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Building Blocks

Despite lingering doubts that the worst of the global crisis are behind us, more signs show that the global economy is stabilizing and that global stock markets are bottoming out.

Recent trends show that:

- The credit system (as indicated by LIBOR, TED Spread, junk bond yields, credit default swap prices, etc.) has thawed on the back of the massive reflation efforts orchestrated by the Fed and other global central banks.
- Commodity prices have recovered with oil now up 38.3 percent year-to-date and the industrial metal copper up 48.8 percent since the start of the year – indicating that the global economy is regaining some traction.
- The defensive sectors (pharmaceuticals, healthcare, utilities, consumer staples) are now catching up with the cyclical sectors (financials, basic materials and consumer discretionary) and growth sectors (like technology) which led the early part of the rally. This sectoral rotation is seen as bullish for stocks.
- Lastly, emerging market stocks are leading the recovery, a sign that global investors are beginning to take more risk – a necessary ingredient for stock markets in general to improve further.

The BRIC foundation

Emerging markets led by Brazil, Russia, India and China (BRICs) have significantly outperformed their developed market counterparts as their economies have rebounded faster and stronger from the global economic downturn.

China, with its huge $585 billion stimulus package, appears to be the first major economy to recover, expanding by 6.1 percent in the 1st quarter of 2009. The stimulus plan and record lending by Chinese banks is aimed to bolster domestic demand as exports falter. Many now expect China to reach its official 8 percent growth target this year. China's CSI 300 index is up 46.4 percent year-to-date.

Brazil, Latin America's biggest economy, is benefitting from the recovery in commodity prices, from coffee to soy beans and iron ore to crude oil. Its currency, the real, has jumped 15 percent against the US dollar since the start of the year. Market heavyweights Petrobras (one of the five biggest integrated energy companies) and Companhia Vale de Rio Doce (the world's biggest iron ore producer) have pushed the Bovespa index by 34.7 percent this year.

Russia, too, has benefitted from commodity prices this year despite the continuing weakness in the Russian economy. Rising energy prices has driven investors back to the stock market even as government has twice downgraded its growth expectations this year. The Russian RTS index, which has closely tracked the price of oil, is up 60.4 percent since the start of the year.

India's stock market jumped an unprecedented 17 percent on Monday last week after the Congress Party thwarted handily the communist party in the national elections, thereby gaining a clearer majority. Their win is expected to pave the way for long-awaited economic reforms such as easing restrictions on foreign investment in insurance, banking and retailing and privatization of state-run oil, banking and fertilizer companies. Year-to-date, India is up 43.9 percent.

With the US recovering from recession, other countries are outperforming and doing their part. The BRICs, as well as other emerging markets, are the new engines of growth. Their outperformance and leadership are the building blocks of the worldwide resumption of the bull market.

Since the start of the year, the MSCI Emerging Makets Index surged by 31.6 percent, the MSCI World Index up slightly by 2.3 percent and the S&P 500 down by -1.8 percent. While the markets are generally up year-to-date, these indices are still down -44.2 percent, -44.1 percent and -43.7 percent from their 2007 peaks, respectively, which should serve as a reminder of the severity of the bear market.

Global Stock Markets Performance

	Current Price	%Chg from 2007 Peak	%Chg Year-to-date	%Chg Week-on-Week
MSCI World Index	941.25	-44.1%	2.3%	2.2%
MSCI Emerging Markets Index	746.417	-44.2%	31.6%	5.4%
Developed Markets				
US (S&P 500)	887	-43.7%	-1.8%	0.5%
US (DJIA)	8277.32	-41.7%	-5.7%	0.1%
US (Nasdaq)	1692.01	-40.9%	7.3%	0.7%
Japan (Nikkei)	9225.81	-49.6%	4.1%	-0.4%
France (CAC)	3229.97	-47.6%	0.4%	1.9%
Germany (DAX)	4918.75	-39.7%	2.3%	3.8%
U.K. (FTSE)	4365.29	-35.4%	-1.6%	0.4%
Average		**-42.6%**	**0.7%**	**1.0%**
Emerging Markets				
Russia (RTSI)	1013.37	-59.4%	60.4%	8.2%
China (CSI 300)	2740.68	-53.5%	46.4%	-2.0%
Hong Kong (Hang Seng)	17062.52	-46.6%	18.6%	1.6%
Singapore (STI)	2245.27	-42.5%	27.5%	4.9%
Philippines (PSEi)	2316.89	-40.6%	23.7%	0.4%
Thailand (SET)	554.02	-40.1%	23.1%	3.8%
India (Sensex)	13887.15	-34.5%	43.9%	14.1%
Indonesia (JCI)	1881.71	-33.7%	38.8%	7.5%
Korea (KOSPI)	1403.75	-32.7%	24.8%	0.9%
Taiwan (TAIEX)	6737.29	-31.7%	46.7%	3.8%
Brazil (Bovespa)	50568.49	-31.6%	34.7%	3.2%
Malaysia (KLSE)	1045.26	-31.4%	19.2%	3.1%
Average		**-39.9%**	**34.0%**	**4.1%**

Source: Bloomberg, Philequity Research

Pro-reform, pro-business

Just like what happened to the Philippines during the time of President Ramos, investors are reacting positively to a structural change in India. Similarly, Taiwan stocks (up 46.7 percent year-to-date) are now benefitting from the economic and business reforms.

As compared to the pro-independence groups, the Kuomintang which won a landslide victory in 2008, has advocated closer business ties with China. In fact, China Mobile is already planning to buy a stake in Far East Tone Telecoms, the first investment by a mainland company in Taiwan in six decades. Meanwhile, COSCO and China Merchants Group are also in talks to invest in Kaoshiung, Taiwan's largest port.

The moves of the equities markets, especially of Taiwan and India, which are pro-reform and pro-business, should be a reminder for those running for office in 2010. A pro-reform and pro-business government is important because it uplifts everybody from businesses to consumers, from the rich to the middle class and the "masa". On the other hand, a populist program, while appealing to the "masa" actually makes life more difficult for the poor. As shown by the markets, a pro-reform and pro-business government is welcome and applauded by investors and the world community.

Laying a more solid foundation

Previously, we wrote "*A Pause that refreshes*" and "*Indigestion*" (see the April 27, 2009 and May 18, 2009 issues of The Philippine Star, respectively). Our major premise is that the market has turned and that what we are seeing now are incipient signs of a bull market. But the "too-much-too-fast" rally made it inevitable for markets to either consolidate near term and give back some of the past eleven weeks' gains.

Such a pullback (which is now taking place) is necessary and healthy. This consolidation/correction should allow the markets to build a more solid foundation, prior to moving higher.

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