PHILEQUITY CORNER (10/30/06)
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Newton's Law of Inertia as applied to the Stock Market

Call this argument unconventional but it seems that the dynamics of natural laws, such as those on motion by Sir Isaac Newton, may also be applied to stock market trading. For a moment, let us substitute the market in lieu of "matter" in the Newton's Law of Inertia.

Newton's Law of Inertia states that: *"Matter at rest tends to stay at rest and matter in motion tends to stay in motion unless acted upon by an unbalanced force or an equal and opposite reaction."*

This law teaches us that if a market is trending sideways, it tends to stay sideways until a powerful enough market force or catalyst takes it out of its trend. Meanwhile, if a market is trending upwards (or downwards), it will tend to continue moving up (or down) until a drastic change in fundamentals and sentiment create an equal and opposing reaction.

We will show how we successfully used Newton's law in Philequity's investment decisions:

1) Global equity markets bottom out as US Fed cut its rates down to 1 percent, PSE Index (PSEi) bottoms near 1,000 level.

Recall that after the 1997 Asian financial crisis, the market suffered a 7-year decline which caused the PSE index plummet 72 percent from its all-time high of 3,447 to a low of 978. By 2001 to early 2003, the market was in a rut as the volume of transactions dwindled while the PSE index barely hanged on the 1,000 level on several occasions.

The catalyst that finally forced the market out of its doldrums was the reflationary moves by the US to put its economy back on track: boosting liquidity by lowering Fed rates down to 1 percent, instituting tax cuts to spur consumer spending, and letting the US dollar depreciate.

This is the reason why in June 2003, when the PSEi was at 1,073 (barely eight percent off its all-time lows), Philequity came out with a newsletter titled "***The Market has bottomed!,"*** urging our investors to put more money in the emerging bull market in Philippine stocks. We even held an investors briefing in Makati in August of that same year. We argued that the market, though bad as it looked back then, will never be worse "*since the 1,000 level for the PHISIX has held through the most trying times, namely: the Asian financial crisis of 1997, a major political crisis (impeachment of former President Estrada) and the US tech & telecom bubble in 2000, a financial market panic after the World Trade Center bombing in 2001, the US-Afghan and US-Iraq war in 2002, and the SARS scare of 2003*."

2) Fiscal roadmap was laid down, propelling the PSEi above 2,000.

This time, the catalyst that propelled the market even higher came from the domestic front. In August 2004, when the PSEi was at 1,582, we wrote a newsletter titled "***Grab the Bull by the Horns***," immediately after President Arroyo announced that the country is in a fiscal crisis and at the same time outlined the roadmap towards fiscal recovery. Viewing this as an opportunity amidst a crisis, we urged investors "*to grab and ride the bull market by the horns just as the government is tackling the fiscal debt problem head-on and grabbing it by the horns."*

3) Staying the course of reforms as the market shrugs off coup threats and external threats.

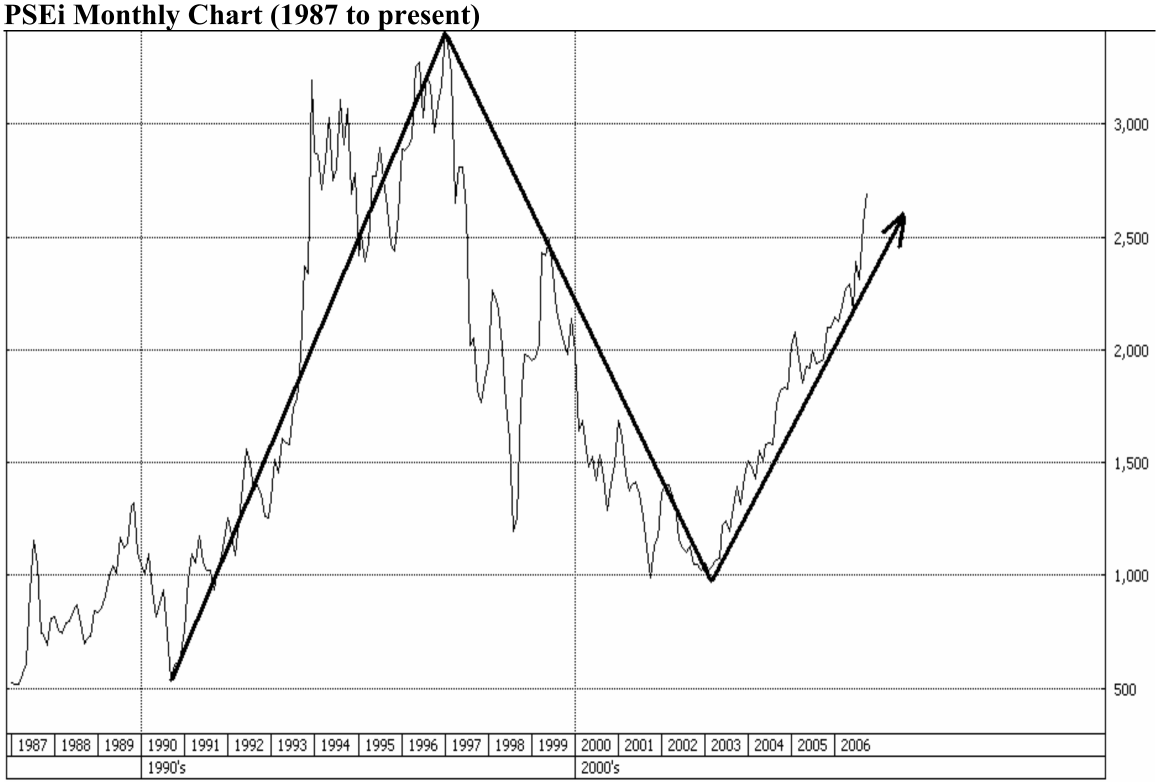
The third catalyst is the fact that the government delivered on its promise of reforms. Key legislations were passed, such as the Sin Tax, the Lateral Attrition and the Expanded VAT laws. Also, the Supreme Court affirmed the Mining Act of 1995, signaling the revitalization of the mining industry.

This is why have consistently urged investors to invest in Philippine assets. In November 2005, when the PSEi was still at 2,079, we wrote an article titled "***It's Time to Make Money – Philequity Corner,***" saying that "*We see a clear path towards fiscal revitalization and sustained economic upturn… Philippine assets are on the way up and you should be buying ROPs, Philippine debt papers, equities and the Peso.*"

In March 2006, we mentioned in our article titled "***Time to Make Money Part 2 - Philequity Corner***" that "*despite the political wrangling, coup threats and external factors such as high level of oil prices and rising geopolitical risks, the PSEi has managed to gain … As long as economic reforms continue and fiscal numbers do not disappoint, we believe that the PSEi will eventually test the 2,600 level or the highs reached in 1999*."

In several articles, such as "***Failed Coups & the Stock Market***" in February 2006, "***The Resilience of Man & the Markets***" in July 2006 and "***Typhoon Milenyo Closes Financial Markets***" in October 2006, we showed that despite temporary setbacks due to coup threats, rising geopolitical risks and even natural disasters the market recovers in the long term as investors focus back on fundamentals.

PSEi Monthly Chart (1987 to present)



Source: Technistock

A Glimpse into the Philequity Mind

It has been more than three years since we in Philequity turned bullish on Philippine equities. With the PSEi now at 9 year-highs of 2,702 (up 170% from its 2003 low) and the Philippine Peso at a four-year high of 49.76 (up 12% from its 2005 low), we are not changing our bullish stance. We will continue to be bullish until "an equal and opposite reaction" tells us otherwise (e.g. a drastic change in economic fundamentals or a drastic drying up of global liquidity).

You have seen how we applied an ancient wisdom such as Newton's Law of Inertia in our investment philosophy. Unlike others who have moved in and out of the markets, we have stayed the course and have reaped the benefits by staying long in the market. Indeed, there is wisdom to be found in every corner of our lives, and if we just look carefully, investment managers like us and individual investors alike will never be lacking in guidance.

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