Philequity Corner (September 20, 2010)
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New High Means Higher

We have received many questions from investors, clients, stockbroker friends and readers on the stock market. The new all-time high in the PSE index aroused overwhelming curiosity. It seems that a lot of people have not joined the bandwagon because the move of the index from 3,500 to 4,000 was so sudden. We are taking this opportunity to answer some of the queries that we have received from our shareholders and readers.

1) Why is this market so strong?

The Philippines is now in a "sweet spot." Growth in the developed markets (US, EU and Japan) are slowing whereas Asian growth, in particular the ASEAN and the Philippines are showing robust growth. Funds are moving into emerging markets, particularly into ASEAN which includes the Philippines. Lastly, the technical picture is much better in the ASEAN and Philippine markets which are making higher highs as opposed to developed markets which are drifting sideways (see *Right Place, Right Time,* August 9, 2010).

2) What triggered the sudden upward move?

Several weeks ago, there were still apprehensions that the US economy will make a "double dip" and the global markets were going nowhere. But Fed Chairman Bernanke said that they will go all out and they have all the tools to prevent a recession from happening again.

Then came a report on US Purchasing Managers Index (PMI) two weeks ago which showed that US manufacturing continued to expand for the 16th consecutive month.

In addition, indications of an apparent soft-landing in China further buoyed the markets. China's GDP was able to grow 10.3 percent in the 2nd quarter (from 11.9 percent in the 1st quarter) while keeping a 3 percent rise in consumer prices.

Lastly, the new BASEL III rules came out giving the banks up to 2019 to achieve the new capital targets. The deadline extension would insulate the banks from further financial distress.

The factors above, coming one after another, arrested the downward move in developed markets and triggered new highs for ASEAN markets.

3) Who has been buying the market?

Foreign funds have been heavy buyers since August. Aside from the traditional mutual funds, exchange-traded funds (ETFs) like those managed by Black Rock and Vanguard have recently disclosed new and additional positions in Philippine stocks. Daily net foreign buying averaged Php887 million the past two weeks.

There was also an obvious trend of selling developed market ETFs like SPDR S&P 500 ETF (symbol: SPY) and buying into emerging market ETFs like iShares MSCI Emerging Markets Index (symbol: EEM) and Vanguard Emerging Markets ETF (symbol: VWO).

Local institutions have also been a big factor in this bull market. Their steady presence was very evident when foreign investors were not around.

4) Don't you see a correction happening soon?

Absolutely, there will always be corrections. Corrections are part and parcel of bull markets. But nobody knows exactly when corrections will come. Corrections can take many forms. It can be a deep correction**.** It can be shallow. It can be an intraday pullback. It can also be a "sectoral rotation" correction. However, what we know is that the general direction of the market is still up and after a correction the market will resume its upward trek. Selling in a bullish market and trying to time corrections may cause an investor to miss a big upward movement in this bull market.

5) What should we do now that the index is at a new all-time high?

We have always said that investors should practice sound asset allocation. Asset allocation is based on one's risk tolerance. If you are underweight equities or you don't have any stock position at all, it would be wise to reallocate a portion of your holdings into stocks, as proven by our Philequity Fund which is up 42.9 percent year-to-date. Take advantage of corrections and pullbacks to add stocks to your portfolio.

If you are fully overweight and overleveraged, it may be appropriate to lighten up on your stock positions. Holding the right amount of stocks will help you tolerate the often volatile moves as stock prices rise to higher levels.

New high means that the stock market will go higher. If you've been a loyal reader and follower of Philequity Corner, just hold on to your winnings, sit tight and enjoy this bull ride.

6) What stocks should we buy?

In a bull market, most stocks go up. There is also buying "rotation" among different sectors or industries. But what we recommend is to buy stocks with good fundamentals. These are the stocks that will attract the inflows of foreign funds. Get exposed to different sectors of the market. A clear example would be what happened last Friday when the mining sector started to catch up while the property and banking sectors paused.

If you don't have the time to monitor the stock market day to day, it is better to buy a mutual fund like Philequity Fund. Even professionals and experts don't know for sure which stock will move the highest on any given period. It is advisable to get exposure by buying a basket of stocks.

7) Is it okay to sell because of the big run-up in prices? Should we sell out and wait for the next dip to come in?

There is nothing wrong in profit taking. But if you like to trade, what we espouse is for you to have both a core position and a trading position. Keep your core positions for the long-term and use your trading position to take advantage of the volatility in the market.

If your stocks go up, you can sell your trading position (about 10% to 30% of your total holdings). If it goes back down, you can buy it back. But the most important thing is to hold on to your core position in a bull market.

In a bull market, the big money is made on long-term investments and not on short-term trading.

8) Isn't the market overpriced? Where do you think the market will go?

Yes, some stocks maybe overpriced but earnings will catch up. In general, we expect corporate earnings to grow by 26.9 percent this year. We project earnings to expand by 14.5 percent in 2011.

Based on fundamental analysis, the index may reach anywhere between 4,340 and 4,880. At 4,340, the market remains cheap at 16x forward earnings. If the market hits the 18x forward PER (reached during 2007 peak) then the PSE index could go to 4,880. But in bull markets, prices tend to overshoot and the index can easily reach 5,000.

Based on technicals, the PSE index could initially go to 4,450. Note that the PSE index made a new all-time high a week ago after breaking above 3,896. In technical analysis, making a new high is significant because after a resistance peak has been broken, that level will now provide support on subsequent pullbacks.

The Bull Rages On

Recall our previous article where we showed how we can apply Newton's law to the stock market (see Oct 30, 2006). We substituted "the market" in lieu of "matter" in Newton's Law of Inertia.

Newton's Law of Inertia states that: *"Matter at rest tends to stay at rest and matter in motion tends to stay in motion unless acted upon by an unbalanced force or an equal and opposite reaction."*

This law teaches us that if a market is trending sideways, it tends to stay sideways until a powerful enough market force or catalyst takes it out of its trend. Meanwhile, if a market is trending upwards (or downwards), it will tend to continue moving up (or down) until a drastic change in fundamentals and sentiment create an equal and opposing reaction.

Newton's Law of Interia suggests that the bull market will continue. The new all-time high for the PSEi means that stocks will go higher. New high means higher. The bull market rages on.

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