

**Philequity Corner (March 5, 2007)**  
**By Ignacio B. Gimenez**

**Is the bull market over?**

Last week, the market suffered its single biggest one day loss in nine years, prompting the once overzealous investors to experience panic from the otherwise untouchable attitude towards the market. The benchmark Philippine Stock Exchange Index (PSEi) fell as much as 10.1 percent last February 28 before closing the day with a loss of 263 pts or 7.9 percent.

Prior to that day, people were more worried about not keeping up with the market or not being able to ride the next high-flyer stock. But now, maybe the mentality has shifted from one of overconfidence and raging appetite to one of cautiousness and capital preservation.

**Global sell-off**

No market was spared in the global chain reaction that took place last week. The first to fall was China wherein the Shanghai and the Shenzhen markets saw losses of 8.8 percent and 9.2 percent, respectively, last Feb. 27. The US markets immediately reacted that night with the Dow Jones Industrial Average plummeted 3.3 percent and the Nasdaq which slumped 3.6 percent. The following day, other Asian markets including the Philippines caught up in the slew of panic.

The following table shows how the US and Asian markets closed the week after the Feb. 27 sell-off. Naturally, the best-performing markets prior the sell-off (China, Malaysia and the Philippines) were the ones with the biggest percentage pullbacks.

**Performance of Selected Markets (Feb. 26 to Mar. 2)**

	Price Feb. 26	Price Mar. 2	%Chg
<b>US</b>			
Nasdaq	2,504.52	2,368.00	-5.5%
DJIA	12,632.30	12,114.10	-4.1%
S&P 500	1,445.48	1,387.17	-4.0%
<b>Asia</b>			
Malaysia	1,272.87	1,164.68	-8.5%
China	188.91	173.40	-8.2%
Philippines	3,380.00	3,140.34	-7.1%
Singapore	3,307.92	3,078.74	-6.9%
Hong Kong	20,597.90	19,442.01	-5.6%
India	13,649.50	12,886.13	-5.6%
Japan	18,215.00	17,217.93	-5.5%
Korea	1,473.03	1,414.47	-4.0%
Taiwan	7,900.20	7,670.77	-2.9%
Thailand	688.70	679.02	-1.4%
Indonesia	1,783.95	1,760.02	-1.3%

*Source: Bloomberg*

China, at its peak, was already up 46.4 percent since the start of the year. In the case of Malaysia, its stock market has gained 17.2 percent at its peak last week. Meanwhile, the Philippine market was already up 14.6 percent from the start of the year. And this was still on top of a 42.3 percent

gain in 2006. The extent of the sell-down from these markets, therefore, does not come as a surprise.

### **External triggers were the culprit**

Similar to the panic in May last year, the causes of the drop in Philippine stocks were primarily external in nature. One factor is the reassessment of the “Goldilocks scenario” in the US following a statement of former Fed Chairman Alan Greenspan that a US recession this year is a very real possibility. Until now, the consensus was that the US was headed for a soft landing, marked by low inflation, slow growth and low unemployment. But troubles in the US market for sub-prime mortgages (or home loans to the riskiest customers) are leading to fears that the housing bubble will soon be spilling over to the rest of the economy.

Another factor is the drying up of global liquidity with the possible unwinding of what economists have dubbed the yen “carry trade.” For a number of years, savvy investors and big hedge funds have been tapping the Japanese funds at near zero interest rates to fund their investments in commodities, emerging markets, and other riskier ventures like takeovers and derivatives. However, the Bank of Japan has already raised interest rates twice in the past seven months. Although the rate hikes have been relatively minimal, it may be enough to change the investment configurations of highly leveraged hedge funds dependent on yen borrowing.

### **Pullback was long overdue**

Even a raging bull needs to pause once in a while to catch its breath. As we have said in previous articles, we expect pullbacks and consolidations in this current bull-run to help the market regain strength for the next leg up. Therefore last week’s correction was long overdue.

Come to think of it, the PSEi has risen by as much as 67 percent to a high of 3,417 last Feb. 21 from a low of 2,050 in June 2006. Thus despite dropping 276 pts from its peak, the market has given back only a fifth of its gains from the prior 8-month run-up.

### **Philippine Stock Exchange Index (June 2006 to present)**



*Source: Technistock*

### **Turning a blind eye toward risk**

Prior to the sell-off, the movement the speculative issues relative to the big caps gave a hint of what was to come.

- 1) Over the last few weeks, the performance of erstwhile market leaders like PLDT and BPI have languished behind that of 3<sup>rd</sup> liner issues.
- 2) Well-followed stock advisors have begun promoting speculative issues.
- 3) Most investors have poured money into “concept” plays in the spirit of blind passion and feverish speculation.
- 4) Lastly, prices have indeed run ahead of fundamentals when even your ultra-conservative investor friends have started inquiring about these issues which they have (prior to this time) religiously tried to avoid.

**Pull-back is constructive for the long-term**

Similar to the sell-off in May 2006, this current market pullback is not fundamentally driven. Valuations, while slightly above average of recent years, are still significantly below historic highs. The sell-off, in our view, is therefore a healthy correction as investors would refocus back to the big-cap/blue-chip issues as prices become more attractive.

We continue to be positive on the macro front. Low interest rates, low inflation, a stable peso and a healthy buildup of gross international reserves should put the country in a better shape to withstand external shocks. Meanwhile the fruits of the fiscal reforms are now expected to translate to growth in the domestic economy thru infrastructure spending and tourism development.

From a technical standpoint, the market needs this correction before it resumes its next leg up. While nobody knows how long this correction will last, the long-term trend remains clearly intact and we therefore view this correction as an opportunity to buy.

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