Philequity Corner (October 17, 2005)
By Ignacio B. Gimenez

Why are we lagging behind?

After hitting record highs in September, emerging market equities around the world suffered huge losses as investors fear that they are becoming dangerously overpriced. Emerging market countries in Eastern Europe, Latin America and North Asia were among the worst hit. Russia, for example, declined 13.4% while Turkey is down 12.2% from their recent highs. The major reason is a global inflation scare which investors fear could prompt the U.S. Fed to raise rates more aggressively.

Meanwhile, the Philippine equity market has performed relatively better recently. Net foreign inflows have been positive for the last 21 days amounting to $60m. From its September peak, the Philippine Composite Index (PHISIX) is slightly down by 1.7%.

At first glance, the Philippines seems to be performing relatively well but looking at the larger picture, you will notice that the Philippines has actually lagged behind.

Performance of Select Emerging Markets

Country	Index	Current Price	Sept Peak	% Chg from Sept Peak	March Peak	% Chg from March Peak
Russia	RTS	911	1,053	-13.4%	722	26.2%
India	Sensex	8,202	8,822	-7.0%	6,954	17.9%
Korea	Kospi	1,190	1,246	-4.5%	1,025	16.1%
Turkey	ISE	31,440	35,809	-12.2%	28,400	10.7%
Mexico	Bolsa	14,893	16,186	-8.0%	13,931	6.9%
Czech Republic	PX 50	1,327	1,482	-10.4%	1,263	5.1%
Singapore	STI	2,303	2,400	-4.0%	2,191	5.1%
Hong Kong	Hang Seng	14,486	15,493	-6.5%	14,273	1.5%
Brazil	Bovespa	29,770	32,052	-7.1%	29,452	1.1%
Malaysia	KLSE	926	954	-3.0%	941	-1.6%
Thailand	SET	700	727	-3.7%	737	-5.1%
Indonesia	JCI	1,091	1,107	-1.5%	1,157	-5.7%
Philippines	Phisix	1,953	1,988	-1.7%	2,173	-10.1%

Source: Bloomberg

Recall that in the 1st quarter of this year, emerging markets had a significant run-up which culminated in March and led to a sell-off towards April. Since then most emerging markets recovered. Russia for example is up 26.2% over its March peak (despite the recent correction). India is up 17.9% and Korea by16.1% over their March peaks. But sad to say, the Philippines is down by 10.1% over the same period.

Why does the Philippine market continue to lag behind? Why is it that while other emerging markets recover and race forward, ours further slows down?

For one, political uncertainty has caused investors to trade cautiously. This is evident in the decrease of liquidity and lack of local participation in the Philippine stock market. For the first two weeks of October, foreign trades comprised 74 percent of market volume. This is also why even trickles of foreign buying and foreign selling have caused wild market swings.

But more than the political uncertainty, it is the pace of economic reforms that have sidelined most of the investing community. While significant progress has been made with the passage of the EVAT, the delays in its implementation is what's causing investors their worries.

The International Monetary Fund (IMF), in their latest growth assessment of the country, is supporting the full implementation of the EVAT law and urging the government not to resist pressures to exempt the EVAT on oil and fuel. Even the major business groups such as the Philippine Chamber of Commerce and Industry (PCCI) and the Federation of Filipino-Chinese Chambers of Commerce and Industries, Inc. (FCCCII), which earlier sought the deferment of the EVAT on oil and fuel, now back its full implementation.

As we have noted in our article last week, it is important that the investment community do not perceive Philippines as backtracking in its push for economic reforms.

We, in Philequity, believe that only full implementation of the EVAT will bring credibility to the government's fiscal consolidation efforts. We cannot help but overemphasize the importance of this crucial reform in order to reduce our vulnerabilities to external shocks such the rise in global interest rates, rise in oil prices, and to downturns in emerging market sentiment (such as what we are experiencing now).

Manila Water Co.

We like Manila Water Company, Inc (MWC PM, MWC.PS – P6.60). The company posted better-than-expected first half results with revenues up by 94% on a year-on-year and net income up by 36.8% over the same period. This was mainly driven by the improved systems losses and higher revenue due to wider coverage.

MWC is currently being vaued at 7.5x price-to-earnings (P/E) using our 2005 earnings estimate of P1.98 billion. It is trading at a discount to the market (P/E of 12.5x) and to regional peers (13.3x P/E). We recommend MWC as a Strong BUY at current prices. We believe that the market will re-rate the issue upwards once political picture improves.

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