Philequity Corner (Jan. 1, 2007)
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It was a very good year

2006 was a very good year for Philippine stocks, bonds, the peso, and the economy in general. Indeed, the economic reforms which were instituted in the past couple of years have set a virtuous cycle in motion. The benchmark Philippine Stock Exchange Index (PSEI) ended the year up 42.3, while the peso strengthened by 7.6 percent against the US dollar.

Looking back, what we said at the start of 2006 set the tone of what would transpire throughout the rest of the year: *"We continue to be long-term bullish on Philippine assets on the basis of improving fiscal and macro fundamentals... If we play our cards right, 2006 will be a banner year for the Philippine economy."* ***(Philippine Peso … No. 1 in Asia & No. 5 in the world - Jan. 2, 2006)***

We are now looking forward and planning out our strategies for 2007. In order to do this, we have to review what we said in 2006, to evaluate our calls, and draw lessons from how the financial markets have behaved last year.

On currencies:

1) **General weakness of the US dollar**. *"The US Fed is already on its last moves this year on its tightening policy stance. This would effectively end the "high yield" trade that led to the general strength in the US dollar in 2005."* ***(Buy Asian currencies – Jan. 30, 2006)***

   "The current trend of US dollar weakening is very evident. There is a good chance that the Fed tightening cycle is over so the carry trade that was favorable for the US dollar last year has started to unwind. The US economy is also in for a soft landing so the US dollar will continue to weaken against other currencies." ***(Staying the course of reforms – July 31, 2006)***

   The dollar declined against most currencies in 2006. Among the major currencies, the British pound appreciated the largest, up 13.6 percent, followed by the Euro which strengthened 11.5 percent. Only the Japanese Yen weakened against the US dollar, down 1.2 percent.

2) **Bullish on Asian currencies.** *"We are bullish Asian currencies and we believe that 2006 is the ripe time for these currencies to shine…The first month of the year saw much volatility in the currency markets with Asian currencies appreciating strongly against the US dollar. Due to cyclical reasons, this trend is likely to continue through the rest of the year… By now, we reckon that China has already overtaken Japan as the world's largest currency reserve holder… With the Chinese economy running huge current accounts and balance of payments surpluses, the Yuan is poised to strengthen further even with continued intervention. A stronger Yuan, in turn, would permit other central banks in Asia to let their currencies to trade higher."* ***(Buy Asian currencies - Jan. 30, 2006)***

   The Thai baht which appreciated 13.6 percent against the US dollar was the best performer despite the recent attempts on capital control. It was followed by the

Indonesian Rupiah which strengthened 8.4 percent and the Korean Won which appreciated 8 percent.

3) **Bullish on the Peso.** *"We are now seeing that what happened to Brazil and Chile in 2005 (when their central banks had to intervene to support the US dollar against their strong currency) may also happen to us. With the peso-dollar rate now heading towards P50:$1, we expect the Bangko Sentral to step in every once in a while to help cushion our exporters from the peso's aggressive moves."* ***(Peso nears 51 …what's next? - Feb. 13, 2006)***

   "Clearly, the current peso strength is not only influenced by factors internal to the Philippines but by external factors as well…All things being equal or as economists often say ceteris paribus, we are maintaining our peso target at P50/$1. However, if the US dollar continues to weaken against regional currencies or if the Chinese Central Bank decides to loosen its grip on the yuan further, we will not be surprised if the peso indeed overshoots our target as some foreign houses have predicted." ***(BSP firmly at the helm – April 10, 2006)***

   The peso in fact hit our target of 50 ahead of time, leading us to amend it to 49.25 last November. It closed the 2006 even higher than our amended target at 49.03, up 7.6% year-on-year.

On equities:

1) **Bullish on global equities.** *"We view the last week's sharp sell-off in the US and equities markets around the globe as a major correction rather than the start of a bear market. Strong corporate fundamentals and no evidence of heavy selling by long-term players such as pension funds and insurance groups reinforced our view."* ***(When the US sneezes, the world catches a cold - May 22, 2006)***

   "Unlike past market corrections, the sharp decline in global equity markets in May-June did not reflect a change in long-term fundamentals. Absent was the irrational exuberance in equity price valuation that we experienced in April 2000. Nor was there a loss of confidence in emerging market economies saddled with huge current account deficits experienced during the Asian crisis in 1997. In fact, equity valuations today are reasonably in line with long-term fundamentals and the emerging market economies have significant current account surpluses and are in strong financial standing." ***(All eyes on the US - July 10, 2006)***

   "The Fed was less hawkish ... the key change in the FOMC statement gives rise to a less affirmative stance on additional tightening... the sharp sell-off in equities over the past two months has brought valuations back to undemanding levels. At this point, we see the downside risks to be significantly less than the potential upside." ***(Markets regain their footing - July 3, 2006)***

   Global equities ended the year strong. The Dow Jones Industrial Average (DJIA) was up 16.3 percent while the S&P 500 gained 13.6 percent. Meanwhile, the MSCI Emerging Market index rose 25.6 percent.

2) **Bullish on Philippine equities.** *"Fundamental support for a positive case in the Philippines is very much valid both structurally and cyclically. Fiscal consolidation has*

progressed well. Good economic growth prospects, a stable peso, low interest rates, and subsiding inflation still provide the cyclical support." ***(All eyes on the US – July 10, 2006)***

"The fiscal reforms are on track and that the country's economic fundamentals remain strong. Looking forward, we are counting on a resurgence of foreign direct investments (especially in the power and mining sectors) and government pump-priming on infrastructure and tourism projects to further boost economic growth." ***(Staying the course of reforms – July 31, 2006)***

The PSEI ended 2006 on a 10-year high at 2,982, up 42% year-on-year. This is the fourth straight year of positive returns as the Philippines remained among the top performing equity markets in the region.

On politics, terrorism, natural calamities & the stock market

1) ***Political maturity.*** *"Coup attempts, coup plots, destabilization moves – real or unreal – always succeed in spooking investors. Apprehensive investors have hung on every rumor, every unfolding event as if their very lives were at risk…If recent history is to be our guide, investors should bear in mind that the stock market possesses an amazing resilience. To some degree, there is always a negative knee-jerk reaction to "sudden political shocks." Stocks tank immediately, but after a while, they go back to doing what they always do - which is looking for value and aligning with long-term economic fundamentals."* ***(Failed coups & the stock market – Feb. 27, 2006)***

   "Amid all the various tales being rammed down our throats through the media by the spin doctors of both camps, we all have learned to think critically. We all have gotten tired and weary of swinging from one end of the pendulum to another… This is apparently true not only for the individual Filipino but also among investors and the business community…Regardless of the motives or objectives behind today's political noise, local politics has taken the backseat as far as investors are concerned. Everything now boils down to fundamentals." ***(Politics has taken a backseat – July 17, 2006)***

2) **Resiliency of markets vs. rising geopolitical risks & natural calamities.** *"There are continued fears of a major sell-off in the global equities markets in case the current crisis between Israel, the Palestinians and Lebanon erupts into a regional conflict. While the immediate impact of such events will unquestionably be negative, it has been shown throughout history that equities markets have withstood the short-term effects such momentous "non-economic" events. In most cases, such catastrophes did not have a lasting impact as investors weighed down the risks versus the positive economic fundamentals."* ***(Resilience of man & markets – July 24, 2006)***

   "Unexpected natural calamities such as the recent typhoon may affect the stock market in the short term… it reminds as of how powerful nature can be and how fragile mankind is in the face of such enormous forces of nature. In the end, however, we are all comforted by the relentless determination of man to claim its place, to reclaim what has been taken and to carry on against all odds." ***(Typhoon Milenyo closes financial markets – Oct. 2, 2006)***

As we have seen, the Philippine stock market has recovered strongly (to finish 2006 on a high note) after suffering short-term declines during these one-time, non-economic catastrophic events.

Philequity Fund earns 52.2% in 2006

To our shareholders, we are pleased to announce that 2006 was one of our most profitable years with a return of 52.2 percent. In 1996, we had a return of 58.5 percent. For those who were fortunate to stay with us since Philequity Fund's inception in 1994, the fund has since gained 1,031% or a compounded annual return of 20.6%.

Watch out for our article next week where we will be discussing our outlook for 2007. We wish all our shareholders and readers a Happy and Prosperous New Year!!!

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