Philequity Corner (April 27, 2009)
By Valentino Sy

A Pause that Refreshes

Stocks took a breather last week after registering six consecutive weekly gains. On Monday, it looked like it was going to be a sharp correction for the S&P 500 Index when it took a 4.28 percent hit for the day. However, the market held ground and started recovering the following day when Treasury Secretary Tim Geithner spoke on Capitol Hill.

The market appeared to take a positive view on Geithner's testimony, including his assessment that "the vast majority of banks have more capital than they need to be considered well-capitalized." Bank stocks, which fell hard on Monday, bounced back after Geithner's comments.

By the end of the week, the S&P 500 Index only gave back 0.39 percent in what seems to be a pause in the market recovery. Just like in boxing, in basketball or in a marathon where athletes need a second wind, the process of correction in the stock market is a process of healing and stabilizing – a pause that refreshes.

Is the bottom in?

With the S&P 500 Index rallying by 30 percent from the March lows, the obvious question lingering on the minds of investors is: Did the market finally bottom? We believe so.

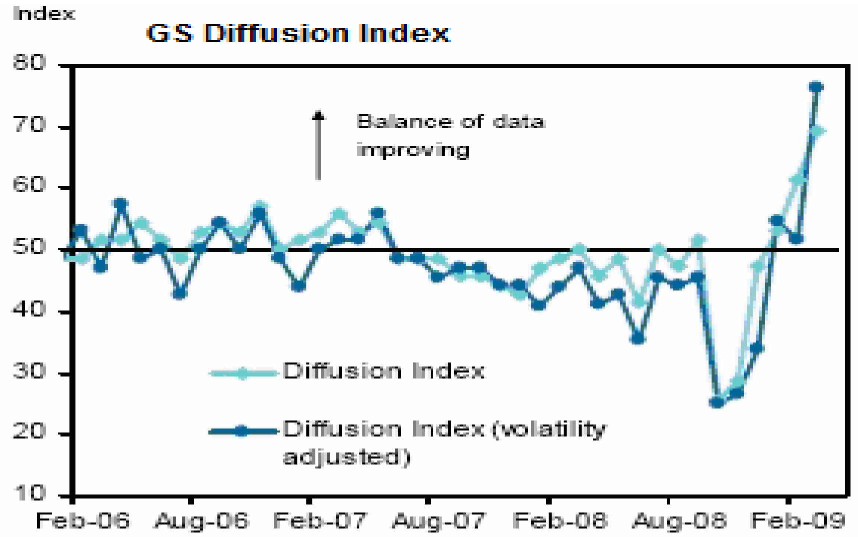
While there is no denying that the US economy (and much of the rest of the world) has not yet recovered fully, we must remember that the stock market is a forward-looking mechanism. In other words, the market recovers well before the economy gets better.

Officially, the US recession started in December 2007. Most economists now predict the recession to end by 4th quarter of 2009 or 1st quarter of 2010. Thus, the market low registered in March is typically where a bottom should be - which is 6 to 9 months before the end of a recession.

Less bad is good

Another indicator that the market has bottomed out is that stocks have been reacting positively on less bad news. In fact, the world economy is showing signs of going from worse to bad. In other words, there is already a slowing in the deterioration in a number of economic variables.

These claims were recently validated by Goldman Sach's Diffusion Index (a composite of 34 economic data points from across the globe) that increased to above 50 in February and March, which means that the data are improving. The chart below shows that the turn in the Diffusion Index coincided with turn in the stock market.



Source: Haver Analytics, GS Global ECS Research

As Jeremy Grantham (co-founder of Boston-based GMO) puts it in his March newsletter, "*Be aware that the market does not turn when it sees light at the end of the tunnel. It turns when all looks black but just a subtle shade less black than the day before.*"

Corrections are harder to predict

"Overbought", "too fast, too soon" and "hitting resistance levels" are three phrases investors and analysts have been arguing lately. In fact, a lot of investment banks (even those that called the bottom) were calling for a sharp pullback last week only to be disappointed by the shallow correction.

Our contention, however, has always been that "nobody really knows where the market bottom is or the market top is." And a correction is even harder to predict. It can be sharp and fast. Or it can also be shallow. In fact, we may have seen the correction already.

Thus, never underestimate the strength of the turn from a bear market to a bull market. This is where the biggest gains can be achieved.

The table below shows that the S&P 500 Index has rallied 29.9 percent from the low registered in March 2009, but it is still down -4.1 percent year-to-date. Meanwhile, the PSE Index is up 24.9 percent from the low registered in October 2008 and has returned 12.3 percent year-to-date.

In the case of Philequity Fund, it has gained 20.8 percent since its low in October 2008. The fund is also up 14.6 percent year-to-date.

	Current Price	% Chg from low	%Chg year-to-date
S&P 500 Index	866.23	29.9%	-4.1%
PSE Index	2103.63	24.9%	12.3%
Philequity Fund	9.0916	20.8%	14.6%

Source: Bloomberg, Philequity Research

A chance to get in

History also tells us that the bulk of the returns in a bull market typically come in the initial months of the rebound. Therefore, the current pause in the markets should give investors an opportunity to get in.

Strategy-wise, for those who missed the bottom, now is the chance to slowly build a position as the market pulls back. Meanwhile, for those who are already positioned in the market, it is never wrong to take some chips off the table to be able to buy-back if the market indeed corrects.

As we have said, nobody can really predict the extent of a correction. And while a correction may be forthcoming, we believe that it is healthy for the market. What is important is that the general direction is upwards, even if there will be corrections along the way. In this kind of environment, it is wise to never get out of the game completely.

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