Regional Valuation : Going Back to Basics

Regional markets have been on a sell mode since early March as investors took profits after Asian markets continued the run up which it carried over from the 4Q 2004. This was compounded by the recent sell off in the global equity market led by the US which declined by 4.5% as evidenced by the Dow Jones Industrial Average which went down more than 400 points week on week.

This recent sell off brought concerns that the Asian market may do a "repeat" of last year when we saw markets across the region declining by 15% to 25% (with China and India having the biggest decline of 24.25% and 29.31% respectively). Recall that some of the reasons for last year's decline were concerns over sustainability of earnings growth, potential China "hard landing" , higher oil prices , etc.

However, a recent report by Goldman Sachs says that the situation in the region is different from last year as they view the current correction as just a "momentary pause" or a "consolidation phase" along bullish market. As such, they do not think that a sharp correction similar to what we saw last year is likely.

Among the reasons cited which supports the above argument were : 1) improved global and regional macroeconomic conditions, 2) improved corporate earnings growth prospects, 3) better overall valuations, 4) investor risk appetite is higher (indicating overall interest in emerging markets), 5) China overheating risk is lower and 6) lower Political risk (mainly as a result of lighter political calendar/elections compared to last year).

As of last Friday's close, Asian markets have declined by an average of 4.36% from the March highs (See table below). Only Singapore and Korea bucked the trend for the same period which gained by 4.43% and 5.62% respectively. If we take out these two countries, the regional average for the recent decline is minus 6.71%.

This is of course a far cry from last year's same period performance as these markets declined by an average of 14.49%

In terms of year to date performance, only Indonesia and the Philippines are still up as both are +9.91% and +2.31% respectively. It is interesting to note that the Phisix still manage to be up despite having been the one which declined the most in the recent sell off (-14.21%).

The local market's sharp decline (more than regional average) has been driven mainly by concerns over the delay of the passage of the VAT law. Investors have been concerned not only by the delay but also by the eventual version that will be passed (whether it's the Senate or House version). There is a growing concern that the passage of a "failed version" of the VAT law would eventually do "more harm than good" and eventually have a negative impact on the country's macro economic environment.

With the significant decline in the Phisix over the past month and a half, we feel it appropriate to go back to basics and look at comparative market valuations across the region in order to have a better perspective on the current situation.

In the table below we have included various price performance and valuation metrics among different markets across the region. From a valuation stand point, we can see that valuations for the Phisix have improved both in terms of PE Ratio and Price to Book. From a PE level of 13.2x in early march, the market PE has now dipped to 11.2x for 2005E. In terms of Price to Book the level has declined to 1.4x versus 1.6x when the index was hitting the year highs last March.

On an absolute basis, the Phisix currently has among the lowest valuation in terms of PE and the lowest in terms of Price to Book levels. Meanwhile, on a the PEG basis we can see that the Philippines still has the second best PEG scenario for 2005 at 0.53x next to Indonesia's 0.49x .

While its true that countries like Malaysia and Thailand are trading at lower absolute PE levels than the Philippines, its projected corporate growth is either negative or show marginal growth for 2005.

Hence from a PE to Growth valuation basis, we can see that the local equity market is still a GARP play with low PE valuation and above average growth prospects. While it is still early to determine whether the market has indeed bottomed out at this point, we can see from the valuations that sharp sell offs from current levels maybe unwarranted as there is no "over valuation" to speak of both for the Philippines and even for the region. Any further sell off should likely be sentiment driven and can easily be reversed as historical examples have shown us.

Comparative Regional Equity Valuation

Country	Index Close	Ytd Change	% Chng from March	PER		EPS Growth		PEG	Price to Book
				2004P	2005E	2004P	2005E	2005E	2005E
China	1218.18	-3.82%	-8.14%	13.00	11.30	52.2	8.2	1.38	1.8
Hong Kong	13681.23	-3.86%	-1.64%	14.80	14.60	30.5	1.6	9.13	1.6
India	6281.3	-4.87%	-9.68%	14.30	11.80	30.2	21.2	0.56	2.7
Indonesia	1099.42	9.91%	-4.89%	12.90	10.90	36.4	22.3	0.49	2.4
Korea	946.25	-7.71%	5.62%	7.90	8.20	57.5	-3.7	(2.22)	1.2
Malaysia	878.91	-2.73%	-3.14%	15.40	14.60	7.8	4.6	3.17	1.7
Singapore	2157.77	-0.98%	4.43%	11.00	13.90	99.8	-20.6	(0.67)	1.5
Taiwan	5888.37	-4.09%	-5.90%	11.80	12.20	51.6	-2.6	(4.69)	1.6
Thailand	698.28	4.52%	-6.06%	10.10	9.10	59.4	9.5	(0.96)	2
Philippines	**1864.06**	**2.31%**	**-14.21%**	**13.42**	**11.21**	**52.6**	**21.8**	**0.53**	**1.4**