

October 2008 Review and Near-Term Outlook

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The Kabuhayan Fund finished October with a NAVps of PHP 0.9433, for a year-to-date (YTD) performance of -28.0%, and a month-on-month (MoM) fall of -13.9%. This fund's current asset allocation is 48% in equities and 52% in fixed income instruments. Meanwhile, The ATR KimEng Equity Opportunity Fund ended October with a NAVps of PHP 1.3481, yielding a YTD performance of -38.6%, out of which the MoM decline comprised 20.6%. This fund's asset allocation remains at 80% equities and 20% cash. The MFMCP-Aizawa Trust Philippine Fund saw its NAVps decline 52.4% YTD and 25.8% MoM to USD 51.38. This fund's portfolio continues to be invested in defensive, yet high-yielding, stocks, but the NAVps has been partly undercut by extended weakening of the local currency (from an exchange rate of PHP 46.92 / USD at end-September to PHP 48.75 / USD at end-October, per Bangko Sentral ng Pilipinas (BSP) daily data).

October distinguished itself as the worst month yet for the local bourse, with fundamental valuations touching historical lows. October was the month which, abruptly, more than doubled the YTD drop in the Philippine Stock Exchange Index (PSEi) to 46.2%. The PSEi posted a steep fall within the month of 24.5%, which would have been even worse had it not been for a 14.5% rally within the last three trading days of October. By the end of October, the PSEi was trading well below a P/E ratio of 10x, or well below the normal historical average of 16x.

This, too, was the case internationally. US stocks fell sharply during October, although prices recovered at the end of the month after it was announced that the economy contracted less than forecast for the third quarter. Investors were belatedly lured by the realization that US equities were reckoned to be at their cheapest valuations in 23 years.

Increased commercial paper sales signaled that the credit markets were thawing. Furthermore, the Federal Reserve again cut rates, restoring a little bit of confidence. The benchmark interest

rate was trimmed by half a percentage point to 1 percent, matching a half-century low, in an effort to avert the worst U.S. economic downturn in the postwar era. As there weren't any grave surprises in the economic data, the economy didn't fall as dramatically as the financial markets.

Crude oil slated for December delivery dropped further to USD 65 / barrel, which is more than 50% down from the historical record of USD 147.27 / barrel on July 11, 2008. OPEC's secretary-general said the group may meet again in November to consider its second cut in production in as many months, if prices fail to react to last week's 1.5 million-barrel-a-day output reduction. The BSP feels that domestic inflation peaked in September, but thinks this would remain in low double digits (i.e., between 10% and 12%) in 4Q08. BSP also believes inflation should fall to single-digit figures by 1Q09. Consumer prices climbed 11.2% YoY, but eased 0.4% MoM. Core inflation in September increased slightly YoY to 7.8% from 7.5%. However, headline inflation dropped because of falling fuel and food prices.

We expect volatility in the stock market to continue through the end of this year. While the market hit a four-year low of 1,704 (a P/E of 9x) on October 27th, we believe there persist good value and cash yields in the telecom, power and utilities sectors. We will remain underweight in financials and property stocks. We also expect the BSP to continue easing monetary policy as inflation settles down below double-digit levels.