UNIVERSITI TEKNOLOGI MARA

FUTURES MARKET OF CRUDE PALM OIL (FCPO) AND KUALA LUMPUR INDEX (FKLI) AS THE PRICE DISCOVERY IN MALAYSIA

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ABSTRACT

Price discovery is known as the factors to determine the prices by using demand and supply. This understanding helps investors, fund managers and speculator efficiently to make decisions for asset evaluation. A lot of study states that a future price is one of the main price discovery factors to predict and determine the spot price. However, there were studies regarding futures price as the price discovery is ineffective when the market is efficient. This event happened due to poor regulatory framework and excessive speculation which can cause a moral hazard. Due to this matter, this research attempts to examine whether there is relationship between the future prices towards the spot prices and to identify the main future contract month that affects the spot contract. This study is based on Malaysia derivative product which is crude palm oil (CPO) from the commodity derivative and Kuala Lumpur Composite Index (KLCI) from equity derivative. The entire samples were taken in daily basis from January 2018 until March 2018 from the Bursa Malaysia website. Ordinary Least Squares (OLS) were used as a method for relationship estimation. The findings of this study are positive relationship between future crude palm oil (FCPO) for one-month, two-month and three-month contract prices towards spot crude palm oil and also positive relationship between future KLCI (FKLI) for next-month, next-quarter month and next-two quarter month contract index and spot KLCI.

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TABLE OF CONTENTS

CHAPTER ONE
INTRODUCTION

1.1 Introduction

Futures contract in a financial term is known as the agreement between two parties which are the buyer and seller to exchange a specific asset with an amount of cash that agreed by the two parties. The asset could be financial, commodity or equity and the transaction is at future date. Forward contract also a future with the gains and losses each day not only on the settlement date. This contract is legal agreement, usually made at the trading floor for futures exchange. It is for buying or selling a particular financial instrument or particular commodity at a predetermined price in a specified time in future.

There are many types of commodity instrument and some countries have their own commodity instrument. Some of the commodity instruments are oil, natural gas, precious metals, industrial metals, grains, livestock and even carbon credits are the tradable futures contract available. As for, equity is the index used in specific country for example, S&P 500 index, Dow Jones index, Nasdaq and KLCI. Besides, the forward contract is riskier because there is no guarantees performance by clearing house. Thus, there is always probability of default as a result there always a premium payment in forwards contract price. One of the function of futures contract price is price discovery.

Price discovery is known as the factors to determine the prices by using demand and supply. This understanding helps investors, fund managers and speculator efficiently to make decisions for asset evaluation. Thus, price discovery shows a signal for investors to allocate their funds and gives information about the asset values. Besides, it also prepared information content regarding other predictors or past returns to predict the return in future. Price discovery, always related to asset pricing, stock market and agricultural product.

Many study conducted a research regarding price discovery. When price discovery related with asset pricing the mechanism is different. A study from Kumar (2016) the price discovery depends on the stock characteristic which are trading volume, idiosyncratic volatility, price bubbles, credit rating quality, book-to-market, total volatility and size. This price mechanism also used in determines the price discovery