Philequity Corner (06/18/2007)
By Ignacio B. Gimenez

PSE Index will reach 4,500

We have been receiving a lot of queries from our shareholders and readers if it is still wise to put money in the market, especially now that it reached new highs. Some say they find it uneasy to buy into new highs because prices already seem expensive. Some worry about a possible correction, while some are scared that they may catch the eventual reversal in trend.

In general, people experience apprehension going into uncharted territories. But as we have said before, while it is harder to predict corrections in the market, it is easier to tell its long-term direction. In the Philippines' case, the long-term direction is UP.

We continue to be bullish on the market for the following reasons.

1) **New historical highs mean it's still going higher**. We in Philequity believe that buying the breakout of historical highs is an important entry signal. In fact, we are more confident when new highs in the index or even in individual stocks are being made. This means that there are no more resistance levels above and that there are less barriers to the continuation of the uptrend.

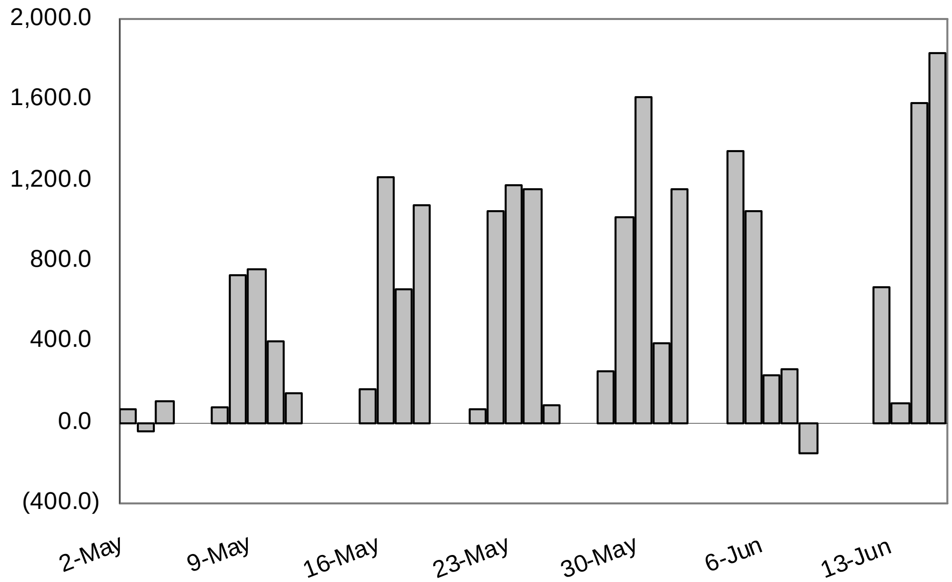
Philippine Stock Exchange Index (1990 to 2007)

Source: Technistock

2) **New money is coming into the market.** After staying much in the sidelines in April (prior to the elections), foreign funds are back in a big way. Data from the Philippine Stock Exchange show that daily net foreign buying since May was positive except only for two instances. Cumulative net foreign inflows to the stock market amounted to P20.2 billion in the past 1 ½ months alone.

So far, it has been the local institutions and local retail clients who are selling. If the market corrects they will surely come back. If it continues to go higher, there is also the possibility that these institutions and retail clients may buy back at a higher price.

Daily Net Foreign Buying in the PSE (May 2 to June 15)



Source: Phil. Stock Exchange

3) **Trust assets of banks and mutual funds are still underinvested in equities.** Unlike in other countries, trust assets of Philippine banks invest only a small proportion of their portfolio in equities. In fact, a balanced portfolio would entail a 50-50 weighting in equities and fixed income. Here in the Philippines, it may only be 5 percent or less allocated in equities.

   Meanwhile, data from the Investment Company Association of the Philippines (ICAP) show that out of the 39 mutual funds registered with the SEC, only 8 are pure equity funds. As of April 2007, equity funds accounted for only 12 percent of the P86.4bn assets under management (AUM) for the whole mutual fund industry.

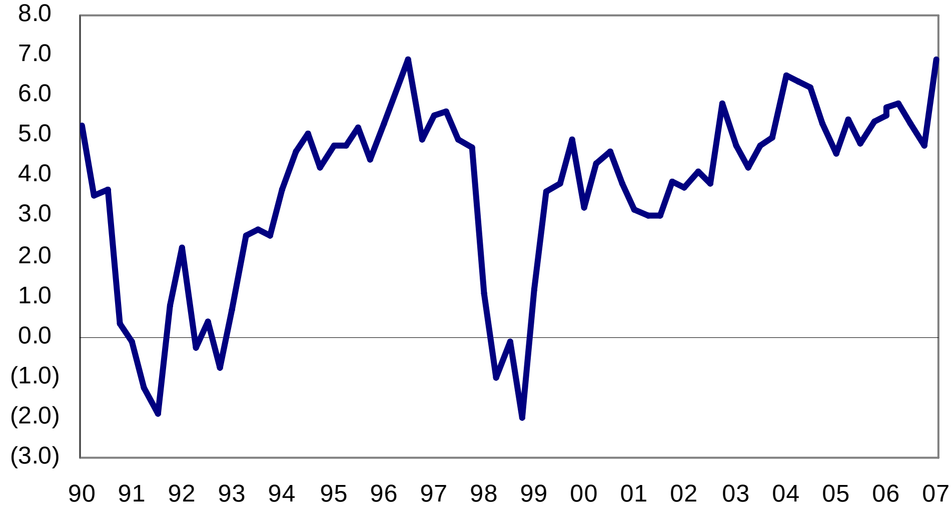
4) **Appreciating peso is bullish for equities.** A lot of Filipinos were used to the peso depreciating. Many have a mindset of buying dollars whenever they have savings. This is why the FCDU deposits in banks are still quite large reaching a record high of $23.6bn as of end-2006, surpassing even the previous record of $21.7bn in end-1997. With the peso appreciating 18 percent since July 2005 and 5.4 percent year-to-date, these FCDU deposits are actually losing. Meanwhile, a peso-based investment such as the Philequity Fund has returned a compounded annual rate of 28.9 percent during the last five years. Sooner or later, those with FCDU deposits and those who continue to buy dollars as an investment would have to rethink.

5) **Higher GDP growth level means a re-rating.** With real GDP growth in 1Q07 surging to 6.9 percent, the market could benefit from a re-rating. Whereas previously the market was being priced at 14x – 16x PE, the market is bound to trade at 17x - 19x PE. Note in the mid-90’s during the time of President Ramos (when quarterly GDP last grew above 6

percent), the market was trading as high as 22x to 25x PE. So a market re-rating now is not that far-fetched.

As of Friday's close of 3,671.29, our year-end target of 3,700 for the PSEi is already within reach. Thus, we are now upgrading our end-2007 target to 4,000 and our end-2008 target to 4,500. The higher valuation reflects the higher GDP growth and continued strong corporate profitability going forward.

Quarterly GDP Growth (%) – 1990 to present



Source: NSCB

For comments and inquiries, you can email us at info@philequity.net or gime10000@yahoo.com.