Philequity Corner (March 31, 2008)
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Bulls by split decision

Philequity Corner's logo in our byline accurately depicts what has been happening in the financial markets over the past months where the bulls and the bears are face-to-face and making their final stand. Just like in a PBA or NBA finals which is decided by a 7-game series or in a boxing match where there are 12 rounds, the battle for supremacy between the bulls and the bears is going down the wire. When the bell sounds, however, we believe that the bulls will be ahead, albeit by the slightest of margins. The bulls will win in the end because the Fed is doing everything it can to avert a credit crisis.

Tale of the tape

Below is a list of bullish and bearish factors showing how the bulls and bears match up.

Bulls	Bears
A more aggressive Fed recently cut the fed rate by 75 bp and opened a borrowing window to non-bank institutions.	A deepening US credit and housing crisis is now translating to broader economic weakness and spreading outside the US.
Major central banks (Fed, BoE and ECT) are now said to be discussing the option of directly buying mortgage securities in the secondary mkt.	More bailouts may be needed after the high-profile failure of Bear Stearns.
The Philippine economy is stronger than ever, growing its fastest in over 30 years. GDP growth in 2007 was 7.3 percent.	Global growth is expected to decelerate due to the economic recession in the U.S and a slowdown in Europe.
Improvements in the fiscal position now provide headroom for investments in vital infrastructure and social services.	Politics remain a problem. Investors may find a better political climate elsewhere, e.g. Taiwan and Korea.
Valuation is at the low end of its historical range (12x to 17x price-to-earnings ratio). With the PSEi at 2,956, the market P/E is 12x.	Technicals still point to an intermediate downtrend. Market still in "bear" territory, down 24 percent from its Oct. 2007 peak.
Cash yield have increased and company share-buybacks have recorded an upsurge.	Philippine consumer prices rose at its fastest pace in 16 months last February, up 5.2 percent amid rising food and oil prices.

Blow-by-blow

The bears were clearly ahead in the earlier rounds.

- The US is experiencing its worst housing recession in history. House prices have fallen significantly from their peak driving households into negative equity and homebuilders into bankruptcy.
- The housing recession translates to sub-prime mortgage losses estimated to be $250 billion to $400 billion.
- The sub-prime mortgage crisis spreads to other forms of unsecured consumer credit.
- Since mid-2007 at least 40 hedge funds have collapsed and 26 more are under watch-list.
- Large US banks like Citigroup, Morgan Stanley, Merrill Lynch, etc. have posted at least $195 billion in write-downs and credit losses tied to sub-prime mortgages and CDOs.
- The credit rating of Ambac, a monoline insurer, was downgraded from AAA to AA on January 18, 2008. Monoline insurers guarantee the payment of the principal and interest when an issuer defaults. Other monoline insurers are under review.
- Bear Stearns, the sixth largest investment bank in the US, nearly went under.

Meanwhile, the bulls came back strong in the latter rounds.

- The Fed has cut rates significantly over the past six months from 5.25 percent down to 2.25 percent.
- The Fed has also opened the so-called discount window to investment banks.
- The Fed extends its swap agreements to 28-days and increases its lending window to $200 billion.
- The Fed, for the first time in history, is using its own balance sheet to bail out Bear Stearns by lending thru JP Morgan.
- The Fed together with the Bank of England and the European Central bank are said to be discussing options of directly buying mortgage securities.
- The US government is set to unveil this week a plan to give the Fed greater powers to ensure market stability.

Latter rounds are the toughest

In boxing, the latter rounds are truly the toughest, especially when the fighter is behind on points and has this final chance to impress the judges.

The bears clearly are still ahead. Yields on US 3-month Treasuries dropped to 0.387 percent (almost zero) in March 20, the lowest since 1954. Meanwhile, the Merrill Lynch monthly survey of fund managers shows that a net of 42% of asset allocators are overweight cash, a record level. All these point not only to a loss of confidence but to the extent of panic in the financial markets. But with global fund managers now holding extreme cash positions, it is very likely that a reversal is near.

Changing the rules

More importantly for the bulls, the Fed is now doing everything (using both conventional and unconventional policies) to break the impasse in the credit and mortgage markets. As we have mentioned in a previous article "more bailouts may be needed …and the Fed, together with other central banks, may need to be more aggressive to put up liquidity in the system (see "*US credit* *crisis and bailouts – Reminiscent of the 1997 Asian crisis*" in the March 17, 2008 issue of **The Philippine Star**)."

The next step that will truly turn things around is for the Fed to buy outright prime mortgage-backed securities or for a full-scale banking bail-out via a state-sponsored recapitalization program. History has taught us that during banking crises (such as those experienced in Korea, Indonesia and Thailand in 1997), unorthodox government intervention was inevitable, once it became apparent that the private sector alone were not able to solve systemic banking problems.

Breaking the bear's grip

All these positive signals late in the match give the bulls a slight edge. This, however, does not mean that the bulls win will hands down. Rather, this means that policymakers are giving the bulls an edge by rekindling some risk-taking in the financial system and reducing the odds of a downward spiral. This credit crisis may continue to drag on and the bears may prolong its tight grip on the stock market. However, at the end, the bulls will win because the rules of the game will be altered to its favor.

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