Philequity Corner (06/06/05)
Philippines: A Re-rating Story Unfolds

By Ignacio B. Gimenez

Philippine market regains lost ground

After more than two months spending time in doldrums, the market mustered enough energy to stage a major comeback last week with the Philippine Composite Index (PHISIX) gaining 147 pts or an equivalent of 7.8 percent week-on-week to close at 2,022. Perennial market leaders PLDT, Ayala Land and Ayala Corp. each gained at least 10 percent - leading the market to its biggest broad-based rally in two years.

Thanks to the passage of crucial reforms - particularly the VAT bill - the country's sovereign risk, which has long caused an overhang on Philippine equities, is slowly being reduced.

If you remember, we spent four past articles just emphasizing the importance of the VAT bill for Philippine equities.

We have noted in the first of these articles that "*the case for Philippine equities is basically a **macro call** – i.e. investors are betting on a better macroeconomic picture hinged on the passage of fiscal reforms, … if a 12% VAT is approved, we see investor confidence going back, the peso appreciating, interest rates easing, the stock market improving, and leading to a credit upgrade -* ***(It's all or nothing for the 12% VAT - April 25, 2005)***."

In a subsequent article, we said that "*President Arroyo will likely be given the standby authority to increase the VAT rate from 10% to 12% … while it may not be a perfect solution of an immediate 12%, the market can live with it as long as it can deliver the required revenue targets -* ***(An urgent appeal to Congress – May 2, 2005)****.*"

Next we mentioned that "*a momentous VAT bill is crucial in laying down the groundwork on which subsequent fiscal adjustments would stand ... that, in the long run, positive momentum from these reforms would translate to higher economic growth thru resurgence of foreign investments and domestic credit expansion* ***(Laying the groundwork with a credible VAT bill – May 9, 2005)****.*"

After the VAT bill was ratified by Congress and the market was slow to react, we said that "*investors underestimated (if not ignored) the positive news coming from the domestic front, namely, the encouraging progress of fiscal reforms, strong corporate earnings, steady inflows of OFWs … that, in the long term, we expect a possible* ***credit re-rating*** *if we continue to get our act together, which should put the market back on its bullish trend after this long consolidation* ***(Getting our act together after taking the bitter pill of fiscal reforms – May 23, 2005)****.*"

True enough Fitch Ratings upgraded its outlook on Philippine sovereign ratings from "negative" to "stable" last May 27, 2005. Since then, the market has closed higher on six consecutive trading days and has already regained much of its lost ground.

Compared to the rest of the region, Philippine equities have transformed from being the worst performer (-16.4%) during the March-April decline to being the best performer (+10.7%) since its April lows.

Regional Stock Market Performance – From Worst to Best

Country	Current Value	March High to April Low (%)	April Low to Current (%)
Hong Kong	13,818.45	-5.3%	3.6%
India	6,735.49	-12.0%	10.1%
Indonesia	1,092.50	-12.6%	8.0%
Korea	976.09	-11.9%	8.1%
Malaysia	865.55	-5.1%	0.7%
Singapore	2,192.67	-3.5%	3.7%
Taiwan	6,107.95	-11.2%	9.7%
Thailand	676.70	-11.9%	3.3%
Average			
Philippines	2,022.49	-16.4%	11.3%

Source: Technistock

Foreign investors are back!

As we have mentioned in the past, we in Philequity Fund, are just part of the huge consensus calling for the front-loaded fiscal reforms. With the passage of the VAT bill, foreign investment houses are now more bullish on the Philippine story.

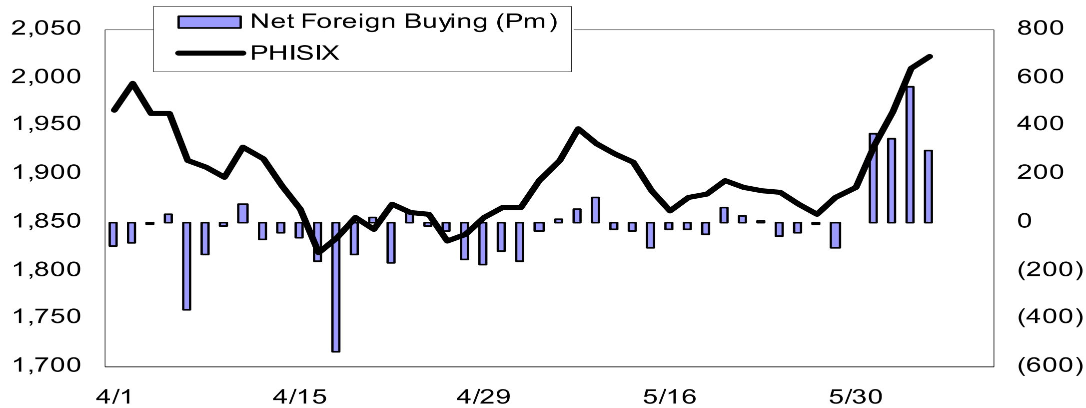
Most of these foreign houses believe that the recently enacted reforms should adequately reduce the fiscal debt ratios down to sustainable levels and that a virtuous cycle of improving fiscal, balance of payments, inflation and asset prices is now unfolding.

In fact, investment bank Morgan Stanley went further saying that *"If the present pace of reforms continues, we believe that as the fiscal accounts reach normalcy and attract foreign investment, there will be some momentum in investment next year, boosted by government involvement in social and infrastructure activities,"* according to news reports over the weekend.

Major foreign houses are also conducting international road shows and recommending investments in the Philippines. It is therefore not surprising to see that net foreign buying in the Philippine Stock Exchange has gone up significantly.

Last week alone, net foreign inflow amounted to P1.57 billion – a huge improvement compared to a net foreign outflow of P199 million during the previous week.

Phisix & Net Foreign Buying



Source: Technistock

As a result, almost all of the PHISIX constituents gained last week with an average increase of 8.5%. Battered issues, such as Holcim Phils, DMCI Hldgs, and First Phil. Holdings, led the resurgence. Ayala Corp., Ayala Land, and PLDT led the blue chip issues, with PLDT reaching an all time high of 1,600. Meanwhile, recent IPOs Manila Water Corp. and SM Investments Corp. have climbed over their respective IPO prices after trading lower during the past two months.

PHISIX Constituents – Price Performance (Week-on-week)

#	Company	Current Price	% Gain from previous Week
1	Holcim Philippines, Inc.	3.90	27.9%
2	DMCI Holdings, Inc.	2.85	15.9%
3	First Phil. Holdings Corp.	51.00	14.6%
4	Lepanto Consolidated Mining Co. "B"	0.35	12.9%
5	Benpres Holdings Corporation	1.06	12.8%
6	Ayala Corporation	377.50	12.7%
7	Filinvest Land, Inc.	1.60	12.7%
8	Belle Corporation	1.26	12.5%
9	Metro Pacific Corporation	0.38	11.8%
10	Ayala Land, Inc.	8.50	10.4%
11	Megaworld Corporation	1.50	10.3%
12	Music Semiconductors Corporation	1.30	10.2%
13	Phil. Long Distance Telephone Co.	1,585.00	10.1%
14	Lepanto Consolidated Mining Co. "A"	0.33	10.0%
15	Digital Telecommunications Phils., Inc.	1.14	9.6%
16	Globe Telecom, Inc.	900.00	9.1%
17	Manila Electric Company "B"	24.75	8.8%
18	Ionics, Inc.	1.30	8.3%
19	Int'l Container Terminal Services, Inc.	8.10	8.0%
20	JG Summit Holdings, Inc.	3.45	7.8%
21	San Miguel Corporation "B"	91.00	7.7%
22	Aboitiz Equity Ventures, Inc.	5.20	7.2%
23	SM Prime Holdings, Inc.	7.90	5.3%
24	Manila Electric Company "A"	16.25	4.8%
25	Petron Corporation	3.35	4.7%
26	Bank of the Philippine Islands	50.00	4.2%
27	Metropolitan Bank and Trust Company	31.50	3.3%
28	Philippine National Bank	34.00	3.0%
29	Equitable PCI Bank, Inc.	51.00	3.0%
30	San Miguel Corporation "A"	59.50	1.7%
31	Jollibee Foods Corporation	29.50	0.0%
32	Ginebra San Miguel Inc.	32.00	0.0%
33	ABS-CBN Broadcasting Corporation	12.00	-2.0%

Source: Technistock

Re-rating story to continue

We, in Philequity Fund, believe a fiscal turning point is at hand and that a re-rating story for the Philippines is well under way.

What we have anticipated a few weeks back is now happening. Philippine equity and bond prices are improving; interest rates are declining; the peso is stable against the US dollar and performing favorably against other currencies such as the Euro and the Japanese Yen.

So far, Philequity Fund has rallied by 6% from its low in April. Barring unforeseen circumstances, we expect equity prices, as well as the Fund itself, to continue appreciating going forward.

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