

November 2008 Review and Near-Term Outlook

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The euphoria surrounding the election of incoming US President Barack Obama quickly evaporated as the reality of the economic recession resumed. The president-elect said he intended to pursue initiatives that address both the immediate economic crisis and as the long-term goals of expanding access to medical insurance and providing middle-class tax cuts while making the tax code fairer. Recently, the US Federal Reserve announced it will purchase as much as US\$ 600 billion of debt issued or backed by government-chartered housing-finance companies, and will also set up a US\$ 200 billion program to support consumer and small-business loans.

The Fed's debt-purchase program is the latest in a series of federal government initiatives over the past year aimed at blunting the economic harm from the collapse of the U.S. subprime mortgage market. Prior to the announcement, The Fed, Treasury Department and the Federal Deposit Insurance Corp. announced on Nov. 23 a plan to insure Citigroup against losses on US\$ 306 billion of troubled assets and inject US\$ 20 billion worth of capital after the company's shares plunged more than 60% in a week. As part of the plan, Citigroup is required to submit an executive-compensation plan for government approval. After Congress turned away the heads of the Big Three automakers, Obama and congressional Democratic leaders said financial assistance to General Motors Corp., Ford Motor Co., and Chrysler LLC should be conditioned on a commitment to make their industry more sustainable.

Concerns about oil consumption have increased after reports showed the US economy slowed and consumer spending declined. Oil prices have also continued falling, as speculation that a potential OPEC production cut to support prices may fail to outweigh declining fuel demand amid the global recession. OPEC members have already reduced output and are still considering a further reduction. Crude oil futures traded in New York have slumped 63% from a record US\$ 147.27 a barrel reached on July 11th. Crude oil for January delivery dropped by 93 US cents, or 1.7 percent, to US\$ 53.51 a barrel.

The local scene, however, turned out to be more positive than initially forecast. Despite the drag from net exports, 3Q08 GDP managed to grow 4.6% year-on-year (YoY), slightly faster than the Q208 expansion of 4.4% YoY (revised down from 4.6% YoY). A recovery in private consumption was spurred by the decline in inflation, especially for food. Government's focus on accelerating spending to make up for delay earlier in the year and to support domestic demand resulted in strong rebounds in public consumption and investments. All these more than offset the drag from weaker exports. Improved spending was reflected in the robust recovery of construction (due to greater public investment), increased production in utilities, and sustained activity in the financial sector. Meanwhile surging remittances from workers abroad pushed up 3Q08 GNP growth to 6.5% YoY from 5.5% YoY in 2Q08. The IMF's range of expected remittances growth for next year is between 3.5% and 3.8% YoY.

Philippine inflation may have also slowed for a third month in November as fuel and food prices eased, according to the Bangko Sentral ng Pilipinas. Analyst consensus has it that consumer prices may have climbed 10.3% to 11.2% from a year earlier – the slowest pace in six months, and following a 16-year high in August. Nevertheless, the weaker Peso and increases in utility charges are factors that may tilt the actual inflation rate upward. Economists have even begun to estimate that inflation may already start hitting single digits by December.

The Bureau of Internal Revenue (BIR) was 4% short (PHP 27 billion) of its 10-month collection target. The BIR is saying it may end 2008 about PHP 35 billion short. Part of the shortfall was due to tax relief given by the government to minimum wage workers. The government is trying to complete the sale of its 40% share in Petron Corporation, estimated PHP 25 billion, to help narrow the gap.

The Philippine Stock Exchange Index ended the month of November at 1,971.57, which was only a modest 1% growth over the previous month-end. In the month, it appeared that foreign funds were net buyers of stocks by as much as US\$ 61 million. Note that this number included a US\$ 125 million inflow from First Pacific relating to its purchase of a 20% share in Philex Mining. Stripped of this trade, foreign funds were still net sellers by US\$ 64 million. Nevertheless, the November figure is far better than the net foreign outflows of US\$ 103 million September and US\$ 202 million in October.

Your local funds have likewise seen modest movement on a month-on-month basis. The ATR KimEng Equity Opportunity Fund ended November with a PHP 1.3233 NAVps, a decline of 39.75% for the year to date (YTD). The less volatile Kabuhayan Fund closed with a NAVps of PHP 0.9355, giving a YTD performance of –28.56%. Both funds have started to increase their equity allocations, geared towards the more reliable telecoms and utilities.

The MFMCP-Aizawa Trust Philippine Fund saw a slight erosion in performance despite the modest pick-up in the local bourse. For the month of November, the ending NAVps stood at USD 49.98, for a YTD performance of –53.65%. Though adversely affected by the foreign exchange, there has already been a slight appreciation in the peso. With remittances starting to pour in for the Christmas reason, the Peso last traded at PHP 48.90 / USD after nearly hitting PHP 50 / USD more than a week ago.

Recovery has come from the sources we expected: private consumption (due to lower inflation) and increased public spending. We see these trends remaining intact in 4Q08, and we believe domestic demand growth will continue to outweigh any further weakness in external demand. Thus, we remain optimistic about market conditions, though cautious with our trading positions. As the year nears an end, we have traded away from more speculative issues and focused on only 15 to 16 high-yielding, low beta performers. At the same time, we are seeking refuge in the more reliable sectors such as telecom, power and utilities. Economists and analysts now see the local market bottoming out over the next few months, and we are trading more actively as a result of our belief in the fundamentals of our own economy.