



# Focused on derivatives

Nasdaq Dubai is focused on beefing up its derivatives platform. The exchange already saw a spurt in derivative trading volumes in the second quarter of this year. **Utpal Bhattacharya** speaks to Jeff Singer, Nasdaq Dubai's chief executive, about his plans for the exchange.

**M**any people still get hiccups at the mention of derivatives, and some just won't have anything to do with the subject. But a small community of those who are curious about the subject is quietly building up. Equity derivatives volumes are rising on Nasdaq Dubai, while some of the other exchanges are trading commodity derivatives in the UAE.

June was a good month for Nasdaq Dubai. The exchange's nascent derivatives platform notched up an impressive performance, trading 11,270 futures contracts, up 39 per cent from 8110 in May. In fact, the second quarter of 2009 saw a good spurt in derivative activity on the exchange, with the total number of traded contracts rising to 26,196 from 7292 contracts in

the first quarter. Of course, these aren't astounding figures compared to what some of the exchange's international peers have achieved in many years. These are still very early days for derivatives trading on Nasdaq Dubai, though. The market was launched only in November last year, and Jeff Singer, Nasdaq Dubai's chief executive, is confident that volumes will build satisfactorily on the exchange over a period of time.

## Equity derivatives

Singer says that equity derivatives are currently his primary focus on Nasdaq Dubai. They are important because they hardly exist on any exchange in the Middle East, being mostly available only over the counter. Many exchanges have ambitions to trade them. Nasdaq

Dubai has established a lead, being the only exchange in the UAE that lists equity derivatives.

Nasdaq Dubai currently trades 20 equity futures and an index comprising 20 stocks, including DP World, as well as nine stocks on the Dubai Financial Market (DFM) and 10 on the Abu Dhabi Securities Exchange.

Singer says it is expected for regional markets to go through a process of evolution, just like they have gone through elsewhere. The journey always begins with very simple, straightforward derivatives that almost every investor can understand.

"We listed futures last November. Then, in April, we introduced an options service. There is nothing extraordinary about them. These are useful tools to hedge your



portfolio and an excellent way to manage risk. Besides, clearing derivatives on-exchange reduces the risk of default because the exchange is the central counterparty,” says Singer.

Members of Nasdaq Dubai are now able to report, trade and clear user-defined option contracts on the exchange, with the price and expiry date agreed by the parties to the contracts.

But banks and financial institutions are hedging their interest rate and foreign exchange risks all the time. Doesn't the exchange see that as an opportunity to introduce derivative products to take advantage of this demand in the region? “Yes, but not soon,” Singer replies.

The immediate focus is to nurture and grow the platform of the equity futures and options platform including trading the FTSE NASDAQ Dubai UAE 20 Index, which is correlated to the market at a 70 per cent level, making it one of the most highly correlated indices in the region. If investors want to go long on any one of the stocks that are part of the index, they can go short on the latter, Singer points out.

Singer says that Nasdaq Dubai plans to introduce more equity futures products and indices, possibly starting in the third quarter of this year. The list this time will include stocks from the whole region, he adds.

“Nasdaq Dubai was always designed to be a derivatives market for the whole region and not just the UAE. We started with the UAE, but now we are going to branch out,” he says.

### Growing liquidity

Liquidity is the lifeblood of any exchange, and since the time Nasdaq Dubai decided to attract more retail investors last year, there has been growing interest from locals as well. The exchange now has 12 local members signed up on its market, alongside 17 international ones that are bringing in increasing liquidity. In the first half of this year, retail liquidity accounted for 15-20 per cent of the exchange's total liquidity, compared to five per cent in 2008. Singer feels that a good balance is building up in the exchange between retail and institutional liquidity. The ideal balance to have is a ratio of 50:50, he says.

The equities trading volumes on the exchange led by DP World rose to 1.76 billion shares in the first half of 2009, up 61 per cent from the 1.09 billion recorded in the same period of the previous year. It was also 35 per cent higher than the 1.3 billion shares traded

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Jeff Singer

on the exchange in the second half of 2008. In June 2009 alone, the market saw 189.5 million shares changing hands, up 110 per cent from 90.2 million in June 2008.

Singer now feels very positive about the retail participation on the exchange. He also describes the behaviour of the local retail investors as very similar to western hedge funds, something that's helping boost the liquidity on Nasdaq Dubai.

“We want more of the local retail investors. Given their size, their scope and breadth and their sophistication, these investors are very analogous to the hedge funds in the west. They have those same capabilities and views on the markets,” Singer explains.

People call these investors speculative, but the reality is that they provide liquidity into the market day-in and day-out, he notes.

So are most investors on Nasdaq Dubai, including institutional ones, hedge fund type investors? They are, is Singer's reply. He also argues that while mutual funds are important, as these provide stability and a solid base for issuers, hedge funds are also very important for an exchange, as they boost the daily liquidity.

But efforts are being made to get mutual-fund-type asset managers involved in the market,

even though most of them have their emerging market allocations in BRIC countries. Besides, most asset managers look at the Middle East as a whole and are at this point picking regional “bright spots across markets”, not necessarily Nasdaq Dubai, explains Singer.

### Enhancing synergies

There are a host of initiatives underway to increase liquidity on the exchange. The focus on bringing more retail investments into the market is paying off. Institutional investors want retail investors and vice versa, as they trade off each other. There is also work going on to consolidate the back offices of the DFM and Nasdaq Dubai. This will make it easier for investors to trade on the two markets, both being majority owned by Borse Dubai.

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Singer discloses that in the future, investors are likely to have the same investor number for both the DFM and Nasdaq Dubai. Efforts are on to be able to make this possible by the end of this year, but Singer thinks it is more likely to be in the first quarter of next year.

“We are creating one single technical back office for the two markets, including custody and clearing. We are also pursuing a strategy for them to be able to draw from a common liquidity pool from an operational point of view, as opposed to different pools,” he says.

Also, with the decision to allow companies to list in the local currency, Nasdaq Dubai will encourage future cash listings of UAE-based companies to be in UAE dirhams. It will help to boost liquidity on the exchange, insists Singer.

International issues will probably continue to list in US dollars only. Singer feels strongly that the already listed local companies on the exchange should shift to UAE dirhams. He says that Depa and Damas are already considering doing so; the matter is with the boards of the respective companies.

“I have advised both these companies to move to UAE dirhams. I think it will increase liquidity. It will enable shareholders to more easily acquire the shares of these companies without having to worry about currency conversions and other transactional risks. It just reduces friction in the process,” Singer argues.

### New listings

On new listings expected on the exchange, Singer feels confident that some of the meetings happening now will result in IPOs, perhaps starting in the first quarter of 2010. Understandably, activity had reduced during the worst months of the financial and economic crisis, but now the numbers of meetings are picking up and discussions are ongoing, with a number of regional and local companies to list IPOs on the exchange.

There are also discussions with international companies to list on the market. Some of these companies are already listed on international exchanges, but are looking to raise a second round of financing on Nasdaq Dubai.

“These are typically companies that have business operations in the Middle East, and they are looking at both listing and raising

capital at the same time. Of course, all these are a function of the market improving before we see these companies making their final commitment,” notes Singer.

Nasdaq Dubai is also putting together a listing structure for Real Estate Investment Trusts (REITs). Although there are no REITs yet listed on the exchange, Singer feels that REITs are a very natural type of listing for Dubai, given the amount of real estate in the country.

The exchange is also working with the Dubai International Financial Centre to help develop the region’s bond market. The aim is partly to create government debt structures that will allow corporate debt to be more accurately benchmarked.

“We are involved in conversations to create the infrastructure and the technical facility to list that (government) debt and, if required, to trade it,” Singer discloses.

To Nasdaq Dubai’s credit, a total of 2477 Dubai Gold Securities (DGS) were traded in the month of June, bringing the total traded since DGS listed in March to 24,432. DGS have been declared Shari’ah-compliant and a unique route in the region to invest in gold. They can be traded just like shares.

Each DGS security is valued at approximately one-tenth of the spot price of gold. Investors can redeem their investments in the security and take delivery of physical gold if they want to. The exchange plans to introduce more such instruments in the future, according to Singer.

It is very apparent that the exchange is working hard on the products side and has come a long way since its launch. The key will continue to be liquidity, which will attract both the supply and the demand side. To date, indications are all positive, and all eyes will be on how the exchange is able to build up its retail investor momentum going forward. That will ensure volumes, which are what any market aspires to for success.