Philequity Corner (March 23, 2009)
By Valentino Sy

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While we were recounting the blow by blow account on Meralco, the US markets staged its best two-week rally since November 2008. The possibility of significant changes in the mark-to-market accounting and the reinstitution of the uptick rule in short-selling of stocks resulted in a broad market rebound led by banks and financial stocks.

The Standard & Poor's 500 index, which is a broader measure compared to the Dow Jones Industrial Average, may have reached an ominous low of 666 on March 6.

Source: www.stockcharts.com

Financials: Back from the ashes

Investors turned more upbeat on the beleaguered financial sector after Citigroup reported on March 7 that it had profits from operations for the first two months of the year (although no clarifications on credit losses, derivatives and toxic assets were made). Other banks like JP Morgan and Bank of America later made similar comments.

Meanwhile, the US House Financial Services subcommittee had a hearing on mark-to-market accounting rules last March 12. The House invited the Financial Accounting Standards Board (FASB) to make proposals allowing companies to use more leeway in valuing their assets under the "mark-to-market" rule. The news further propped up shares of financial companies, especially those with distressed balance sheets.

As a result, financial shares rose like a phoenix from the ashes. Among the best performers was Citigroup whose share price rebounded as much as 300 percent from

a low of .97 on March 6 to a high of 3.89 last Thursday. This was followed by Bank of America whose share price surged as much as 186 percent from a low of 3.00 on March 6 to a high of 8.57 last Thursday. Despite giving up some of their gains on Thursday and Friday, Citigroup and Bank of America are still up 170 percent and 106 percent, respectively from their March lows.

By Friday, most US banks already had triple-digit gains with the best returns coming from those which registered the biggest peak-to-trough declines.

	Date	Peak	Date	Trough	*%Decline*	Current	*%Rally*
Morgan Stanley	6/15/07	75.32	10/10/08	6.71	*-91.1%*	20.24	*201.6%*
Citigroup	12/29/06	56.66	3/6/09	0.97	*-98.3%*	2.62	*170.1%*
Bank of America	11/24/06	55.08	2/20/09	2.53	*-95.4%*	6.19	*144.7%*
Goldman Sachs	11/2/07	250.70	11/21/08	47.44	*-81.1%*	97.32	*105.1%*
Wells Fargo	9/19/08	42.50	3/6/09	7.80	*-81.6%*	13.99	*79.4%*
JP Morgan	5/9/07	50.40	3/6/09	14.96	*-70.3%*	23.15	*54.7%*

Source: Bloomberg, Philequity Research

Bear market rally?

Despite the 15 percent gain in the S&P 500 index from its lows, many investors still dismiss this recent recovery as just another bear market rally. Who can blame them? In the past year alone there were four other (10 to 28 percent) rallies that failed.

The first was in March to May 2008 when the S&P 500 index rallied as much as 15 percent. The second was in July to August 2008 when it rebounded 10 percent before faltering. The third was the sharp 25 percent two-week recovery in October 2008. And the fourth was the steady 28 percent climb from November 2008 to early January 2009 prior to reaching fresh lows in March 2009.

As John Maynard Keynes famously said, "*Markets can stay irrational longer than you can stay solvent*." So it is not surprising that only a few would dare to call a bottom this time around because most of the bulls have already given up and most of the bears have already turned early bulls and were wrong.

Climbing a wall of worry

Nevertheless, we think that the odds have dramatically improved that an important bottom is at hand. The fact that financials led this current rally makes it more credible than previous rallies. Because financials are the root of this global crisis, we believe their improvement is also the key for the revitalization of the global economy.

There are currently a number of major government programs that are now in place to deal with the banks' capitalization, the frozen consumer and corporate loans, and the real estate mess. The latest plan was the announcement this week for the Fed to buy up to a trillion dollars of US government bonds, mortgage agency notes and mortgage-backed securities.

In addition, key market sentiment surveys (the *Daily Sentiment Index* by MBH Commodity Advisors and *AAII Bulls Minus Bears Index* by the American Association of Individual Investors) both registered all-time pessimism extremes. Usually, extreme negative recordings in sentiment often point an important bottom of some sort.

While most are still saying that this is just another bear market rally, we are keeping our hands crossed. Actually, a reversal to a bull market always starts with what seems like a bear market rally. In the initial stages of a bull market, investors "climb a wall of worry." This is similar to the start of a bear market, when investors "slide down a slope of hope."

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