# Reaction Paper on Ybañez's "Rates of Return on Stocks,T-Bills and Deposits in the Philippines, 1987 - 1992"

By *Peter B. Favila*

The study conducted by Professor Ybañez on the historical yields offered by the different investments available to local investors provided an interesting insight to the domestic financial markets. Undoubtedly, this would be of valuable help to investors wishing not only to diversify, but likewise improve the profitability of their portfolio. To the more jaded of portfolio managers, the data analyzed by the study provided empirical proof of the truism often expounded by them, yet rarely proved on paper.

There are several points that I would like to raise though, both to elaborate on the conclusions reached by the study and to provide an alternative perception to the results of the study.

Foremost amongst these would be the period covered by the study, specifically the base period used, i.e., November 1986. Should the base period of the study have been moved forward by at least six months and applying the concept of *ceteris paribus*, the results of the study would have been drastically different. Bereft of the actual data, one can only look at the wealth index in Chart 1 to infer that should it have been so, investments in shares of stocks would have deteriorated in value in the periods from mid-1987 to mid-1989, and in the interim between 1990 and 1991. As a matter of fact, such a change in the base period would tend to show that an investment in the stock market would fare a little better than savings deposits, and would definitely be lower than inflation growth.

Then again, the volatility of the capital markets precludes the investment of funds on a long-term scenario. More often than not, participants in the stock market actively trade their portfolio to take advantage of intermediate price swings. Taken in this context, a successful investor would then be able to maximize his returns to a level that substantially exceeds those indicated by the study.

Second would be the inclusion of savings deposits in the study. Unlike the other three alternatives included in the analysis, savings deposits are generally considered to be transitional funds and not investible resources. As the very name suggests, monies were placed in these accounts more for depository or safekeeping purposes rather than for anything else. On the other hand, assets invested in shares of stocks, treasury bills, and time deposits were undertaken with the primary consideration of increasing - or at the very least, protecting - the value of the asset invested.

It would have been more contextually correct if the study, in lieu of savings deposits, utilized alternatives offered by the foreign exchange market or the foreign money markets.* Also, it would be interesting to find out if the rates of return offered by the foreign money markets coupled with the fluctuations in the foreign exchange market would combine to provide a better rate of return to the investor.

But such is already outside the scope of the study, which limits the investment alternatives under review to domestic financial instruments.

Finally, an interesting point raised by the study was the observation that treasury bills pay more than time deposits where it would have been more logical to expect the opposite to be true. The answer of course, would have to be fundamentally, rather than technically, tackled.

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*This has been done in the final version of the paper submitted by Prof. Ybañez for publication (see p. 35) - *The Editors.*

Note that for most of the period under review, the national government has been both on a deficit spending mode and in the midst of maintaining a tight monetary policy. The combination of these factors effectively increased the government demand for funds to a point that crowded out private borrowers. Faced with the absence of investment outlets, financial institutions had no recourse but to invest their funds in government securities, particularly treasury bills.

In order to do this profitably, and to avoid refusing deposits, banks had to price their high-cost time deposit funds at a level lower than government securities - the borrowing rate necessarily having to be lower than the lending rate.

Furthermore, treasury bills generate returns that are consistently higher than the inflation rate because these instruments are being utilized as the primary tool in the government's monetary policies. And foremost among these monetary goals is the control of inflation.

Generally, the study would be a helpful guide to the different investors in the domestic markets. Treasury bills would offer the best risk-return ratio compared to the stock markets or to time deposits. On the other hand, the more aggressive of investors can always look into the capital markets which, if studied properly, can provide investment opportunities with tenable risks.