WEATHERING THE STORM

ASX SURVIVES THE TEST OF 1987

by LAURIE COX

The October sharemarket collapse occurred in a year of historic development for Australian stock exchanges. The creation of the national stock exchange added to the ability of the securities industry to withstand the shocks.

Nineteen eighty-seven has been a momentous year in the development of Australia's stock exchanges. The deregulatory process which began in the early 1980's, is largely complete. It has seen the Australian market develop and mature at an incredible pace.

It was a momentous year because as a final step in the deregulatory process, a national stock exchange was created on April 1.

Momentous also for the huge increase which has occurred in sharemarket activity, and for the volatility which has characterised the market over the past month in particular.

Simultaneously with the establishment of the National Exchange, the Australian Stock Exchange (Melbourne) Limited became a subsidiary of the Australian Stock Exchange, as indeed did all other captial city stock exchanges.

Policy is now centralised in one board of directors, with certain responsibilities being delegated to State subsidiaries, including membership and financial matters, and surveillance of members' conduct.

New major capital investment decisions are made once only, for the benefit of the whole Australian securities industry. Economies of scale will be substantial.

Without the establishment of the national exchange, major capital investments in technologically advanced systems such as automated trading, the most advanced of its kind, which commenced on October 19 last, may never have come to fruition.

Other major capital investment decisions, including a long-overdue streamlined clearing system, are expected to place Australia at the forefront of world stock exchanges in terms of transactional efficiency of the market.

The new National Listing Committee has also created a level playing field through uniform interpretation of listing requirements throughout Australia.

This new committee has significantly increased the efficiency of the listing process, with applications now taking two weeks less than previously was the case.

Integral to the establishment of the national exchange was the creation of the National Guarantee Fund which today has a corpus of approximately $65 million.

The comprehensive protection provided by the National Guarantee Fund represents a significant enhancement on the previous fidelity funds of each of the former capital-city stock exchanges.

It is not well understood that this fund guarantees the completion of *all* contracts made on the exchange. Also it provides protection to investors against insolvency by Australian dealers. This protection is in addition to that provided through the stringent liquidity requirements which brokers must maintain at all times.

Mr Laurie Cox is chairman of the Australian Stock Exchange (Melbourne) Limited. This is an edited version of his address to the annual dinner of the exchange on November 17, 1987.

More than 60 companies in the US announced plans to buy their own shares . . . Had these arrangements been in place in Australia, the fall would not have been as dramatic.

The continual monitoring of brokers' liquidity requirements has proved to be a sound first-line protection for investors and I am pleased to report that the liquidity of Melbourne stockbrokers has come through the difficult period since October 19 in a strong position.

It is important that the events of the past couple of weeks should not overshadow the major innovations made by the Australian exchanges over the recent past.

In addition to the automated trading system and the proposed clearing house, a number of other major initiatives have also occurred.

Since the establishment of second-board markets, growth has been enormous — 300 companies listed in the space of two years, with turnover showing a rise in the year to June 30 of 470 per cent.

There is a flourishing options market in Sydney, the innovative Australian financial futures market has commenced in Melbourne and short-selling has been re-introduced.

The integration of the synthetic financial instruments and securities dealings within the one management provides significant attractions for domestic and overseas investors. In most major world centres, options, futures and securities dealings are operated by different institutions.

Since October 19 the market has shown unprecedented volatility and record turnovers have been efficiently handled by the Australian exchange.

In the week of October 19 the number of trades was more than double the high level that had prevailed throughout 1987, and represented a 700 per cent increase on that of 1982, the low point for this decade.

This coincided with the first week of automated screen trading when more than 9,000 trades were executed by "electronic handshake" — quite staggering, as the securities of only 20 companies were included in this first phase.

In that week, the number of inquiries of the exchange's market information system rose from an average daily level of 100,000 to more than 200,000 and was more than five times that of 1982.

Despite the 30 per cent decline in share prices on Australian markets in that week, turnover was more than $2 billion.

In the post October 19 environment, it is of significance that the Australian Stock Exchange has for some time been strongly urging the Government to introduce legislation to permit companies to acquire their own shares.

During the week of the collapse, more than 60 companies in the United States announced plans to take advantage of the weaker market to buy their own shares, and these moves no doubt helped to stabilise that market.

Had these arrangements been in place in Australia, I feel sure that the fall here would not have been as dramatic as that which occurred.

It is also important to stress that there was no shortening of trading hours, and closure of the market was not contemplated.

When deregulation of the Australian broking industry began in 1984, fixed rates were abolished and brokers were also able to incorporate and hence broaden their capital base.

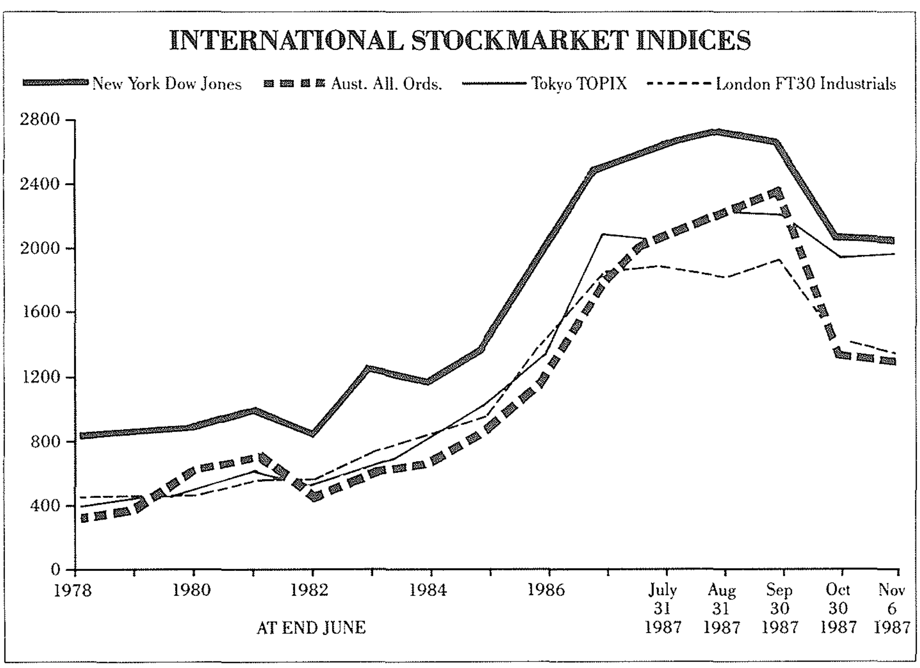
Proprietors' funds of Australian brokers are now about $600 million. This compares with a capital base of brokers just 10 years ago of a mere $20 million.

This enlarged capital base is essential for brokers to make the substantial capital investments in the latest technology which will enable them to compete internationally, at the same time funding the significantly increased level of activity that the market is now seeing.

The value of equity turnover on Australian exchanges has risen nearly tenfold since 1980. In the past three years alone, turnover has risen by a factor of about five to a level of $59 billion in 1986/87.

Australian equity turnover as a percentage of gross domestic product was 22.5 per cent in 1986/87, compared with a level of only 4 per cent, for example, in 1983.

The importance of the Australian securities market to the Australian economy as a whole is now equal to the importance of the Tokyo market to the



Japanese economy and the New York market to the economy of the United States, and is more important than is the London market to the UK economy.

Consistent with growth in turnover, and the importance of the stockmarket to the economy generally, the number of listed companies has increased rapidly over the past four years, rising by 30 per cent since 1983.

While the growth may slow following recent events, the exchanges have facilities in place to provide for a continuation of this long-term trend.

The number of companies nationally listed on the Australian market (even excluding the 300 companies listed on Australian second-board markets) is now similar to the number of companies listed in the Tokyo, New York and London markets.

Over the decade of the 1970s, Australian market capitalisation increased by slightly more than 100 per cent.

Since 1980, market capitalisation has risen by a factor of almost 4 — a much faster rate of increase than that recorded for Tokyo, New York or London.

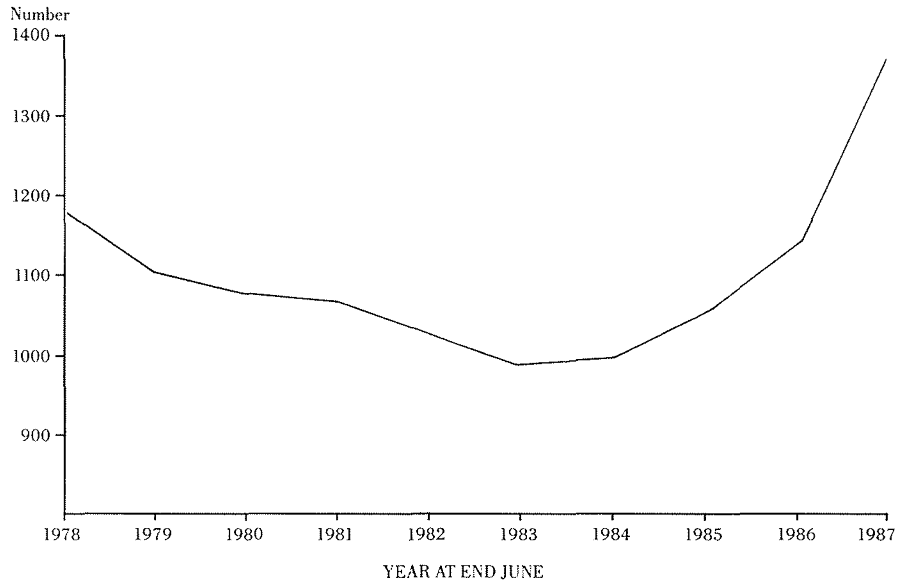
While there has been a decline in market capitalisation of $115 billion since October 19, it is still 20 per cent higher than in June last year.

The growing strength and maturity of the market is also confirmed by the role of Australian stockbrokers in new capital raisings. These have shown explosive growth over the past 10 years, from a level of $154 million in 1977 to $11.5 billion in 1987 — a rise of more than 70-fold in 10 years. The rise in 1987 itself was nearly 400 per cent.

As the absolute and relative size of the Australian market has risen significantly in the wake of deregulation, its efficiency has increased in similar measure.

Liquidity of the market has more than doubled since 1980, and is an essential inducement for the continued involvement of major domestic and overseas investors.

ASX LISTED COMPANIES MAIN BOARD



This compares with fairly small rises in liquidity in both Tokyo and London over the same period, while the percentage rise in New York has been slightly lower than that for Australia.

Australia's higher level of liquidity and improved transactional efficiency now make this market much more attractive to international investors.

Contrary to expectations before deregulation, the number of stockbroking organisations has not declined.

Nearly 70 per cent of all brokers in Australia are incorporated, and more than half of these have overseas partners. Shareholders now include major domestic and overseas banks and other financially powerful institutions including investment banks and international stockbrokers.

These changes represent the first steps in the long-term trend towards a more robust, integrated and internationally competitive securities industry in Australia.

A key point to emerge from our recent experience is not that the collapse was unanticipated, rather that the speed and magnitude of the decline was not anticipated.

The fact that a sharp and substantial decline took place concentrates the mind much more than a lengthy drifting market.

Indeed, since 1936 there have been three occasions where the market has fallen by 30 per cent or more over a period of months, before recovering to its long-term trend level. However these experiences have been given comparatively little exposure.

The role of the media, therefore, cannot be overlooked in these recent events.

In a market which suffers severe shocks, participants are more sensitive to a wider range of information than normally is the case.

Hence there is added responsibility on those reporting events to do so accurately and carefully and to make every endeavour not to contribute to a level of panic in the community.

The quality of the best financial journalists in Australia is, by any standards, high but unfortunately their editors are still motivated by the overriding need to sell their product.

Extravagant headlines, misinformation, or rumour-mongering can have very damaging effects on the fine balance of the market system, which is so essential to our economic framework. □

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