

**Philequity Corner (11/06/2006)**  
**By Ignacio B. Gimenez**

### **Philequity Fund sees peso at 46 and PSEi at 3,400**

We recall our very first article for The Philippine Star which came out in January 31, 2005 where we advocated the country's necessity to push thru with its fiscal reforms. As early as then, we predicted that the Peso will hit 50 against the US dollar and the PSE index (PSEi) to hit 2,660 assuming the reform measures were passed. Now almost two years later, the peso is at 49.69 against the US dollar and the PSE Index is well past 2,700. So what's next for the peso? And where is the PSEi headed?

As we've pointed out last week, the economic reforms have already set a *virtuous cycle* in motion, such that Philippine assets (the peso, ROPs, stocks, etc.) will continue to appreciate unless an equal and opposite force is applied as Newton's Law of Inertia suggests. This is notwithstanding the political disruptions which investors have learned to disregard anyway. Call it political maturity or political apathy, but foreign and local investors alike have learned to ignore these political noises and have focused on the country's economic recovery instead.

Going forward, Philequity sees the peso reaching 46 against the US dollar and the PSE Index testing its all-time high of 3,447 by end-2007 or 1<sup>st</sup> quarter of 2008.

### **Mineral exports & OFW investments have yet to be factored**

While some global banks and foreign houses have forecasted the peso to reach P48 to P49 to the US dollar, it should be noted that these banks paid emphasis to the fiscal state of the government, growing dollar earnings from BPOs, and the strong OFW remittances.

But what most economists have yet to incorporate into the picture are the additional strong dollar earnings from mineral exports which will grow by leaps and bounds. This will substantially improve our country's trade and current account balances. Taking the cue from Latin American countries such as Brazil and Chile, the Philippines is poised to profit from the secular boom in commodities. While Brazil has steel, iron ore, sugar and soybeans as its major commodity exports, the Philippines has its mineral exports such as gold, copper and nickel.

In addition, many have yet to factor in the changing nature of OFW remittances. In the past, OFWs would send money for mere financial assistance to relatives. Today, OFW money has become more productive as these are now being used for investments. In fact, OFWs have become a major market for property companies.

### **Regional currencies to carry the peso further**

The peso is likely to strengthen further given the prevailing strength in regional currencies. While the Thai crisis precipitated the fall of the peso in 1997, this time around the recovery of Thailand and our ASEAN neighbors is leading the peso higher. The Thai Baht, for example, is trading at a seven-year high and is up 10.4 percent year-to-date. Meanwhile, the Singapore dollar is at a nine-year high and is up 6 percent year-to-date. This is despite the weakening yen, indicating that the ASEAN currencies have apparently decoupled themselves from the Japanese currency. Another factor leading to the strength in regional currencies is the booming economy of China. It helps that the ASEAN has been strengthening trade ties with this economic giant.

Regional Currencies vs. US Dollar	Current Exch Rate	% Chg Year-to-date	1997 Crisis Low	% Chg from 1997 Low
Thai Baht	36.73	10.4%	56.45	34.9%
Korean Won	937.20	7.3%	2,000.00	53.1%
Indonesian Rupiah	9,116.00	7.2%	16,950.00	46.2%
Philippine Peso	49.69	6.4%	46.50	-6.9%
Singapore Dollar	1.56	6.0%	1.82	14.1%
Malaysian Ringgit	3.65	3.5%	4.89	25.4%
<b>Average (ex-Peso)</b>		<b>6.9%</b>		<b>34.8%</b>

Source: Bloomberg

It is also important to note that while the peso has appreciated substantially from its all-time low of 56.50 to the US dollar, it still trails the other regional currencies in terms of their recovery from their post-1997 Asian Crisis lows. The table above shows that while other currencies have recovered by 34.8 percent on the average, the value of the peso is still 6.9 percent lower than its 1997 Crisis low of 46.50 to the US dollar. This notion that the peso has recovered less than the other currencies in the region suggests that it has a bigger room to appreciate further.

### The technical picture speaks louder than words

While technical picture shows an intermediate resistance for the peso at 49.25, Philequity ultimately sees the peso appreciating towards 46 which is our target for next year. This level is technically significant because, firstly, this is the lowest level the peso hit against the US dollar during the 1997 crisis before it gradually recovered. Secondly, this is the highest level the peso hit after EDSA 2 in 2001 before it resumed its decline.

**Peso Chart (1997 – Present)**



Source: Technistock

## PSE Index at 3,400

As for the stock market, the increased economic activities and brighter economic prospects next year are seen to underpin the earnings and price appreciation of listed companies. Our intermediate target of 3,000 for the PSEi is just about 8% from where we are now. What could help the index reach this level is if market-leader PLDT can appreciate to at least P2,650. The scenario is not farfetched given that this price level translates to price-earnings multiple of just 12.5x the 2007 consensus earnings forecast for PLDT.

What could further fuel the market's rise to potentially hit its all-time high of 3,447 (see chart below) is the prevailing strength in the global equities market led by the Dow Jones Industrial Average which is trading at a new record high. In other words, the Philippine stock market is just catching up with other markets which have made new highs, surpassing the levels achieved prior to the 1997 financial crisis. Another catalyst is the soft-landing of the US economy which would prompt the US Fed to cut interest rates for the first time since 2003.

While we see a correction in global equities in the short-term (in fact it is already happening) because of the strong run-up in the past two months, Philequity sees the correction in prices as healthy and advises investors to take advantage of this pullback as an opportunity to buy.

### PSE Index (1990 to Present)



Source: Technistock

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