Philequity Corner (October 1, 2007)
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Peso oil in p terms

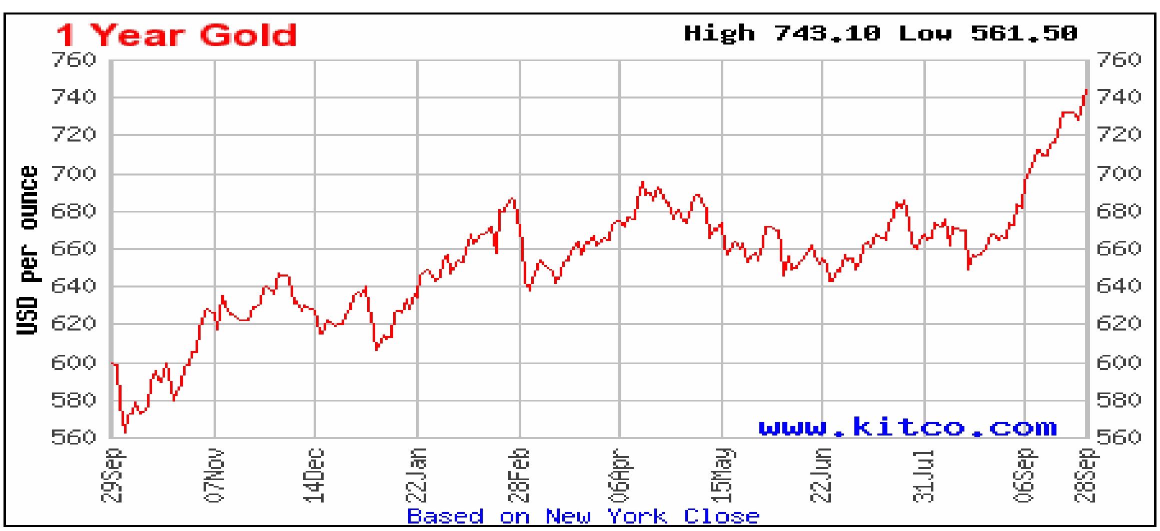
Oil and other commodities surge as Fed eases rates

The arguments which made us bullish on equities - after the Fed decided to ease rates to avert a possible recession - are also the same reasons why we remain bullish on oil, gold and other commodities. In fact, we were about to publish this article two weeks ago but it was put off so that we can first discuss the implications of Fed policy on the stock market.

Commodities had their biggest monthly gain in 32 years as investors turned to oil and gold after the US Fed signaled it was going to fight off recession with greater liquidity.

Crude oil climbed to an all-time high of $83.90 on September 20, 2007.

Meanwhile, gold rose to a high of $752.80 an ounce last Friday, the highest since January 1980.



Effect of the Fed rate cuts on commodities

Commodities is benefiting from the added liquidity brought about by the Fed easing in the wake of the US housing debacle. As real interest rates fall in the US, the liquidity created is driving up commodity prices as investors and central banks search for alternatives to paper currencies. Moreover, investors turn to commodities as a hedge against the falling dollar.

With interest rates dropping and oil trading at new highs, there is also fear that inflation is rushing back into the economy. This is bullish for gold which is usually used as a hedge against oil-led inflation. Meanwhile, the strength in crude prices bolsters sentiment towards commodities as a whole.

Investment choice in times of uncertainty

Investors typically turn to gold and other hard assets in times of economic uncertainty. And since gold tends to move contrary to paper assets, it is serves as a good alternative to diversify one's portfolio. Due to advances in finance, the demand for gold now comes not only from traditional buyers such as jewelers, but also from hedge funds and other investors seeking long-term investments.

As a result, funds are now flowing into gold exchange traded funds (ETF) in quantities that were much larger than before. StreetTracks' Gold Shares ETF (GLD), the world's largest gold fund, increased its holdings of the precious metal to 567 tons by September 13, constituting a record high for the company. GLD now holds more gold bullion than the Bank of Japan.

Similarly, oil is also becoming an investment choice among funds. According to the Bank of International Settlements, the claims on real barrels of oil rose nearly six-fold from December 2004 to June 2006 largely because of the rise in the notional value of oil derivatives held by financial institutions. Demand from the investment community has caused oil prices to rise sooner than they would have otherwise.

What's in it for the us?

While our economy has to brace for higher oil prices, rising metal prices mean a tremendous lot for the Philippine economy. We have written extensively in the past on the potentials for the Philippine mining industry (see "*The Philippines Does Not Have to Remain Poor*" and "*Mining Boom, Back to the 60s*" on the April 3 and April 24, 2006 issues of *The Philippine Star*, respectively). We highlighted that the country is the fifth most mineralized country in the world but we have barely tapped into the country's vast potentials. The prevailing strength of world metal prices should spur further investments in the sector which we have barely tapped.

Meanwhile, in another article (see "*Metals Regain their Luster*" on the April 9, 2007 issue of *The Philippine Star*) we noted that bright opportunities await investors in mining companies, either directly or through the stock market. Investors, however, have to exercise prudence and do their research as only a handful mining companies are already producing, while most are just in the initial stages of exploration. Similarly, most oil companies listed in the stock exchange are in the process of exploration and rehabilitation of abandoned oil wells.

Nevertheless, despite its nascent stage, the mining and oil sector has significantly outperformed the broad market since the Fed first eased in August 17. The sector has since gained 64.8 percent compared to the 23.9 percent rise in the PSE index (see table below). **Implication: investors are once more embracing risks because of the Fed's move.** This augurs well not only for the mining and oil sectors, but for the stock market in general.

Mining and Oil Sector Outperforms!

	Aug. 17	Sept. 28	%Chg
PSEi	2,884.3	3,572.9	23.9%
Financial	791.8	908.5	14.7%
Industrial	3,951.8	4,572.7	15.7%
Holding Firms	1,593.3	2,033.0	27.6%
Property	1,310.9	1,612.7	23.0%
Services	1,389.6	1,740.5	25.2%
Mining & Oil	4,472.2	7,372.1	64.8%

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