Philequity Corner (July 2, 2007)
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Why is the market correcting?

After an exciting ride over the past month, the market finally corrected last week. Hardest hit were some second- and third-liner stocks which had quite a runup during the past two months. Many investors called us to inquire what has caused the market downturn. Our reply is that the correction was triggered by a confluence of factors, both global and domestic. These include:

1. **Greed and irrationality hit the market**. There has been a dizzying but worrying run-up in the share prices of second- and third-liner issues. The top 50 stocks in terms of share price performance have generated returns ranging from 56% to 500%! But on a closer look, these stocks are not even included in the index. In fact, the only index issue that can be seen in the roster of top performers since May was Meralco and it only placed 66th in the list.

   Many of these top performers also offered limited or no fundamental backing, and some even exhibited capital deficiency. One can therefore only surmise that their spectacular performances were driven largely by speculation and punting. This has therefore made them vulnerable to a correction.

2. **PSE threats to delist capital deficient companies with no business plans.** This preemptive move put rationality back to the market and should protect the investing public from undue speculation. It prodded many investors to evaluate the quality of their investments in relation to the current financial state of these companies. Some learned to separate the grain from the chaff and sold off their purely speculative stock holdings.

3. **Last week's correction also hit global markets.** It was not exclusive to the Philippines. As we mentioned in previous articles, most markets still take their cue from the US. Unfortunately, the scenario there was not entirely encouraging. The recent spikes in US Treasury yields and persisting concerns on inflation have only heightened the inevitability of interest rate hike. And then, there are the persisting problems affecting the US housing sector which have either created problems or have led to the fall of big hedge funds. These problems are largely seen to be spilling over to other segments of the US financial services industry. These developments have kept investors wary and cautious, leading some to stay at bay from stock investments.

4. **Net foreign buying turns to net foreign selling**. Last week alone, net foreign selling in the Philippine stock market amounted to P3.5 billion. This follows almost two months of successive net foreign buying. This turnaround had a significant impact in the local market given that it was generally the foreign investors who have supported the market on its successive ascent since last May. Domestic institutional investors were not as active.

5. **Liquidity drain arising from IPOs**. The forthcoming big-ticket IPOs are causing a liquidity drain from the market as investors would like to keep their funds ready for these investment opportunities. In all, we are talking of between P69 billion to P78 billion of funds that will potentially be tied down and temporarily siphoned off from the market between July and August this year.

6. **Concerns on the fiscal data**. The release of fiscal data last month raised concerns among investors regarding possible slippages by the government. As of May, the budget deficit was at P41 billion or about two-thirds of the full-year target. This came largely on shortfalls in revenue targets and elicited fears that the government will miss the full-year target for the first time in four years. It also casts doubts on the ability of the government to meet its goal to balance the budget sooner than later.

7. **Entering the lean months.** The summer months usually comprise the lean months in the stock market. The logical reason is that most fund managers, especially the Europeans, will be taking their summer break. Meanwhile, superstitious Chinese investors would also be staying out of the markets before we enter the so-called ghost month. This coincides with the seventh month of the lunar year which usually falls in July or August.

Role reversal

A year ago, investors were looking for stocks that can potentially generate reasonable returns over a holding period of a year or so. Today, we hear of clients wanting to generate unreasonably high returns on their stock investments in week or a single day! Until recently, most investors were cautious and exercised utmost prudence in choosing stocks. They sought the help of seasoned analysts and experienced stock brokers. Today, it is the neophyte investors advising their brokers what to buy. When investors throw caution to the wind and engage in reckless trading, the market is vulnerable to a correction. When desperate housewives, acquaintances, clients who have not called for a long time and neophyte investors start calling to ask for IPOs or brag about their gains from speculating in little-known stocks, we know too well that the market has reached its peak.

Back to rational investing

In our article entitled "Sit Tight and Enjoy the Ride (Philippine Star, May 28, 2007), we highlighted our positive long-term outlook on the market and the economy. We are still keeping this view. But we have also cautioned our readers and investors that the expected market climb will be punctuated by corrections along the way.

There is no way to predict the depth and length of a market correction. But when it does happen, we advise investors to take it as an opportunity to evaluate their portfolio and pick up stocks with sound fundamentals. Not all small stocks are speculative and some may even be diamonds in the rough. In this regard, we again emphasize the value of fundamentals and intensive research to determine the good stocks. In this way, one can minimize risks and have a more meaningful and rewarding stock investing experience.

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