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By Valentino Sy

2009: A Year of Opportunity

The best thing about 2008 is that it is over. Yet as the new year unfolds, there is reason to hope. We believe that 2009 will be a year of opportunity for those investors willing to stay in the game. Not that stocks and the economy will stage a speedy recovery, but that economic conditions will begin to stabilize in the latter part of the year.

Economy will begin to stabilize in 2nd half of 2009

We enter 2009 with great uncertainty, low expectations, and significant problems. For sure there will be a lot of negative news still to come just like the December jobs report which came out on Friday which claimed 524,000 jobs. These negatives include:

- Recession in the developed world and market slowdown in emerging economies
- Significant earnings declines and analysts downgrades
- More write-offs, more bankruptcies
- More hedge fund redemptions, margin calls and deleveraging
- Higher cost of debt funding for most businesses
- More job losses and higher unemployment
- And widespread deflationary expectations

Buried under the bad headlines are the not-so-obvious positives for prices of risk assets. These include:

- Trillions of new dollars on bank balance sheets waiting for the multiplier effect to turn them into 10 times that amount.
- Upwards of $1 trillion that will be pumped into American businesses and returned to consumers in the form of tax breaks and outright government spending
- Up to $500 billion allotted by the Fed to purchase agency debt and mortgage-backed securities to provide support to the mortgage and housing markets
- Up to $200 billion allotted by the Fed to facilitate extension of credit to households and small businesses
- US and European governments and central banks bailing out their private sectors and recapitalizing their banking system.
- Trillions of US dollars sitting in foreign reserve accounts and sovereign wealth funds that could be used to purchase assets at distressed prices.
- The recent crash in commodity input costs, like a huge tax break, should temporarily help businesses increase profitability despite lower revenue levels.

Eventually, we expect these policy-induced reflationary efforts to offset the credit-led deflation. Our view is that towards the end of 2009, the massive fiscal and monetary stimulus coupled with quantitative easing by the Fed will have counter-balanced any deflationary expectations remaining.

Economy bad, stocks good

Typically, the stock market is a reliable forecaster of the economy and usually moves 6 to 9 months ahead of the economy. With this in mind, we should start looking at the stock market even though economic news and headlines continue to be bad.

Time to invest in risky assets

This year, unlike last year, we believe that equities, as well as other risk assets, will outperform safe assets. We believe that the equities market is already in a bottoming process. Bottoms take time to happen. It is difficult to forecast and likewise foolhardy to try to

pinpoint the exact bottom. Nevertheless, it is our view that the market has made important lows in the latter part of 2008.

October 10th appeared to be the selling climax post-Lehman failure. Meanwhile, November 21st is the day the market retested the lows of the climax in October and established an even lower reference point (refer to chart below).

We may test those levels again before this first half is over but our view remains that the massive, unprecedented fiscal and monetary stimulus that is expected to kick-in by the 2nd half of the year will offset the credit-led deflation, and therefore, help support asset prices.

Stocks are cheap

Valuation-wise, stocks are cheap. Valuation parameters, such as price-to-earnings, price-to-book, are at the low end of their historic ranges, while dividend yields are rising to their highest in years.

While the market may or may not retest its November 2008 low, we believe that the almost 50 percent decline in the benchmark Dow Jones Industrial Average (DJIA) since it peaked in 2007, already discounts most of the problems currently faced today.

Money on the sidelines

Risk assets may also get a boost from the huge pile of money sitting on the sidelines. Approximately $3.8 trillion is currently invested in the form of money market funds, treasury bills, and the like, getting returns close to zero. At some point in time, these will get reinvested, and the consequent rebalancing should cause risk assets to outperform this year.

In fact, we are already seeing that happen. On average, equities markets are already up 20 percent from their lows last year. We are also seeing money flowing out of US Treasuries and into municipal bonds, high-grade and high-yield bonds.

Last week, the Philippines sold $1.5 billion of bonds in the international market, while Turkey, Brazil and Colombia sold $1 billion of bonds each. We are seeing yields on emerging market debt decrease over the last two months, reversing a surge in September and October sparked by the global financial crisis.

Inflation in free-fall

Another overlooked aspect is that the prices of oil and other commodities, which are inputs to production, have fallen drastically in such a short period of time. Oil, for example, has fallen from $147 to $40. As prices from these production inputs decline, profit margins would improve. Thus, the cost pressures that were felt not so long ago would no longer be there, temporarily cushioning company profitability from revenue shortfalls.

Baffled? Tired? Discouraged?

Despite the not-so-obvious positives mentioned above, it is easy to get baffled, tired and discouraged given the extreme volatility and horrendous market performance last year. This is also the time that most investors will give up altogether on the market. However, one has to be in the game especially at this stage rather than quitting the market. This is the time to rummage through the rubble.

Staying in the game

Staying in the game does not mean that you just buy stocks blindly. It does not mean holding on to and averaging down your losses. Rather, staying in the game keeps you on your toes. It keeps you from picking stocks that are worthless. It keeps you from speculating in situations that can wipe you out. It keeps you from leveraging or buying on margin when risks are high. It keeps you from averaging down on bad stocks.

Moreover, staying in the game allows you to remain focused on the long-term, ride out potential volatilities, look for buying opportunities, and above all, rely on the basic tenets of proper asset allocation and diversification.

Not the time to bailout

In fact, now is not the time to bailout because prices are so cheap. The market has dropped so hard that opportunities are just so much because stocks have dropped as much as 70 to 80 percent on an individual basis. The reason that most people don’t get rich with stocks is that people can’t stay long enough to win, even when opportunities abound.

Asia’s Best Finance Minister

In 2005, Sec. Teves who was then a director of Philequity Fund, was called upon to become Finance Secretary. While it was a loss for Philequity, it was a gain for the country. We are very proud of him, now that he not only became Finance Secretary but more so because he was named recently by the London-based magazine *The Banker* as The Best Finance Minister in Asia for 2008. Congratulations to Sec. Teves!