'Ask The Experts' provides answers to all your financial queries. Brought to you in association with the following organisations, we seek to give you the best professional investment information and advice from some of the top players in the financial industry. If you have a question on equities, unit trusts, insurance, bonds and financial planning, send it to smartinvestor@panpacmedia.com, or fax us at 2934 704.

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Q I was told to shun derivatives like futures, options and warrants. They are considered speculative and risky. Are they and why?

A Let us start by addressing the second part of the question. Derivatives are financial instruments whose value is determined by the value of another security, usually referred to as the underlying.

The leveraged nature of almost all derivatives is perhaps their greatest source of risk or, if they work out, returns. The leverage may come from the low down payment in relation to the value of the underlying. Hence, in the case of the Singapore Straits Times Index futures, an initial payment of only $1,000 is required to gain an exposure of about $20,000 at the current index level. Nevertheless, this feature is also available to investors who take on margin financing for ordinary stock investment.

More importantly, the leverage comes from magnifying the price movement in the underlying. You can see this clearly by observing the magnified price swings of warrants trading in the Singapore market as compared to their underlying stocks.

Another feature of derivatives that leads to their being perceived as risky is that you might be called upon to come out with an unexpectedly large cash flow to maintain your original investment in the derivatives. For example, if you had sold the STI futures or a stock call option and the market or stock rallied, you are obliged to make good the difference on the amount that the underlying had risen – and more because of the magnification factor. Very often, it is on short notice. In this sense, an investment in a stock that had gone sour would let you sleep better.

> On their own, derivatives can be risky. Nevertheless, a little derivative can, when combined with other investments like ordinary stocks and bonds, lower your risk or improve your return.

The biggest risk is perhaps ignorance. Some derivatives can have very complex terms and conditions. A full appreciation of the risk involved under various market scenarios may be beyond the ordinary investor.

Having said that, however, there is still a place for derivatives. In fact, by including them, your investment portfolio may yet achieve higher returns or lower risks. On their own, however derivatives can be risky. Nevertheless, a little derivative can, when combined with other investments like ordinary stocks and bonds, lower your risk or improve your return. The key is to get good financial advice to put together a sensible combination that works best for your objective.

~Cheong Kum Hong, Chief Investment Officer, Commerzbank Asset Management Asia.

Q What should I do with the shares in JIT, which I bought with my Central Provident Fund (CPF) savings? Do I have to sell them when I get the Flextronics shares in exchange for the JIT shares, considering that Flextronics is not listed on the Singapore bourse?

A According to the CPF, there is no deadline for selling the Flextronics shares, after you receive them in exchange for your JIT shares. You may sell them whenever you like but all proceeds from the sale will be credited back to your CPF investment account. As the CPF investment scheme does not permit shares that are not quoted on the Singapore Exchange to be purchased, you will not be allowed to buy more Flextronics shares using your CPF funds after you have sold them.

~ Smart Investor

Q Why is it that my broker, which is not related to a bank, only credits my bank account on T-plus-four days instead of T-plus-three days?

A The Singapore Exchange has confirmed that settlement is T-plus-three market days, which has been the rule since 15 March, 2000. According to the SGX, this rule has been closely adhered to by member firms and if there should be a discrepancy in the practice, it is "an issue that (you) should take up with the broking firm." The SGX further advises that "if the situation persists, you could write formally to the Head of Market Surveillance & Enforcement."

~ Smart Investor

Q Lately, the stock market has been so unruly that I have lost all sense of direction. Sometimes, I feel more like a gambler than an investor. What can one do in a turbulent cycle like this?

A The legendary investor Ben Graham, who counts Warren Buffett among his disciples, once said that you should imagine stock market quotations as coming from a fellow named Mr Market. Mr Market shows up each day and gives a price for which you can either buy or sell him your shareholdings in a business. He is, however, manic-depressive. On days when he feels euphoric and sees nothing but positives about business prospects, he quotes an exorbitant price. Other days, when he is gloomy and sees only downside, he quotes a rock-bottom price. Is Mr Market your friend or foe?

No doubt, any investor in the stock market can immediately relate to the above analogy. Stock prices are more volatile than ever before, due in part to global deregulation in brokerage fees, online trading, and instant information made possible by the Internet. While the tools, investment themes, and intensity may be different, the emotional undercurrents of the markets have not changed. Mr Market's constant torment between fear and greed is alive and well.

So, what is an investor to do? Should you join Mr Market for the ride, treat the stock market as another casino, buy the hot tip and keep your fingers crossed? All too often, it is only human to do so. Sooner or later, however, you will find that Mr Market has taken you to the cleaners!

While many, especially in Asia, would argue that "investing" is partly synonymous with "gambling", I have observed over the years that true investors are rarely gamblers. Some of the most successful investors have little idea of how to place a bet at the races. They consider gambling risky, while investing is not. True investors make educated and conscious investment decisions that, on balance, they fully expect to reap justifiable returns from over the long term. And in most cases, they do.

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What can you do to become a successful investor? Very simply, homework. As Mr Buffett, the tried and true investor, observed in one of his famous annual reports: "We look at the economic prospects of the business, the people in charge of running it, and the price we must pay." With homework comes knowledge, and with knowledge comes confidence that is essential to weathering the emotional roller coaster of today's markets. So, do your homework such that the next time Mr Market comes knocking, you'll be ready to take full advantage of his folly. Si

~ Chun-yin Chow, CFA, Director, irasia.com Ltd