US, which should favour Asian countries that depend heavily on US imports. Fundamentally, the economy is expected to achieve 4.5% growth and maybe even 5% if the private sector can drive and stimulate, especially the services sector. After all, the Budget was geared towards providing the private sector with as much assistance as possible.

The equity market should be at least six months ahead of the economy and to invest in KLCI futures contracts, an investor should ponder on whether the underlying is over-reacting or under-reacting on its notion of the economy.

So let's ponder on what's in store over the horizon. IPOs would continue to keep investors' interest lingering, especially with the listing of Astro coming up end of October. Then there's the stepping down of Datuk Seri Dr Mahathir Mohamad as Prime Minister. All eyes then will be on Datuk Seri Abdullah Ahmad Badawi, his successor.

In late October, there's the APEC Summit in Thailand, which may be the platform US officials might use to persuade leaders whose countries are pegged to the US dollar to be revalued again. Events within the next four weeks could well produce the spring the KLCI needs to continue its upward path to 800 before the end of the year - assuming all goes well.

Technically, we consider 722 and 705 as strong first and second support levels that will hold, barring any external fundamental factors. Throughout the period of May till September, the spot month futures contract has been trading at an adversely high premium above the underlying (occasionally over eight points). Arbitrageurs trimmed on the premium and prevented further divergence.

However, at the time of print, the premium has shrunk considerably, even down to a discount at the close. Investors seems to be bracing for heavier profit-taking and hedging activity from both local and foreign funds that have increased their weighting on Malaysian equities recently. KLCI may consolidate a little longer between the 732-748 levels but we are optimistic the high of Sept 8 (757-point level) will be breached soon after.

Futures contracts should trade close to parity with the share market and even if a premium exists, it may not be too wide, especially if the underlying approaches the 800 mark and towards the year-end. The KLCI futures contract has an expiry date and would normally trade closer to par with the underlying, especially during thin trading days - towards the end of the year market is expected to trade on thin volume due to the holiday period.

This year the KLCI futures contract has witnessed a resurgence of activity from foreign fund, especially during the second quarter. At the time of print, their open interest shrank slightly on profit-taking but there is evidence it may return soon in the near future. Some quarters are speculating on the possible date of a general election once Datuk Seri Abdullah Ahmad Badawi takes over at the helm. Bids were shown as early as

December, some predicting 1H 2004 and some even quoting much later dates. Nonetheless, interest is back on Malaysia - good or bad, derivatives may be the insurance needed against any volatile movement in the equity market.

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