Philequity Corner (August 9, 2010)
By Valentino Sy

Right Place, Right Time

Among emerging markets the Philippines has often been overlooked because of the small size of our market in terms of liquidity and market capitalization. Once a darling of the investment community in the early 1990s when the Philippines was known as one of the emerging Asian Tigers, the Philippine market has been a laggard when compared to its Asian and Latin American counterparts.

In recent years, however, a lot of factors have changed. In fact, this year the PSE index is at a new high for the year at 3,516.28, up 15 percent year-to-date. Our Philequity Fund is also at a new high at Php 16.11 per share, up 23 percent year-to-date.

Among the reasons to invest in the Philippines now include:

- Growth in developed markets are slowing whereas Asian growth, in particular the ASEAN region (+6.5 percent GDP growth in 2010) and the Philippines (+6 percent GDP growth in 2010) are showing robust growth
- There is a marked shift towards investment in emerging markets and in Asia as opposed to developed markets such as US, Europe and Japan
- The technical picture is much better in the ASEAN markets which are making higher highs as opposed to developed markets which are still in the process of consolidation
- Strong domestic corporate earnings results which has been supportive of higher equity prices
- Resilient and well-capitalized Philippine banking sector
- Mild inflation which is expected to average 4 percent in 2010
- Steady flow of OFW remittances which has kept the domestic economy growing despite the recent global crisis
- An appreciating peso on the back of surpluses in the current account and balance of payments
- A more transparent new government with a clean governance platform that will likely reinvigorate business and investments

With the right macro picture, right political environment, right growth area which is the ASEAN and our proximity to China, we believe it is now the right time for the Philippine market to get noticed once again.

Back in the Radar

The Philippines is definitely back in the radar of foreign funds. In fact, Goldman Sachs included the Philippines in its "Next Eleven" (or N-11) list of countries – identified as having promising outlooks for investment and future growth.

The N-11 (which includes Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines and South Korea) is a follow-up to their 2003 paper on the BRIC economies (composed of Brazil, Russia, India and China). Goldman Sachs used macroeconomic stability, political maturity, openness of trade and investment policies, and the quality of education as criteria for selection.

Chinese Growth Pulling the ASEAN and the Philippines

Economic and trade relations between China and the ASEAN have strengthened significantly in the past years. China is currently ASEAN's second largest trading partner with total trade between the two reaching around US$200 billion in 2009.

The full establishment of China-ASEAN Free Trade Agreement (CAFTA) on January 1st 2010 will further promote economic and trade ties. Touted as the biggest Free Trade Area, CAFTA boasts of 1.7 billion consumers with a combined gross domestic product of US$2 trillion and total trade of US$1.3 trillion.

With China now back on its growth path after engineering a soft-landing, the ASEAN economies will further be benefited (see *Our Time is Now*, July 26, 2010).

ASEAN markets outperform

Given the bright economic prospects of the ASEAN countries, the ASEAN stock markets have shone bright this year as a leading investment destination. In fact, four of its members are in the top 15 best performing markets in the world year-to-date according to data compiled from Bloomberg.

Indonesia (ranked 9th) has surged 25 percent year-to-date. Thailand (ranked 10th) has gained 21 percent despite the political unrest. Meanwhile, Philippines (ranked 13th) and Malaysia (ranked 14th) have returned 15 percent and 14 percent, respectively.

In comparison, the benchmark S&P 500 index is down 2 percent year-to-date. Debt-laden Spain and Greece are down 19 percent and 29 percent, respectively.

Funds Flowing into ASEAN

One of the major reasons why the ASEAN markets have been outperforming is the strong investment inflows coming from exchange-traded funds (ETFs).

According to a Morgan Stanley paper, ETFs tracking emerging market indices had the biggest share of net inflows in the 2nd quarter of 2010 among equity ETFs. The two biggest EM ETFs, Vanguard's Emerging Markets ETF (symbol: VWO) and iShares MSCI Emerging Markets Index Fund (symbol: EEM) registered net inflows of US$4 billion and US$3 billion in the 2nd quarter of 2010, respectively.

Among emerging market regions, it is Asian ETFs which registered the biggest inflows with the iShares MSCI All-Country Asia ex-Japan Index Fund (symbol: AAXJ) receiving US$307 million. Meanwhile, Latin American ETFs such as the iShares S&P Latin America 40 Index Fund had net outflows of US$216 million in the 2nd quarter of 2010.

ETFs Disclose New Positions in the Philippines

With the US and European economies weak, more funds are reallocating a greater portion of their portfolio in fast-growing Asia. The Philippines, which held well through the recent global credit crisis, is getting the better share of those inflows. Especially after P-Noy's election, investments are starting to return.

BlackRock and Vanguard (the two largest emerging market ETF providers) disclosed significant additions to their holdings of Philippine stocks in their most recent disclosure (June 30, 2010) with the US SEC. The purchases of these ETFs are one of the major reasons why the Philippine market is moving higher.

Possible Philippine ETF listing in New York

While there are already single-country ETFs dedicated to other ASEAN countries as shown in the table below, there is none yet for the Philippines. We are confident that ETF proponents like BlackRock, Vanguard, State Street Global Advisors, Morgan Stanley and others would make a bid to make a Philippine ETF listing in New York.

Country	ETF	Symbol	Market Cap (US$m)
Indonesia	Market Vectors Indonesia Index ETF	IDX	455
	iShares MSCI Indonesia Investable Market Index Fund	EIDO	8
Malaysia	iShares MSCI Malaysia Index Fund	EWM	683
Singapore	iShares MSCI Singapore Index Fund	EWS	1,699
Thailand	iShares MSCI Thailand Index Fund	THD	334
Vietnam	Market Vectors Vietnam ETF	VNM	146
Philippines	iShares MSCI Philippines Investable Market Indes Fund		not yet operational
	FTSE Philippines 30 ETF		not yet operational

Source: Bloomberg, ETF.com

Note that in February 2010, iShares already announced plans for an iShares MSCI Philippines Investable Market Index Fund. At about the same time, Global X also announced intentions to put up a FTSE Philippines 30 ETF.

We believe that a Philippine ETF listing in New York would be the next catalyst for our market to reach the all-time high of 3,896 that was last reached in October 2007.

Buy on Dips

For sure there will be dips and corrections along the way as our market makes new highs but we are sticking to our targets. In fact, our initial target of 3,500 has been reached early. We reiterate that the PSE Index will ultimately retest its all-time high of 3,896.

In a bull market, the strategy is to be buying on dips as opposed to selling on rallies when it is a bear market.

REIT Implementation Will Push Through

In our previous article (see *Size Matters*, August 2, 2010), we said that the implementation of the Real Estate Investment Trusts (or REITS) might be delayed since the government is trying to address its fiscal problem. Introducing REITs would result to foregone revenues amounting to billions of pesos.

Last Thursday, however, Finance Secretary Cesar Purisima said that the government is studying “scheduling” or “graduating” tax breaks for REITS in an interview with Bloomberg.

The impact of the tax breaks will be substantial, he said. But any change won’t go against the intent of the REIT law, he added.

Property markets turned as a result of his comments.

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