PHILEQUITY CORNER
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Risk Appetite
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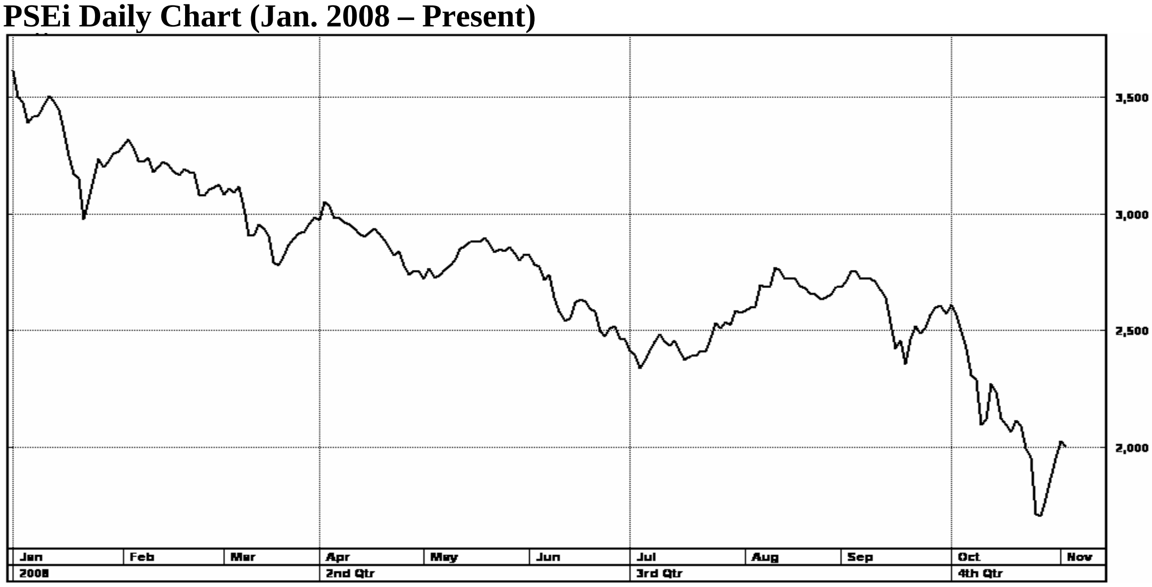
In the midst of the October meltdown, the rallying cry had been, “cash is king”. This belief in keeping capital in its most liquid form went to the extreme of selling at a loss in a gigantic redemption wave and fearful withdrawal from mutual funds and other pooled investments. The panic selling further exacerbated values of equities to the point that they hit record lows where even index stocks fell by over 50% year to date and as much as 85% from their fifty-two weeks’ highs.

Philippine Stock Index (PSEi) Constituents

	Stock Code	52-Wk High	52-Wk Low	% Drop		Stock Code	52-Wk High	52-Wk Low	% Drop
1	LCB	0.59	0.07	-88.2%	17	BDO	63	21.75	-65.5%
2	LC	0.54	0.065	-88.1%	18	AC	537.5	197	-63.4%
3	MEG	4.5	0.58	-87.1%	19	MER	89.5	36	-59.8%
4	FPH	86.5	12.25	-85.8%	20	UBP	50	20.25	-59.5%
5	VLL	6	0.99	-83.5%	21	GLO	1,750.00	720	-58.9%
6	FGEN	63.5	10.75	-83.1%	22	HLCM	8.3	3.45	-58.4%
7	FLI	1.88	0.36	-80.9%	23	SM	395	167	-57.7%
8	JGS	11.5	2.46	-78.6%	24	PX	8.65	3.85	-55.5%
9	RLC	21.25	4.6	-78.4%	25	SMPH	12	6.3	-47.5%
10	ICT	49	12	-75.5%	26	TEL	3,205.00	1,810.00	-43.5%
11	URC	15	4.5	-70.0%	27	BPI	57.08	33.33	-41.6%
12	ALI	17	5.1	-70.0%	28	MWC	19.25	11.25	-41.6%
13	EDC	7.6	2.3	-69.7%	29	JFC	52.5	32	-39.1%
14	MBT	63.5	19.25	-69.7%	30	AEV	7.8	4.8	-38.5%
15	RCB	29	9.3	-67.9%	31	SMC	61.5	38	-38.2%
16	PNB	54	18.5	-65.7%	32	SMCB	62	38.5	-37.9%

Source: Technistock (as of Oct. 31, 2008)

PSEi Daily Chart (Jan. 2008 – Present)



Source: Technistock

The chart above shows how deep the fall of the index stocks has been. As a rule, the faster a stock has dropped (and some have shown precipitous falls of 50%) in a matter of two weeks, the easier it is to bounce from the record lows and make a 50% recovery. The ride back to green territory can be just as fast. This is assuming intrinsic value in the stock and the fall arising from indiscriminate rush to cash.

In what can be termed a bear rally two weeks ago, which seems to be gaining momentum, is cash still king? Should those who headed for the fire exits stay out of the movie house or take back their seats to see how this movie ends?

The first question that private bankers or investment analysts ask their clients is their investment philosophy. This is a simple evaluation of the client's appetite for risk. If the goal is to just conserve the principal and perhaps get a modest semestral coupon, the direction will be for either fixed-income bonds or dividend-paying stocks. If the risk appetite is a bit more robust, the portfolio may go for growth stocks that have a bigger upside and also the possibility of a downturn. Risk and reward always go together. The higher the return anticipated, the higher too is the risk of losing capital. Truly, there are no sure ways to get rich quick.

Here are some thoughts on the need for considering one's appetite for risk.

Cash is not risk free. There is a mistaken notion that cash is the safest form of investment. This belief disregards inflation, and if the cash is in pesos, the effect of a currency depreciation. While cash is seldom kept under the pillow, as this is too lumpy to allow sleep, the interest from even a special deposit cannot cover the twin effects of inflation and foreign exchange risk. So, "parked cash" entails its own downside hazard.

Opportunity cost has to be considered. Keeping investments in one form necessarily leads to giving up potential yields in other forms of investments. Especially if the present cash level is the result of liquidating already at a loss a position in equities or a tranche of managed funds from an investment pool, waiting on the sidelines entails opportunity cost. If the equity markets have bottomed out, as they may already have done in the last week and a half, hanging on to cash entails giving up any participation in a stock rally. This loss of opportunity equates to foregone profits. This is a cost too that needs to be computed.

Risk and reward go together. Even a conservative investor need not keep his total portfolio in cash. This can be a risky strategy too, as shown in the points above. It's possible to spread the risk and allocate even a third of the cash back to equities. To further cushion the risk impact, it is possible to acquire only dividend-paying stocks. This allows the investor to participate in a stock rally; even if modest while still looking forward to some returns that given the prices near the bottom can offer annualized yields of up to 14%.

The equities market has too often been called a "casino". This metaphor is too simplistic. Bets in the casino are decided by the luck of the draw and there are no underlying fundamentals to balance off the risk being undertaken. There is no holding period at all as profit and loss is computed in each round. While skill can play a role in certain games of chance like poker, it is mainly in determining whether to let a particular turn go and limit losses. The upside cannot be as reliably computed.

It is the leveraging of investment using borrowed funds or stocks to make investment decisions that have exacerbated the steep declines in value as the investors covered their positions. Note the quirky rise of Volkswagen from 200 to 1005 Euros in one day due to the shrinking of available stocks from Porsche's exercise of some options, burning some short sellers in the process and catapulting VW into the largest market cap in the world for one day. Quite often in the bear rally, equity gains have been doused by late selling in the last thirty minutes of trading. This was true for both the foreign and local markets. Margin calls and redemptions have distorted the selling pressure in the panic cycle of the downturn.

Is it time to come back from the fire drill? Is the cash waiting in the sidelines ready to be out back to work?

This is a decision each investor needs to make. He has to ask himself what risk levels he is willing to accept. Staying with a strategy of 100% cash in one's investment portfolio may be a risky proposition and can lead to investor's remorse. The time frame for one's investment returns is critical. Anyone looking at a horizon of over six months needs to put his cash to work.

Cash is not an investment. It is a store of value which is not really constant.

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