

# September 2008 Review and Near-Term Outlook

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The Philippine capital markets continued to reflect the global uncertainties surrounding the US financial fallout, most recently marked by the collapse or near-collapse of a number of large investment banking, commercial banking and insurance entities there.

Your funds managed to outperform the local stock market, both in the month of September and for the first nine months of the year; that is, your funds posted more modest declines than did the Philippine Stock Exchange Index (PSEi). During September 2008 and 9M 2008, the PSEi was down 4.41% and 29.05%, respectively, whereas The Kabuhayan Fund yielded decreases of 2.53% and 16.31%, respectively; The ATR KimEng Equity Opportunity Fund showed falls of 3.90% and 22.66%, respectively; and (in Peso terms) The MFMCP-Aizawa Trust Philippine Fund declined 2.94% and 26.34%, respectively.

Sound fundamentals should allow the Philippines to recover from the capital markets slump sooner rather than later. The country is not exposed to any direct impact from the current crisis facing the US. Expectations for the second half of 2008 and early 2009 are for inflation to slow down and for the recent tightening of monetary policy to become less aggressive. Hence, the Peso is expected to gain against the US Dollar, and local stock market valuations are expected to revert back to the mean.

There is no property bubble or banking crisis in the Philippines. During the Asian Crisis of the late 1990s, Philippine banks were heavily scrutinized and many were forced to merge or go out of business. The result of this cleanup was a stronger, and more fundamentally sound, banking sector. Although loan growth is up close to 20% in 2008, the BSP's policy rate is still below 2004 - 2006 levels. This strong loan growth is fueled more by demand from large corporate borrowers rather than by housing or other consumer loans. Meanwhile, the banks' balance sheets are not at all stretched, with Loan-to-Deposit ratios across the sector still at a healthy 60%.

The main problem for the Philippines in 2008 is inflation. Even though fuel and food prices have begun to retreat, we expect that monetary policy will remain unchanged and that the Bangko Sentral ng Pilipinas (BSP) may further tighten rates by 25 to 50 bps.