Philequity Corner (June 22, 2009)
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Correction … Now what?

After gaining as much as 50 percent from its March lows, the PSE Index appears to have started its correction phase last week. On Monday, the index hit a year-high of 2,626, reaching the low end of our target (2,600 to 2,800) for this year. Afterwards, it recorded its worst two-day drop of 170.1 points since this rally started.

Since markets never move straight up, this pullback has been long overdue. The PSE Index closed the week at 2,398.3, down 7.7 percent.

Too fast, too furious

The rally in global equities since the March lows has been too fast and furious as the table below shows. Despite last week's pullback, developed markets are up an average of 36.4 percent from their March lows. Meanwhile, markets in Asia ex-Japan are up an average of 48 percent. As a result, it is not surprising to see some profit-taking and some sort of healthy correction. This should allow the market to pause and refresh before noticeably moving higher.

Market performance since March 2009 lows

Developed Markets		**Current**	**Performance**	
Country	**Index**	**Price**	**Since March Lows**	**Year-to-date**
Italy	S&P/MIB	19,347.98	56.9%	-0.6%
US	Nasdaq Composite	1,827.47	44.4%	15.9%
Japan	Nikkei 225	9,786.26	39.4%	10.5%
US	S&P 500	921.23	38.2%	2.0%
Canada	TSE 300	10,287.95	37.5%	14.5%
Germany	DAX	4,839.46	34.8%	0.6%
US	DJIA	8,539.73	32.0%	-2.7%
France	CAC 40	3,221.27	30.7%	0.1%
UK	FTSE 100	4,345.93	25.6%	-2.0%
Australia	S&P/ASX 200	3,899.60	25.0%	4.8%
Average			**36.4%**	**4.3%**

Asia ex-Japan		**Current**	**Performance**	
Country	**Index**	**Price**	**Since March Lows**	**Year-to-date**
India	BSE SENSEX 30	14,521.89	80.5%	50.5%
Hong Kong	Hang Seng	17,920.93	58.0%	24.6%
Singapore	STI	2,273.18	56.2%	29.0%
Indonesia	JCI	1,990.47	55.6%	46.9%
China	CSI 300	3,080.00	46.6%	69.4%
Thailand	SET	588.98	44.1%	30.9%
Korea	KOSPI	1,383.34	39.4%	23.0%
Philippines	PSEi	2,398.30	37.4%	28.1%
Taiwan	TAIEX	6,231.15	36.1%	35.7%
Malaysia	KLCI	1,059.50	26.7%	20.8%
Average			**48.0%**	**35.9%**

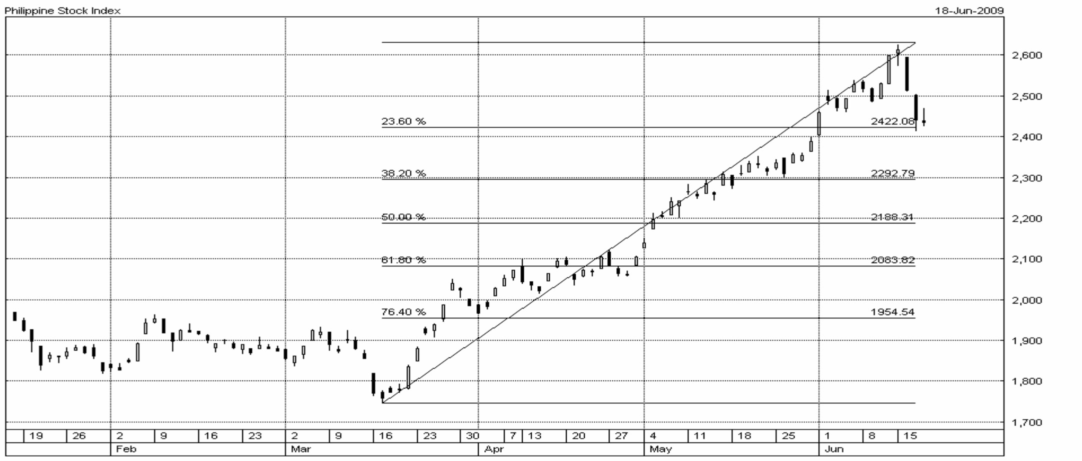
Source: Bloomberg, Philequity Research

Who is Fibonacci?

In a previous article, where we mentioned that the S&P 500 index may have hit bottom on March 6, 2009 (see *666 on 3-6-9* in the April 13 issue of **The Philippine Star),** we also discussed Fibonacci retracements. We pointed out that this esoteric technical trading tool is used to identify possible support and resistance levels.

Named after Leonardo Fibonacci, who was reputed to be the greatest mathematician of the Middle Ages, a Fibonacci retracement is created by taking two extreme points (usually a major peak and trough) on a stock chart and dividing the distance by key Fibonacci ratios of 23.6%, 38.2%, 50%, 61.8%, and 100%.

Typically, corrections give back between 38.2 percent and 50 percent of the gains. Should this occur, it would result in a short-term drop to between 2,188 and 2,292 for the PSE Index.



Source: Technistock

In the case of the S&P 500, a 38.2 percent to 50 percent retracement would bring the index back to between 811 and 845.

Source: Technistock

What do we do?

If you are a short-term trader, you can sell and lighten up on your positions to be able to buy back on significant declines. You can also look at Fibonacci levels and support areas as possible re-entry points.

If you are a long-term investor, you have to look at your asset allocation and re-balance your portfolio every once in a while. For example, if your equity-to-fixed income allocation ratio is 60-40, you have to sell some equities (now that equities have rallied significantly) and buy some government securities or money market funds to bring back the ratio to 60-40.

On the other hand, if your fixed income portfolio is too large in relation to your equity portfolio or if you were left behind by the sudden upturn in equities, this may be your opportunity to get into equities or equity mutual funds, by buying slowly in a staggered basis. As we've said before, corrections are hard to predict. Nobody really knows where corrections will stop. Thus, a more effective way is to buy in tranches at different levels.

Moreover, corrections can also be in the form of sector rotations, i.e. there might be corrections in some sectors while other sectors pick up. In fact, this is what happened last Friday in the US market when energy and materials declined while health care, financials, and technology went up. This type of correction is actually healthy for the market.

Long-term trend is still up

In many ways, the financial markets have been following the typical pattern associated with economic recoveries. The stock markets have been rising, with the emerging markets outperforming the developed markets. Credit spreads have tightened, commodity prices have advanced, US Treasury yields have risen and the US dollar has been declining (see our article *Why is crude oil rising?* in the June 15, 2009 issue of **The Philippine Star**).

Despite the near-term correction, we believe that it is highly unlikely that prices will retest their March lows. Over the long-term, we expect improving economic conditions will help equity prices move higher.

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