AB Capital Securities, Inc.

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Stock Market Outlook

In Search Of The Bottom

The Philippine Stock Market has had a wild swing in the past nine months. From its peak of last October 2007, the main benchmark stock index has tumbled by as much as 41.3% to its July 2008 low. Surely, such a drop could mean that we may have already reached a bottom for stocks. However, this is proving to be hard to call as the root cause of the global market's bearishness remains unresolved.

Downward Revisions

The outlook for the Philippine economy and for the rest of the world is growing dimmer and dimmer each day. The main risk on the local economy is the mounting inflationary pressures driven mainly by high energy and food prices. High inflation is eating up profit margins, as it raises input costs of companies who can't pass the higher expenses to consumers. Moreover, external risks is growing with an impending US slowdown, made worse by a tightening credit market. The growing weakness in the financial markets is slowly spreading to the global economy. The double barrel concern of high inflation and the shaky state of financials has resulted to a major crisis, which many consider as comparable to the financial crisis of the 1930s. The government for its part, revised its growth forecast for 2008 to 5.7%-6.6% from an original forecasted growth range of between 6.3%-7%. We are projecting a 2008 GDP growth of 4.5%, a sharp drop from the 7.3% growth achieved in 2007.

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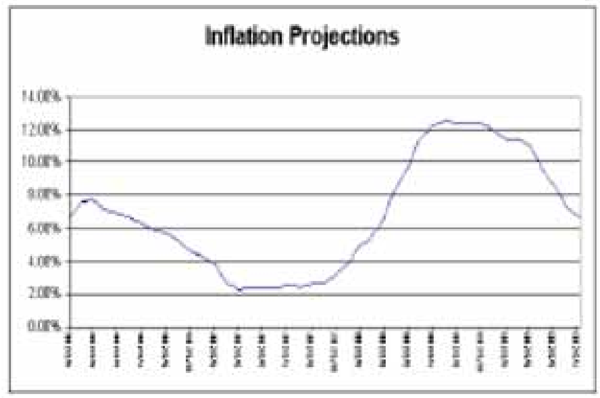
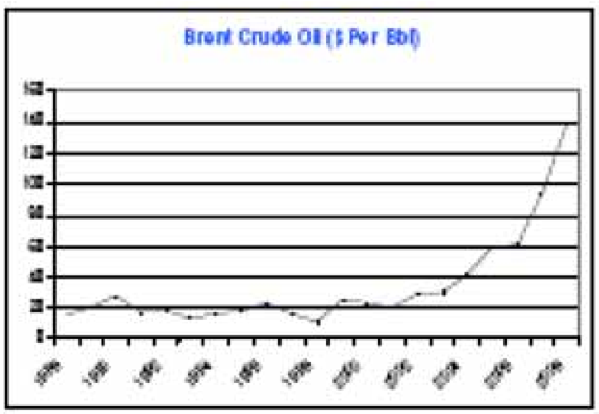
Cost Push Inflation

The main concern for the domestic economy is the rapid rise in the prices of consumer goods and services. The country's annual inflation rate is currently at a seventeen year high and it hasn't even peaked yet. We expect annual inflation to peak sometime in October at around 12.5%. It will likely stay in double digits till May of next year. The high inflation in the country is driven primarily by the high price of oil and some agribased products.



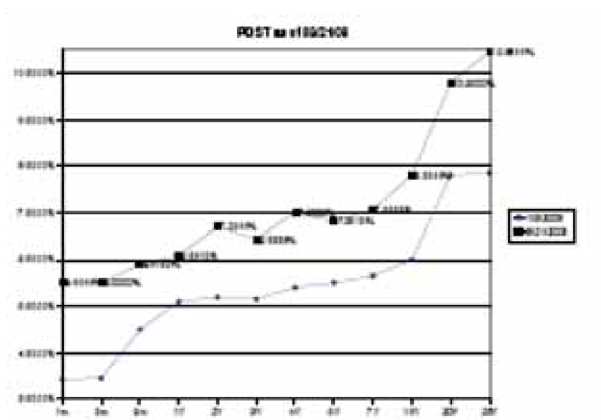


Contractionary Policies

High inflation will continue to apply upward pressure on domestic interest rates. As it is right now, domestic interest rates are actually yielding negative returns because of the prevailing high inflation rate. In view thereof, the Bangko Sentral ng Pilipinas (BSP) will be maintaining a tightened monetary policy. The BSP had already raised their key overnight rates twice this year by a total 75 basis points. We believe that this will not be enough and that further adjustments will be expected. The benchmark 91-day treasury bill rates have also caved into the inflationary pressures. After rejecting numerous bids, the government finally allowed the yields of short-term bills to rise. There is very little pressure coming from the government's borrowing requirements as they have maintained a healthy cash position and have managed their deficit well.

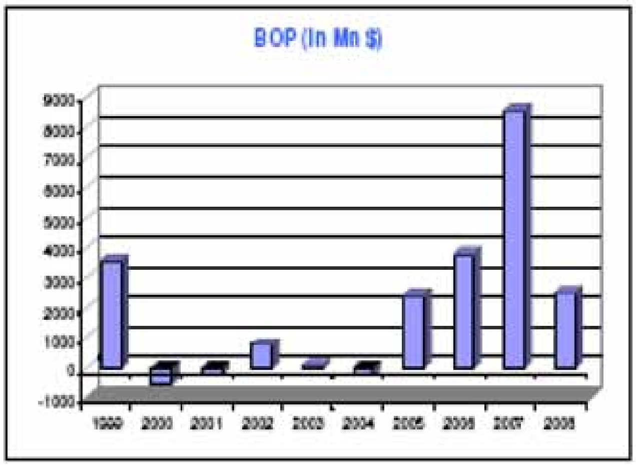
Price Pressures

The sharp rise in the prices of these basic items have led to similar upward adjustments in wages and transportation fares. High prices maybe here to stay due to the growing supply problems and relaxed monetary policies. The demand for oil from emerging economies like China, India and Russia, are expected to remain high. Oil prices have tapered off for now, but it should increase again with the coming of winter in cold countries. Moreover, oil is very sensitive to geo-political issues. The rapid rise in global inflation has prompted us to adjust our 2008 inflation forecast to 10% from our original projection of 7.7%.



Not So Hot Money

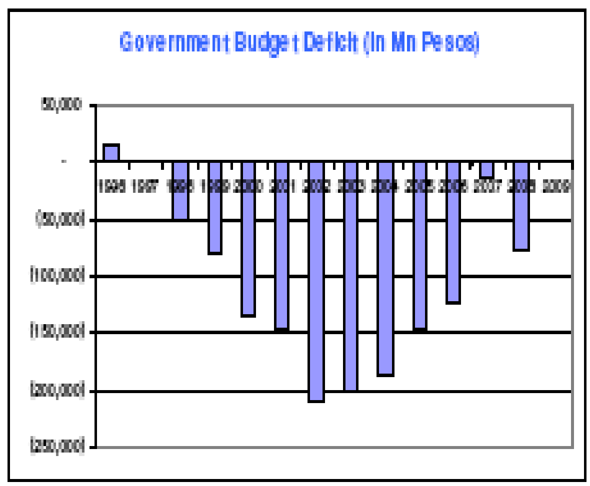
Although the Central Bank and the government have both moved into contractionary modes, the degree of tightening is viewed as a bit too conservative. Admittedly, it is hard to strike a balance between controlling inflation and sustaining economic growth. Such tentativeness towards inflation has caused the Peso to weaken against the Dollar.



However, the Peso's weakness has been capped so far by our ability to maintain a positive balance of payment position, albeit the surplus has shrank dramatically compared to that of last year. Despite a 10% increase in OFW remittances to $17 billion, the BSP has projected that the 2008 BOP surplus will go down to $2.5 billion from $8.6 billion in 2007. The drop will be due largely to reduced foreign direct and portfolio investments. Moreover, the country's current account position will also be adversely affected by weaker exports and higher import costs. The sharp rise in commodity prices will increase our import bill while a slow down in the global economy will dampen export demands.

Unrealized Dream

The goal of a balanced budget for the government has remained unachieved at the moment. Notwithstanding, the government has done well considering the very difficult macroeconomic environment that we are facing now. Their tax effort has improved to 12.79% in the first quarter from 12.2% in the same period last year. The government has to provide aid for the less privileged Filipinos. They have set aside a total of P93.6 billion for various pro poor programs to cushion the impact of the rising costs of living. Sudsidies have been granted to the public transport sector, small power users, students and public utility vehicle drivers.



For this year, they are expected to incur a deficit of P75 billion or 1% of gross domestic product. On the public sector level, the Finance Department expects to incur a deficit of P25.6 billion this year.

Industry Situationers

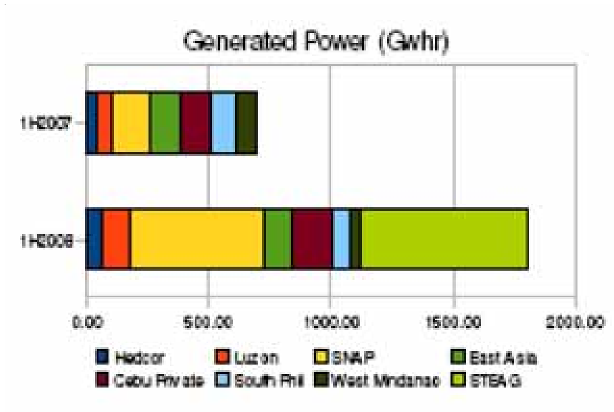
Banking - Negative Association

Earnings for most of the listed banks have declined due to trade related losses and a slow down in lending. However, banks' balance sheets have remained healthy as the sector's bad loan ratio has been on a decline. Banks are liquid and well-capitalized enough to absorb any adverse impacts of the present global economic woes. Concerns about exposures to the US mortgage market has been squashed as the local banks' collective exposure is very minimal. Exposures to collateralized debt obligations, or CDOs, of banks and financial institutions in the United States is P89 billion or no more than 0.2% of total assets. Although the Bangko Sentral ng Pilipinas expects local banks to sustain a doubledigit growth in lending activities this year, this is seen unsustainable due to the gloomy economic outlook.

Power - Rising Costs

The continuous rise in oil prices during the first half was a negative factor to the operations of most power companies. Operating expenses have increased as plants which are powered by crude oil and other alternative sources such as coal faced rising costs of obtaining the commodities. This was however, partially offset by the full utilization of some hydroelectric plants upon the early onset of the rainy season. Despite the current drop in oil prices, Power companies will still have to deal with high costs and, in most cases, underrecoveries as a result of the recent historic rise of oil prices. Companies must adopt better cost management or cost-efficient measures to maintain significant earnings. Their investments and funding must likewise be focused on providing better quality of services with the least amount of cost on their part.

Expansion has fueled the growth of companies such as Aboitiz Power (AP), through new power plants, and Manila Water (MWC), through an increased capacity to serve areas such as Antipolo. Further expansion will give rise to further growth in revenue and net income. The ability to reduce system losses (or non-revenue water for MWC) will significantly affect the net income of distribution companies. Meanwhile, Meralco's (MER) future performance will depend largely on whether or not it gets a favorable resolution in several issues such as the pending implementation of a rate hike due to PBR.



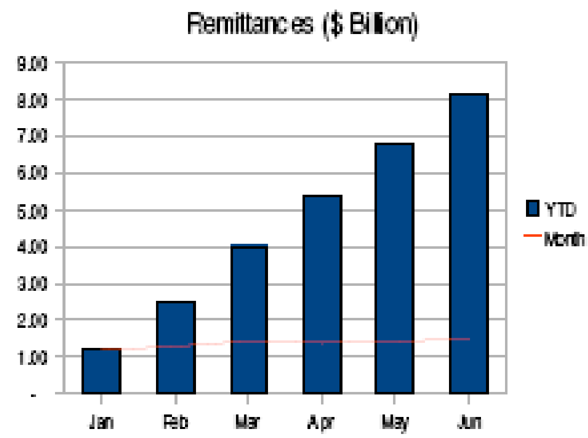
Food - Shortage

The increase in prices of food, with rice in particular, was one of the drivers for the steep inflation figures over the past months. Imports of rice became more costly due to the rising world demand with the highly populated countries competing for a vast share of supply. The waning domestic production and issues on rice hoarding put pressure on the price of the commodity. This led the government to subsidize the rice needs of the poor. Prices of processed meat and other goods are expected to rise in the next months brought by higher import costs and packaging expenses. Rice serves as a bellweather for other foodstuff and the steep rise of the price of rice over the past year is not isolated to it.

Tin can prices are expected to rise 30% for the second half while rice production may remain moderate due to the impacts of typhoons. Higher costs are still expected as the country competes with the neighboring regions for supply of rice and even beef. Although food is the most basic of necessities and will continue to be spent on despite high inflation, companies are finding that their margins are getting narrower and narrower. Price increases for their end products are behind the increase in costs. For th second half of the year, growth will be hard to come by as producers have to increase their prices while trying to contain or even lower their costs. The problem of demand is secondary to the problem of squeezed margins. The fact that San Miguel (SMC or SMCB), which controls the local beer market, is looking to expand to other fields underscores the difficulty currently surrounding the food industry.

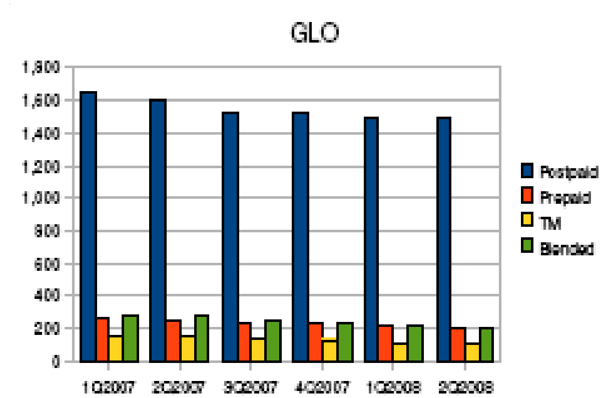
Property - Susceptible To The Crisis

The housing and credit problem in the US trickled down to the local property and construction companies as demand from Filipino workers abroad slowed down. High inflation led to a rise in prices of steel and other commodities in the past months. Meanwhile, the rise in oil prices made sales and marketing somewhat challenging especially with housing projects which are far from Metro Manila. As such, a bearish sentiment enveloped theproperty sector. However, companies have surprised with strong earning and impressive growth. Most property companies mitigated expenses by locking in the prices of their basic materials early in the year, this will help keep up their margins in the coming months.



Construction companies have also passed on some of the higher costs by increasing prices. While a moderation in performance is expected of most companies, the property sector is set to overperform its expectations. Interest rate adjustments may lower home loan applications but companies who are prepared for the coming difficulties will survive and even thrive. Knowing what type of product is in demand is the key to thriving in difficult types.

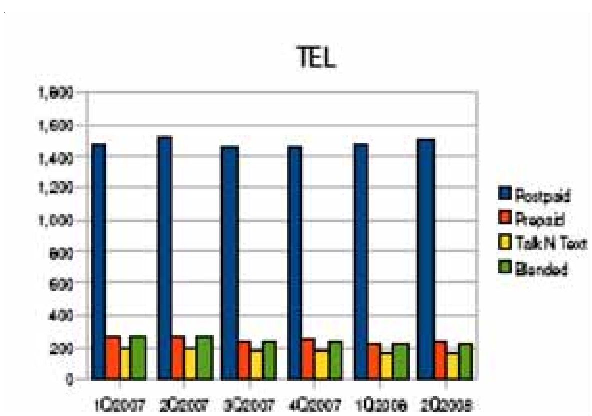
From affluent villages during economic booms, today's situation of high inflation and slower growth calls for more affordable low cost housing that are easily accessible. In terms of rental rates and values, we maybe nearing a peak due to a looming glut in the business process outsourcing (BPO) office space and condominium segments.

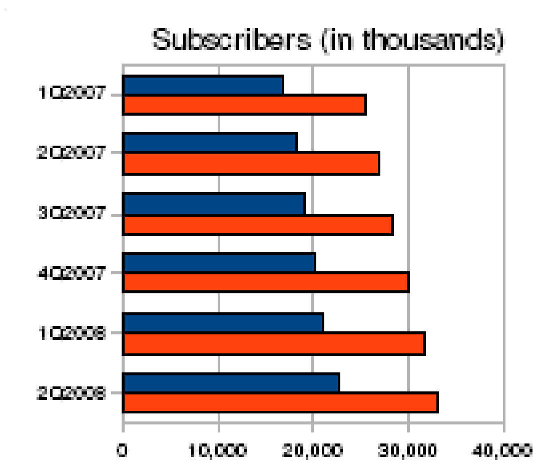


Telcos- Dividend Plays

With inflation reaching levels unseen in a decade, the National Telecommunications Commission (NTC) sought to lower interconnection charges between different networks in a bid to lower text messaging costs. While Telecommunications companiesinitially resisted, President Gloria Macapagal Arroyo announced in her SONA (State of the Nation Address) that the government had successfully brought down rates to 50 cents per message. However, it turned out that the 50 cent text message was part of a promo that the telcos were offering, just part of the ongoing trend in the industry. Recent data has shown a trend towards higher subscribers counts and lower ARPUs (Average Rate per User on a per month basis). With the cost of acquiring subscribers continually dropping, telcos have been prudent enough to offer cheaper services in exchange for higher volumes.

As with most other industries, telcos have to face that fact that consumers are tightening their belts and spending less. Among the lower income brackets, consumers are spending more on necessities such as food and less on others. Thus, it can be expected that ARPUs will fall further. However, the Philippines still remains the text messaging capital of the world and no amount of inflation will change that. As such the key for success in this industry is more subscribers. Quite simply the company with the most users, as a result of the quality of services and affordability of its promos, will wind up the winner. Also, despite the daunting economic environment, telcos remain a good investment due to its superior dividends. PLDT (TEL) Globe Telecom (GLO) and Piltel (PLTL) have all recently announced attractive dividends.





Mining and Oil - Sunrise Industries

After being the darlings of the stock market for most of the latter part of 2007 and the early part of 2008, stocks in Mining and Oil companies have taken a breather due to the correction in commodities prices worldwide. At the height of the commodities craze several dormant mining companies suddenly became active. However due to the nature of the mining industry, most of them have yet to start commercials operation even until today. Aside from the drop in commodity prices, another factor mining companies have to contend with is stricter guidelines in both reporting exploration results and obtaining the necessary permits for commercial operations.

Jan-Mar Totals	2007	2008
Gold (kg)	10,308	10,484
Nickel Shipped (DMT)	1,108,954	338,590
Copper Concentrate (DMT)	20,306	24,900

Project Development	Years
1) Preliminary Evaluations	5 - 8
2) Feasibility Studies	1 – 2
3) Engineering and Design	1
4) Financing	1
5) Development/Construction	2

Going forward, the government is keen on fueling the mining industry as it has earned the interest of huge mining companies from all over the world. Philex (PX) remains the most stable producer of copper and gold in the Philippines but several other companies have been making waves. Shares in Atlas Mining (AT) are sure to appreciate once the rehabilitation of their Carmen Copper Mine is complete and they start mining huge amounts of copper. Geograce (GEO) and its affiliate NiHao (NI) has recently tied up with Jiangxi Rare Earth and Rare Metals Tungsten Group of China. However, their mines remain in the exploration and developmental stages.

Mining stocks remain high risk and high reward stocks as the development of a mine from the exploration stage to full scale operations can take anywhere from 3-5 years or even more. The key for mining companies to succeed remains having quality mines and the ability to extract the metals being mined.

Transportation - Oil Factor

Two factors are adversely affecting stocks of transport companies: the slowdown in the global economy and the surge in oil prices. The global economic slowdown, which had emanated from the problems of the US, the world's biggest economy, is largely seen to affect the volumes handled by transport companies. As the world economy slows, so will imports and exports, leading to lower demand for the services of transport companies. The high price of oil has also squeezed the margins of transport companies. Cost cutting remains high on the list of what companies must now do in the face of a less favorable environment.

Transport companies that rely highly on fuel have been given a respite with the current pull back of oil prices to below $120. However, the price of oil is still the key to future performance. The moves that companies make in order to mitigate the risks of another possible oil price hike will largely affect future performance. The farther oil prices fall, the better for transport companies. On the other hand, other transport companies like International Container Terminals (ICT) are withstanding the effects of high inflation and low economic growth. Even with the economic slowdown, companies such as ICT have been able to drive volumes higher with a combination of organic growth and acquisitions. Traditionally, ICT trades at high P/E levels but the drop in the local stock market coupled with the increased volume handled by ICT has brought it to an attractive level.

The Stock Market - In Search of the Bottom

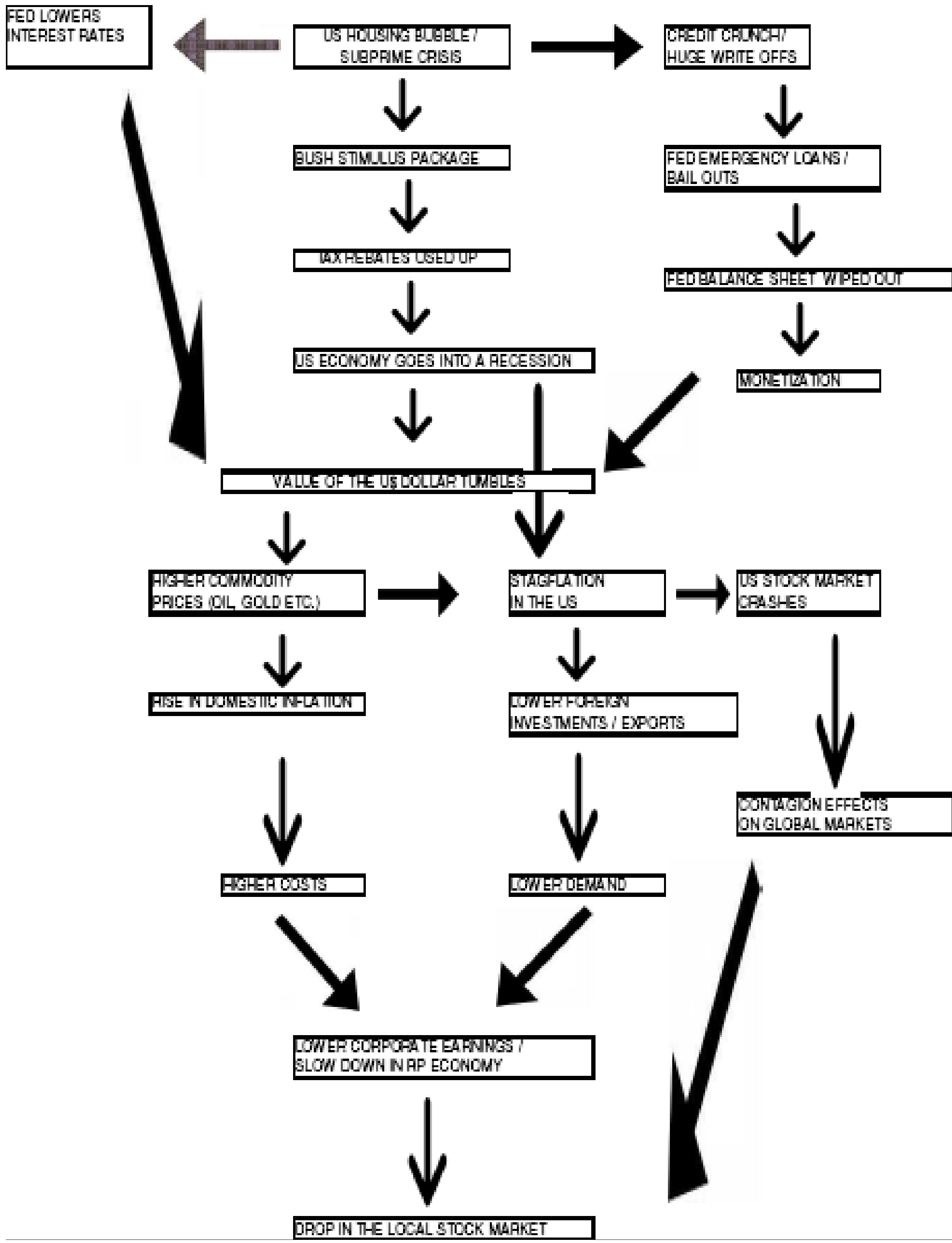
The US subprime crisis is turning a year old and we have yet to call a definite bottom for the Philippine Stock Market. The US remains to be the most influential market and is one of our most important investor and trading partner. The problems in the US will affect us in two ways: weaker demand (exports, investments) and rising inflation. As such, the contagion effect of a possible US market crash should be considered. We believe that the US housing and credit crisis hasn't gone full circle and there is the potential of testing new lows. There has been a debate about when the US housing sector will bottom, whether the global financial sector has bottomed and has the stock markets bottomed. We tend to believe that things could still get worse before it gets better. We believe that the US economy has managed to stay afloat because of higher exports brought about by a weaker dollar and consumer spending aided by the recent stimulus package. Meanwhile, US financials have been propped up by the Fed's short term lending facility. In effect, the Fed is taking the bank's losses, eventually monetizing it. Outside of the Fed, the US financial sector will need to get new investors to recapitalize the banks. However, new investors will be hard to find during these bad times. The US housing sector seems to be in a better shape and we expect it to bottom out late 2009. Although inventories remain high, housing sales seem to be picking up. Eventually, all the bail outs and lendings will have to end. What happens after that?

On the local front, inflation is on the rise while interest rates have just bottomed. Weaker real and portfolio investments have also put pressure on the Philippine Peso. All this will dramatically slow down the domestic economy and trim down the government's tax base. This may further delay the government's goal for a balanced budget and a sovereign ratings upgrade. Private companies are also going to get hit as earnings growth is seen to drop to single digit levels.

Industry Valuation Table

Sector	Ave Growth 2007-2008	2008F Average P/E	2009F Average P/E	Average P/BV
Financial	(8.04%)	11.89	7.62	1.53
Industrial	19.03%	12.56	8.04	1.32
Holdings	(4.71%)	14.87	8.26	1.15
Property	(5.91%)	12.24	10.20	1.17
Services	24.46%	10.89	9.23	2.16
Mining-Oil	24.58%	13.48	10.09	2.18
All	8.64%	12.57	8.65	1.52

Worst Case Scenario



Regional PE Ratios

COUNTRY	2008 PE	2009 PE	5-YR AVG PE	2009 EARNINGS GROWTH AVG
Hong Kong	13.3	11.2	14.5	18.0%
Japan	15.9	15.4	17.0	-0.04%
Malaysia	11.5	10.4	13.0	10.6%
Philippines	12.5	10.9	12.2	15.1%
Singapore	12.6	11.0	13.4	14.8%
South Korea	11.0	9.5	16.7	9.2%
Taiwan	13.8	12.2	12.0	14.2%
Thailand	8.0	6.5	9.9	23.0%
China	14.3	11.7	16.2	21.0%
Indonesia	11.6	9.3	10.9	24.4%
Averages	12.5	10.8	13.6	15.0%

Technical Outlook

PSEi - Possible Bottom

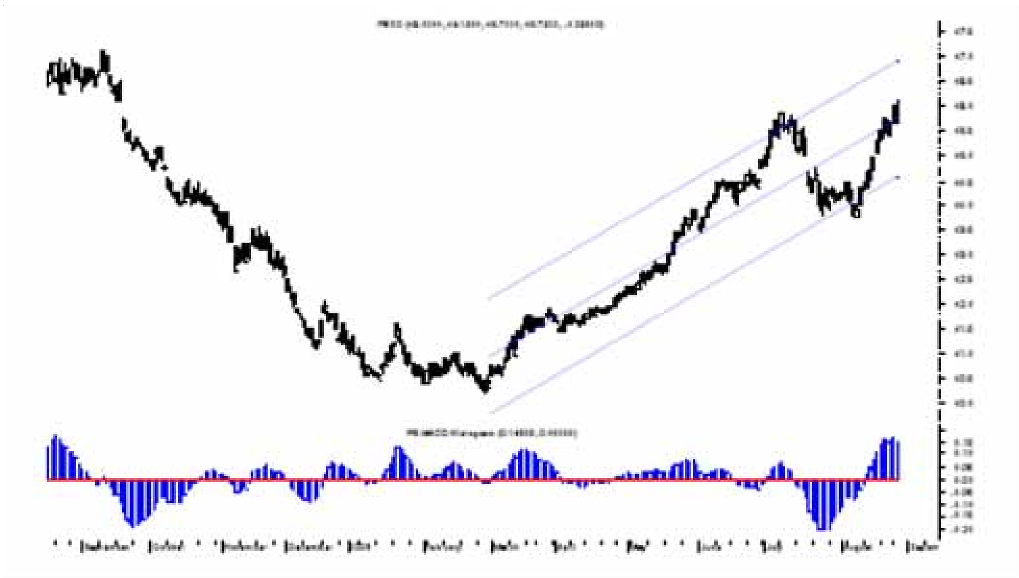
Despite the very negative fundamental backdrop, the local equities market made a significant break out early this month. After more than nine months, the primary down trend channel of the PSEi was broken last August 6. From a purely technical standpoint, we may have seen the bottom for the local stock market. The PSEi made two breakaway gaps and has since stayed well above the old down trend. Although it has recently breached its intermediate uptrend channel, it lacks conviction as shown by the thin volume and small spinning top formations. At present, the PSEi failed to follow through on its recent breakout and is now consolidating. It seems to be forming a support base at its 50-day exponential moving average, which has flattened. It's too early to say that the PSEi can start a new primary uptrend. No clues can be derived from its oscillators and volume indicators. Support levels are at 2,620 and 2,500 while resistance is at 2,755.

The Dow Jones Industrial Average - Indecisive

After touching the support of its major down trend channel last July 16, the Dow Jones Industrial Average has since been moving sideways. Although it is in an intermediate uptrend, the slope of the said trend isn't steep enough to show sustained upward momentum. There has been a lot of volatility in the US markets but the Dow has still managed to stay within a narrow 500 point range. On the other hand, volume has fallen below average since the first week of August. The Dow seems to be having a hard time breaking out from its 50-day exponential moving average line. Besides that strong resistance, there seems to be some growing pressure on the Dow's support at the 11,300 level. Momentum indicators and oscillators are giving short term sell signals. Moreover, the Dow seems to be on the verge of completing the fifth wave of its current Elliot wave cycle. The fifth wave target of the said cycle is at 12,500. If the Dow breaks the minor uptrend support in the next couple of the days, we may see it retest the July 16 lows. Support for the Dow is at 11,125 while resistance is at 11,620.

Philippine Peso - Looks Weak

The Philippine Peso seems to have completed a five wave bull cycle yesterday. It culminated the said cycle as it formed big black candle after piercing thru the P46 support level. Since the Peso's Bollinger bands have been wider than average, we expect the Peso to at least pause or correct after its steep run up. Sell signals were also triggered yesterday by the relative strength index and stochastic oscillators. Notwithstanding, we expect any correction to be minimal as the medium and long term moving averages are both pointing towards further weakness for the Peso. Resistance for the Peso is seen at the 45 level.



Crude Oil - Peak Oil

Brent crude oil prices touched the support of its uptrend channel at around $110 per barrel level. It has since consolidated at around the price of between $110 to $114. Key oscillators are not showing any strong bias towards any direction. The same could be said for its moving averages. Oil's long term moving averages remain bullish while the medium term average has turned lower. We are pegging support at $110 while resistance is at $120 per barrel.

Gold - Not Losing Luster

Gold prices appear to be choppy after it tried to break out from its intermediate downtrend. Its weekly chart formed a neutral harami, an indication that Gold may be moving sideways for now. Like oil, Gold recently reached its uptrend channel's support at $790. However, the precious metal has shown a lack of buying power as shown by the small spinning tops that followed after the metal gapped up earlier this week. Longer term chart remains bullish as it has stayed within its primary uptrend channel.

Stay Defensive

We believe that the key catalyst that will pull the global stock markets out of the doldrums is the recovery of the US housing sector. As of now, existing home sales are recovering but new home sales have remained weak. Foreclosures continue to grow while home inventories are at a twenty five year high. As a result, home prices continue to decline albeit at a slower pace. We expect the decline in US home prices to slacken further and possibly bottom towards the latter part of 2009. The financial sector's recovery will lag but it should pick up once property values recover. For now, investors are advised to stay defensive as the global economy will still feel the after effects of US credit crisis. The situation can still worsen and pull global asset values lower. Emerging economies like the Philippines are perceived to be fundamentally better off. Our exposure to US assets and shares of troubled financial institutions are close to nil. However, we still can't decouple from the rest of the world. The contagion effect on a high beta market like that of the Philippines is always a threat. The risks of a global slowdown and even turning into a depression will also put the clamps on our economy. In view thereof, we believe that the best strategy is to stay defensive and adopt a wait and see strategy. If indeed the US housing sector will show signs of a possible recovery in late 2009, then we may consider positioning in the 2nd quarter of next year.