Philequity Corner (December 21, 2009)
By Valentino Sy

Where is Santa Claus?

It's barely four days left before Christmas and five trading days to go before the year ends but there are no signs yet of a "Santa Claus rally" in stocks. Global stock markets have gone nowhere this month primarily because of the recent strength in the US dollar, the debt problems in the Eurozone, lower commodity prices and the huge follow-on offerings by US banks.

Since the start of December, the US benchmark S&P 500 index has inched by just 6.84 pts or 0.6 percent. Our own PSE index is even slightly down by 27.98 pts or -0.9 percent.

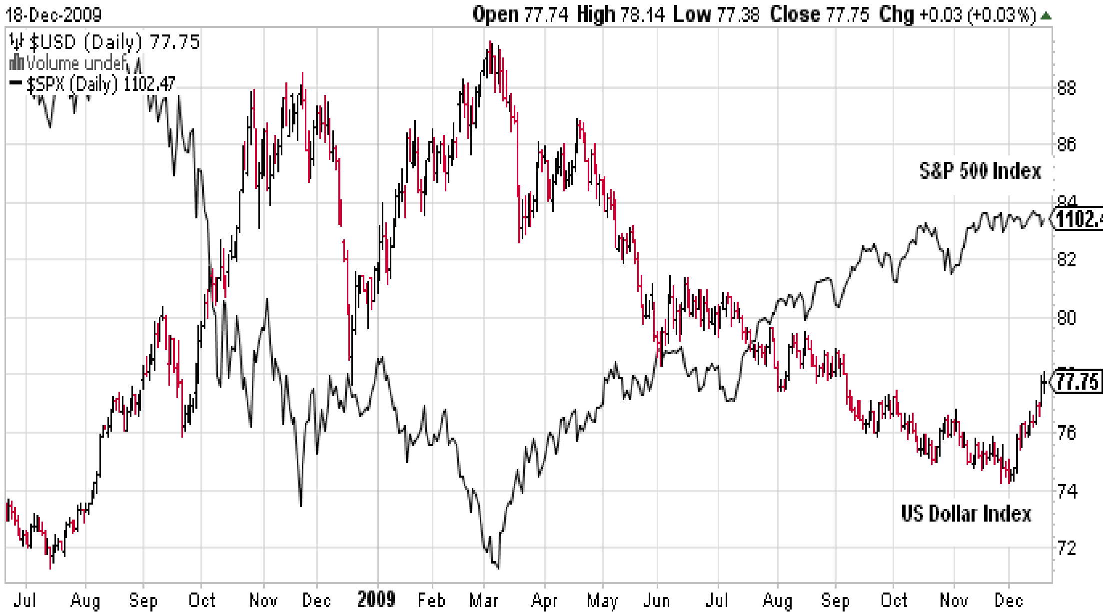
The Philippine market, whether we like it or not, always follow the movements in the US and the region. That is why we at Philequity always make it a point to follow the global events and happenings.

Below, we are citing the different reasons why the stock market has been tentative this December.

Dollar Recovery

One of the reasons why the stock market is hesitant to move forward is because of the huge move in the US dollar in recent weeks. From a low of 74.23 registered last November 25, 2009, the US dollar index has rebounded 4.74 percent to 77.75 as of last Friday. This is the biggest US dollar rally since the March-April period of this year (refer to chart below).

US Dollar Index vs. S&P 500



Source: www.stockcharts.com

Note also from above that during the past 1 ½ years, the US dollar (bar chart) has exhibited strong negative correlation vs. the stock market (line chart). With the US dollar up sharply this December, investors are wary of a potential pullback in equities markets.

Problems in Europe

The problems in Europe also helped fuel the US dollar rally and hold back the end-of-the year rally in stocks.

The Eurozone has been under pressure in recent weeks due to fiscal problems in member countries such as Greece which has been slapped with ratings downgrade on their sovereign debt from Fitch and Standard & Poor's last week.

The downgrade on Greece and continued widening of Greek sovereign credit default swap (CDS) spreads triggered a break in the recent tight ranges in the euro. The euro last traded at 1.43 against the US dollar on Friday, down 5.3 percent from its high of 1.51 on November 25. Incidentally, the euro has a weighting of 57.6 percent in the basket of currencies that comprise US dollar index.

Cockroach Theory

In a previous Philequity Corner article, *Dubai's Phantom Punch* (November 30, 2009), we mentioned that the greatest danger to Dubai's financial woes is a contagion to other countries whose fundamentals are weak, such as Greece. The general view, back then, is that Dubai is only a one-off situation. But two weeks later, Greece's sovereign rating was downgraded.

History tells us that contagions can begin in the most remote places such as Thailand during the 1997 Asian financial crisis. The contagion eventually spread throughout Asia, and later to Russia and even Latin American countries such as Brazil and Argentina.

The so-called "cockroach theory" tells us that if you see one cockroach, you will see more coming. After the first cockroach (Dubai) surfaced, the next one appeared (Greece). Now there are rumors circulating that Spain and Ukraine which similarly have runaway deficits and high debt-to-GDP ratios maybe next.

Commodities pulling back

The strengthening of the US dollar during the past two weeks led commodity prices to drop, in almost every category. This has contributed to the overall cautious tone in the stock market in recent weeks.

With regard to gold, which reached a price high of $1,226.4 per oz. in late November, we did mention in our article *Gold Rush* (November 30, 2009) that investors should exercise caution given its parabolic rise. We said that a good entry point for those wanting to invest is somewhere between $1,050 and $1,100 per oz. Since then gold has indeed fallen to $1,112 per oz. as of last Friday. At this point, we believe that it can even fall further back towards $1,000 per oz.

Huge follow-on offerings

Similar to what happened back in May, the US markets is being swamped by sizeable follow-on offerings this December. We said in our article back then (see *Indigestion*, May 18, 2009) that markets typically suffer a period of follow-on offering "indigestion" as liquidity is drained from the system.

A number of US banks have been raising additional capital to be able to exit the Troubled Assets Recovery Program (TARP). Last week, Bank of America raised $19.3 billion while Wells Fargo raised $12.3 billion.

Meanwhile, Citigroup's share sale was handled poorly. It sold $17 billion in equity and $3.5 billion in convertible bonds to repay $20 billion in TARP aid. The low price that Citigroup got for its share offer ($3.15 per share) forced the US government to scrap its own plan to sell Citigroup's shares worth up to $5 billion. The cost of the US government when it converted its preferred shares in Citigroup into common shares is $3.25 per share.

Fund managers on early vacation?

Another reason why the stock market has been moving sluggishly this December is that fund managers may have gone to vacation early. Because of the huge returns among mutual funds and hedge funds this year, fund managers may already be locking-in the gains already, rather than risk jeopardizing end-of-year bonuses.

Pullback in stocks & commodities is healthy

While this article may sound pessimistic, the irony is, even if stocks and commodities go down, it is good for the domestic economy. Lower commodity prices such as that of crude oil, rice and wheat, which our country imports, should benefit domestic consumers.

Price Performance of Select Commodities

	Recent High	Date	Current Price	%Change
Crude Oil ($/barrel)	81.96	10/21/2009	73.36	-10.5%
Gold ($/t oz)	1,226.40		1111.5	-9.4%
Silver ($/t oz)	19.235	12/2/2009	17.32	-10.0%
Copper ($/lb)	325.85	12/2/2009	313.85	-3.7%
Rough Rice (USD/cwt)	15.98	12/14/2009	15.23	-4.7%
Wheat (USD/bu)	596.5	11/17/2009	528	-11.5%
Corn (USD/bu)	417.5	11/30/2009	397.75	-4.7%

Source: Bloomberg

Even the strong peso is not always good because of the OFWs and exporters which are being hit. This is why the Bangko Sentral does not want the exchange rate to move sharply below the P46/$1 level.

The pullback in stock and commodity prices is also healthier for the overall market especially those whose prices have gone parabolic, such as gold and other metal commodities. Meanwhile, the recent strength of the US dollar should provide opportunities for those investors wanting to diversify into other currencies such as the Euro, or the commodity-linked currencies such as the Canadian Dollar and the Australian dollar.

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