

CHAPTER 1

INTRODUCTION

1.1 Overview

The Kuala Lumpur Stock Exchange (KLSE) provides trading facilities for common equities, preferred stocks, corporate debt securities, transferable subscription rights and warrants. There is no doubt that Malaysia has established a solid foothold in the world arena of capital markets, its market capitalization is ranked among the top in Asia. It has also been a blue-ribbon performer and a power to be reckoned with. Many empirical research have been done on "weekend", "January", "size", and "monthly" effects on stock returns representing interesting and puzzling empirical evidence on local capital market anomalies/seasonalities. In the last few years, the increasing availability of intraday data is opening a new area for financial market researchers for studying securities markets. However, the behavior of KLSE's stock prices over the course of the trading day remains relatively unknown to the local academic researchers.

1.2 Trading Mechanism

In order to study the intraday trading behavior, it is imperative that we understand the mechanism and practices of the local market. Trading was done traditionally by auctioning (open outcry) which was locally referred as the trading post. On 15 May 1989, trading is done through a semi-automated trading system named System on Computerized Order Routing and Execution (SCORE). Under SCORE, buy and sell

orders are entered into computer terminals located at the member companies' offices and are then routed to the KLSE's matching room where the matching is executed by the KLSE's staff. The KLSE employs two different processes of order-matching price discovery known as:

- i) the *call market system* represents a periodic single-price auction which is a computerized form of the clearing house auction discussed by Mendelson (1982),
- ii) the *continuous market system* is a double auction system where bids and offers are submitted continuously over time and transactions occur when the orders cross.

Unlike most of the automated continuous double auction markets that use the clearing house auction solely for market openings, the KLSE employs the call market system to determine both the stock's opening price and its closing price for a particular trading session, while its continuous market system is used to determine matching prices throughout the trading session. According to the KLSE's plan, the fully automated matching system, where price determination will be based on the call market system only, will replace the semi-automated system currently under SCORE for stocks listed on the main board, thus eliminating the continuous auction system. The understanding of the mechanism is essential as the study of the stock price behavior at the KLSE adds another dimension to research on the relationship between market volatility and the trading method.

1.3 Objectives Of The Study

The objective of this study is to describe the intraday price behavior of Malaysian common stocks. The study will seek to examine the returns and the volatility of the major indices and more specifically, the study intends to test the U-shaped behavior of the returns variances of these indices.

1.4 Significance Of The Study

The study will be able to assist the traders in formulating their short term trading plan. In addition, by knowing the open-to-close, close to open, open to open and the close to close variance in the returns pattern, the presence of "price manipulation" or "window dressing" effect can be detected so that the investors will not be victimized by the big players' vicious plot.

1.5 Organization Of The Report

The report is divided into five chapters. A brief content of each chapter, with its title in bracket is listed below.

Chapter 1 (Introduction) starts with an overview. It also describes in detail the trading mechanism of the local bourse. The objective and the significance of the study are also presented in this chapter.

Chapter 2 (Literature Review) summarizes the empirical results of the study conducted on intraday returns found in different countries.

Chapter 3 (Research Methodology) is organized into four sections. The first section describes the methodology employed in the study. The second section covers the data description. Third section includes all the formulas that are applied in this study. The last section lists the hypotheses to be tested.

Chapter 4 (Research Results) describes the behavior of the intraday returns for each of the index. The various hypotheses are verified by conducting some Anova tests and Correlations tests.

Chapter 5 (Conclusion and Recommendations) summarizes the findings of this study. This chapter also discusses the implication of this research to the investing public. Finally, it provides some suggestions for future researchers.