

ABSTRACT

The changes in volatility of the Malaysia bond and stock markets over the period of 1994 to 2002 have been documented in this study. It is observed that PDS has the highest monthly return volatility level, followed by stocks and MGS. There are fewer significant changes in volatility over time for stocks compared to MGS and PDS, indicating that while the stock market is having a higher level of volatility, its volatility is more stable than bond market volatility.

The 12MMA SDR analysis indicates that PDS has the highest SDR, followed by MGS LT and other MGS classes. The test on the SDR trend-lines shows that only the PDS and the MGS LT have the positive trend while the MGS AS, ST and MT have the negative trend. This implies that the volatility level for the PDS and MGS LT (MGS AS, MGS ST and MGS MT) increases faster (slower) than the stocks volatility. An analysis of the beta slope indicates that only PDS has the positive trend while MGS (AS, ST, MT and LT) has the negative trend. In other words, there has been an overall increase (decrease) in the risk of PDS (MGS) relative to the risk for stocks. MGS have negative beta and high SDR, which supports the notion of "flight-to-quality" and "decoupling" effect. On the other hand, PDS is extremely volatile and it moves in the same direction as the stocks. These trends send a beneficial signal to the bond analysts and the portfolio managers that MGS is a suitable risk hedging capital market instrument compared to PDS.