Philequity Corner (May 18, 2009)
By Valentino Sy

Indigestion

One of the definitions of "indigestion" offered by the Merriam-Webster dictionary is "inability to digest or difficulty in digesting food". In the stock market, what we are currently suffering from is the inability to digest the sizeable follow-on offerings during the past two weeks. A total of 50 companies raised $34.7 billion in the first two weeks of May which is the biggest in years.

Following the stress test of banks by the government, Wells Fargo and Morgan Stanley sold a combined $12.6 billion in new shares two weeks ago. US Bancorp and Bank of New York Mellon raised $2.5 billion and $1.2 billion, respectively last week.

Although the bulk of the offerings still came from banks which are beefing up their capital following the completion of the stress test, other industries were represented. Ford Motor Co. raised $1.6 billion, Anadarko Petroleum Corp. raised $1.4 billion and MGM Mirage raised $1.0 billion.

Similarity with Philippine follow-on offerings

With almost $35 billion now in new shares supply, the market wasn't as accommodating as it has been in recent weeks due to follow-on indigestion as well as a broader pullback in stocks after a period of gains.

This is similar to what happened in the Philippine market two years ago when a number of big-ticket IPOs and follow-on offerings swamped the market and drained liquidity (see our article *Why is the market correcting?* in the July 2, 2007 issue of **The Philippine Star**).

The pullback

Nobody can predict the extent of a correction. Even Warren Buffett admits he cannot predict what will happen to the stock market next. What makes it more difficult is that corrections or pullbacks can take several forms.

For one, a correction may be sharp and fast. If this is the case, we can again make use of Fibonacci retracements which we discussed a few weeks back (see our article *666 on 3-6-9* in the April 13, 2009 issue of **The Philippine Star**) to identify areas of support.

Secondly, a correction can also be a sideways movement, i.e. there is no general direction for a few weeks, after which the uptrend resumes.

Lastly, corrections can also take the form of sector rotations. This is the case where erstwhile leaders such as financials and technology stocks take the back seat and defensives such as pharmaceuticals, healthcare and consumer staples regain leadership.

In the Philippine context, stocks that have gone down severely (such as Philippine National Bank and DMCI) are catching up while the previous leaders are pausing.

Sell in May, Go Away?

Still, there are those that advocate the old Wall Street advice during this time of the year, "Sell in May and go away." The reason for this is that during the summer season, most American and European fund managers will be taking long vacations, thereby interest in the stock market will be seasonally low.

In the Philippine stock market, the period following May is the time when people pay for school tuition fees and other education-related expenses. Typically, this period of relative stock underperformance extends up to August which is about the time of the Chinese ghost month.

It is during the "BER" months of October, November and December that the market starts to move up again.

Budding bull market

Of paramount importance is that we believe that the market has turned. What we are witnessing now is not a bear market rally but the rise of a "budding" bull market.

Meanwhile, the current market pullback is just a correction from a market that has gone up too fast, too soon and needs a pause to refresh itself.

Nevertheless, what is important is that we have seen the bottom. And while there will be corrections along the way, the general direction is now upwards.

Review your asset allocation

During this consolidation period, people now should review their asset allocation. Those with huge cash positions and fixed income placements may want to increase their equity exposure as the market pulls back.

Those who want to buy individual stocks should look for companies with a good business model and good management. Others may opt for equity mutual funds to achieve instant diversification.

Those aggressive investors with leveraged stock positions may also want to take profits and lessen their leverage exposure.

For comments and inquiries, you can email us at info@philequity.net. You can also view our archived articles at www.philequity.net or www.yehey.com/finhance.