

December 2008 Review and Near-Term Outlook

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Positive news came in, as local headline inflation was reported at 8% YoY for December 2008 - well below the consensus of 8.8%, and even beneath the 8.6% - 9.5% range forecast by the Bangko Sentral ng Pilipinas (BSP). Core inflation also decelerated for the first time since July, slowing to 7.3% YoY in December, from 7.9% in the previous month. This gives more room for monetary authorities to cut rates, if needed. Indeed slowing inflation across Asia has allowed central banks to cut borrowing costs to spur growth and cushion falling export demand. In December, the BSP shaved its benchmark interest rate, for the first time in 11 months, to 5.5%.

The Philippine Peso also strengthened to 47.30 against the US Dollar, rising on the first trading day of 2009 on speculation that remittances had piled up during the extended holidays. The Peso's recent uptick was its most marked appreciation since mid-December, thanks to overseas Filipino workers' (OFWs') Yuletide inflows. All told, the currency climbed 3% in the month of December, thus trimming the full year's depreciation to 13%.

The BSP expects OFW remittances to reach a new record of US\$ 17.3 b - US\$ 17.9 b this year from an estimated US\$16.3b in 2008, according to news reports over the holidays. While remittance growth would decelerate from last year's estimated 13%, it should still be significant at 6% - 10%. Even such modest gains for 2009 would be quite a feat, considering that remittances declined during previous crises. For instance, in 1998, OFW remittances fell by 14.2%; these also contracted by 11% in 2000, and by 0.3% in 2001. Earlier, the BSP Governor explained that Filipinos who have gained permanent residency status abroad would have better flexibility in looking for replacement jobs compared to workers who rely on contract renewals. Separately, he said the inelastic demand for medical and healthcare practitioners from the aging populations of developed countries should also sustain demand for such Filipino workers. Remittances, which play a vital role in the local economy's GDP, account for 10% of the Southeast Asian nation's gross domestic product.

Crude oil, however, jumped by 23% last week, with a 14% gain on December 31st alone capping the biggest weekly advance since August 1986. Israel's offensive against Hamas fighters in the Gaza Strip raised concern that oil production in the Middle East, which is the source of one-third of the world's supply, could be reduced. To start the year, crude oil delivery for February jumped to US\$ 48.80 a barrel.

The much-hyped December effect, wherein year-end share prices tend to edge higher due to window dressing, failed to materialize because the Philippine stock market ended trading unusually early in 2008, well before foreign investors went into window-dressing mode themselves. The local market was closed in the last 11 days of December.

Although the PSE Index (PSEi) declined by nearly half in 2008 (by 48.3% to 1,872.65, to be exact) to settle at an attractively cheap market multiple of 9X earnings, your funds have been able to hold up comparably well, as we have been able to implement defensive measures. The NAVps of The ATR KimEng Equity Opportunity Fund fell to a final 2008 value of PHP 1.2857 (as

of December 24th, 2008, the last trading day of the year), thus posting a return of negative 41.46% for the year. The more shielded balanced fund (The Kabuhayan Fund) saw a more modest NAVps decline of 29.20% for 2008, to settle at PHP 0.9271. Meanwhile, The MFMCP-Aizawa Trust Philippine Fund ended 2008 with a NAVps of US\$ 50.29, for a 52.80% decrease in value. This apparent underperformance relative to the PSEi was due to the local currency's depreciation from PHP 41.401 / US\$ at the start of 2008 to PHP 47.485 / US\$ by year-end. Factoring these BSP-provided exchange rates, NAVps of The MFMCP-Aizawa Trust Philippine Fund really declined by only 45.86%, in peso terms, in 2008.

January 2009 promises positive returns. It was not surprising that the PSEi surged 5% on the first day of this year's trading, as investors considered that the consensus EPS growth forecast stands at a respectable 8% for 2009, indicating an encouraging upswing from the 10% decline estimated for 2008.

This sentiment was in consonance with U.S. stocks, which rose to a two-month high on the first trading day of the year, with the Standard & Poor's 500 Index (S&P 500) gaining 3.2% following General Motors Corp.'s receipt of its first cash infusion from the federal government. The same Wall Street strategists who (last year) told investors to buy stocks in the worst year since 1937 are even more bullish today, predicting the S&P 500 may rise 17 percent in 2009. As we, too, look forward to 2009, we hope the combination of government stimulus and oil's 69 percent drop from its July record high of US\$ 147.27 per bbl may dispel the spectre of pessimism.

To start off 2009, U.S. Senate Majority Leader Harry Reid said President-elect Barack Obama is considering stimulus packages totalling as much as US\$ 1.3 trillion. Obama is also pushing for tax cuts that would amount to about 40% of a stimulus package he is asking Congress to pass within the next several weeks, according to transition official and a Democratic aide. The measure could in fact start at US\$ 800 b, meaning that tax cuts may constitute more than US\$ 300 b of the legislation.