

Philequity Corner (April 26, 2010)

By Valentino Sy

Who's Afraid of Election Failure?

We have been receiving similar questions from our readers. Enumerated below are their questions:

- 1) The election is getting near. Should we sell before elections, especially with the possibility of election failure?
- 2) The markets have reached our targets of 3,300 for the PSE index and 1,220 for the S&P 500 index. Should we sell now?
- 3) What should I do with my peso with elections getting near and the possibility of election failure?

We recently had a board meeting of Vantage Equities, Inc. (the parent company of Philequity Management, Inc.) and maybe the discussions we had can answer the queries of our readers.

Below are the excerpts from Vantage's board meeting:

IG: "A lot of buzz has been going around lately about the possibility of election failure. I think it would be prudent for us to take these rumors into consideration. As directors of a public company, we have the fiduciary duty to discuss the different scenarios for the markets and position our portfolio the best possible way."

RL: "The market has gone up a lot. We were forecasting 3,300, which has been reached. At this point, it may be good to consider lightening up our position. If there is election failure, we may suffer a substantial correction."

EB: "At this junction, the decision is binary. If we believe that there is going to be election failure, then we should be selling and raising cash. If we believe that the elections will not fail, then we should hold on to our positions."

JO: "Thailand has been experiencing this problem for some time. Thailand in essence has had this failure of election scenario for the past two years with no single government lasting more than six months or so. And despite last month's violent protests (which left 26 dead and more than 800 injured), the Thai SET index has just dropped as much as 10 percent from its year high of 820.09. Looking at Thailand as a parallel case, our market may just drop 10 to 15 percent if a similar failure of election scenario occurs here."

WS: "Vantage is a Philippine corporation. We own operating companies. But as far as our investible funds are concerned, our mandate is to buy Philippine stocks and Philippine bonds. Right now, we have investments of PHP 3 billion. Roughly fifty percent is in stocks and fifty percent in fixed income. I am comfortable with our asset allocation even with the possible scenario of political uncertainties."

JO: "I am also confident because we are invested in fundamentally strong Philippine companies."

WS: *“Yes, we are invested in companies with very strong fundamentals that can withstand a downfall caused by political upheaval.”*

EB: *“Our bond portfolio is holding government securities and strong commercial papers, so we expect to get paid. Moreover, they are mostly short-dated and the longest is 10 years.”*

AS: *“I have mentioned this before in the recent Philequity board meeting. There is a distinction between failure of elections and failure of automation. If the automated counting does not work, the back-up plan is that we can always revert back to manual counting.”*

IG: *“Regarding concerns of a military junta if there is massive cheating, I don’t think the people will allow it. People will go back to the streets and there will be political upheaval.”*

GY: *“It will be very difficult to pull off because people are more vigilant. So many people are looking at the process – the people, the media, the church, the political parties, the military, and the outside world. It is highly unlikely that such fears shall be realized. Besides, an eight point lead (based on SWS Special March 2010 survey of March 28-30, 2010) is a very big lead with only two weeks left before elections. Cheating in such a massive scale with so many eyes watching will be very difficult to execute.*

AS: *I am an optimist at heart. I believe things will work out fine. Also, as Filipino corporate citizens it would look so bad and irresponsible if we were seen to be the first to panic, expressing no confidence in our own future.”*

WS: *“I am also optimistic that the will of the people will prevail and not be subverted. In fact, if the election goes as expected and nothing bad happens, the risk is to the upside. The market may easily overshoot our targets. In addition, our market is not as liquid as the US. So if we sell, we cannot buy back our positions. And unlike other markets, we don’t have an option market where we could buy put options or sell call options in order to protect our positions.*

AS: *“I agree. The potential gains from a successful transition far outweighs the risks of chaos of no elected leaders come May.”*

EB: *“For the individual punters who are interested, there are still the NDF (non-deliverable forward) contracts on the Philippine peso that you can play with. Also, one can dabble in credit default swaps on Philippine bonds which act as insurance buffers for holders of ROP bonds. The present CDS premium is 100 points for Philippine bonds.”*

IG: *“It is good that we discussed these things openly. It was a good exercise to hear the different views and finally agreeing on what to do. It is also very reassuring to hear from our expert directors their faith in our capital markets.”*

Conclusion

So based on our discussion, the board agreed that we are staying put and we are not selling at this point. Our mandate is to use our investible funds to buy Philippine stocks and bonds. We love our country, so we should be patriotic and not cop out now. We are also comfortable with the risks involved and confident in our positions. Besides, we are still in a bull market and the risk is to the upside if nothing untoward happens during the elections. The board thus agrees that maintaining the 50/50 mix of equities and fix income is still the best tack to go.

We hope the questions of our readers have been answered by this synopsis.

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