CHAPTER 6
CONCLUSION & RECOMMENDATION

regression of the volatility of stock returns against the volatility of both bond and MGS returns confirms Zhou's (2000) findings that the volatility of the two asset classes is closely related (We reject Reilly, Wright, and Chan's (2000) conclusions that there is generally very little correlation between the volatility of the two asset classes). Given the higher volatility of the stock market, the negative coefficient of correlation between stock and bond volatility would mean bonds are a more viable investment alternative.

We presented evidence that bond returns and MGS returns, together with return on fixed deposits, has explanatory power for stock market returns. The results are in line with the studies done by Shiller and Beltratti (1992), and Campbell and Ammer (1993), that there is a positive correlation between returns on outstanding stocks and long-term bonds. Therefore, the co-movement of stock and bond returns need not be negatively correlated in order for investors to earn excess returns. A larger sample size or longer period of study would probably indicate that the positive correlation between stock and bond returns increases over time.

The above findings are summarised below:

- Average bond and MGS returns are marginally higher than average stock returns for the whole period of study.
- There is positive correlation between stock and bond returns (PDS and MGS). However, bond returns by themselves cannot be used to predict stock returns. There are other independent variables to be considered.
- The stock returns are more volatile as bond returns.
- The volatility of returns between stocks and listed bonds (PDS) is negatively correlated as opposed to volatility between stock and MGS returns. This model may be useful for predicting volatility of stock returns.

6.2 RECOMMENDATION

We would also mention here that there are other variables that have an impact on both stock and bond returns; Fama and French (1988,1989), Fama (1990), and Schwert (1990) focussed on economic factors; Booth and Booth (1997) examined monetary policy stance, and Zhou's (2000) paper finds that the stock market movements are closely related to shifts in the state of the term structure of interest rates. Further studies on these variables will help fund managers and market analyst better understand or predict stock returns in order to earn abnormal profits.

6.3 CONCLUSION

In conclusion, the results of our study find the bond market to be a better investment alternative than the stock market. Higher-grade bonds, which have lower risk of default, were much sought after following the economic crisis. Also, the government plans to liberalise the bond market by allowing investment papers of any grade to be traded. This is likely to spur more interest in the bond market. The bond market is also expected to spur bigger interest in asset securitisation or the issuance of asset-backed securities (ABS). This is the missing instrument in the market.

Tan Kok Kheng, Chief Executive Officer of UOB-OSK Asset Management, expects the domestic bond market to continue growing mainly because investors are beginning to view the sector as an alternative investment tool. "The more developed a country, the more developed the bond trading volume" he says[22], citing Singapore and South Korea as examples. Yet, most industry experts say the Malaysian market has a long way to go as it lacks liquidity, for one. In any case, we believe that Malaysia is moving in the right direction. The authorities have made it administratively easier to issue new paper; the government has

[22] Kamiso, Sidek, "Vibrant 2001 for Bonds", The Edge Daily (December 30, 2000)

established an auction calendar to issue MGS more regularly to create a more transparent and efficient benchmark yield curve as corporate bonds are priced above this curve; and the Securities Commission have introduce the Capital Market Masterplan to support Malaysia's basic capital and investment needs. There is no doubt that in Malaysia, bonds will rise to become the preferred financing choice and a popular investment option.