

Philequity Corner (November 1, 2010)
By Valentino Sy

PSEi vs. EPHE

A very large percentage of institutional money is either indexed to – or evaluated relative to – market benchmark indices. In the US, money managers are evaluated by comparing their returns to the S&P 500 index for large cap stocks or to the Russell 2000 index for small cap stocks.

In the Philippines, the main equity benchmark is the PSE index (PSEi). The performance of equity fund managers, such as Philequity Management, Inc., is generally assessed versus the performance of the PSEi. So far this year, Philequity Fund has outperformed the PSEi with a 53.95 percent gain compared with the benchmark's 39.84 percent return.

Recomposition of the PSE Index

Last week the Philippine Stock Exchange announced that it will revise the composition of the PSEi on November 8, 2010. The changes are based on a specific set of criteria. In particular, the companies that will make up the 30-member PSEi are required to meet the following:

- 1) Free float level of at least 10 percent
- 2) Liquidity or average daily trading value of at least Php5 million
- 3) Volume turnover ratio of at least 10 percent
- 4) Tradability of at least 95 percent of the total trading days
- 5) Free float market capitalization

Three companies will join the PSEi, namely DMCI Holdings, Inc., First Gen Corporation and JG Summit Holdings, Inc. They will replace GMA Network, Inc., Security Bank Corporation and San Miguel Corporation.

Impact of the Changes in the PSE Index

The recomposition of the PSEi which happens every six months has a noticeable effect on the share prices of its members due to the large amount of assets indexed and benchmarked to it. In anticipation of the one-time demand shock by index funds that mimic the PSEi, the shares being added to the index usually outperform the shares being deleted.

Indices and Passive Investment

Market indices are a common basis for a certain type of investment, i.e. passively managed mutual funds and ETFs. The biggest large cap stock ETF in the US, for example, is the SPDR S&P 500 ETF (symbol: SPY). SPY tracks the S&P 500 index. But if an investor wants to buy the Russell 2000, there is also the iShares Russell 2000 index fund (symbol: IWM).

Meanwhile, an investor who wants to buy the PSEi can invest in the Philequity PSE Index Fund which attempts to replicate the holdings of the PSEi.

Another avenue for passive investment in the Philippine equities market is the recently launched Philippine ETF which we covered in our article last month (see *Historic Moment*, October 4, 2010). The iShares MSCI Philippines Investable Market Index Fund (symbol: EPHE) is listed in the New York Stock Exchange which gives it a much wider reach and exposure to foreign investors.

EPHE Index Composition

EPHE seeks investment results that correspond generally to the price and yield performance of the MSCI Philippines Investable Market Index. The underlying index is a free-float adjusted market capitalization index designed to measure the performance of equity securities in the top 99 percent by market capitalization of equity securities listed in the Philippine Stock Exchange.

Below is a table which compares the holdings of EPHE to that of the PSEi:

EPHE vs. PSEi

Stock Code	PSEi	EPHE	Diff (EPHE - PSEi)
TEL	16.39%	12.20%	-4.19%
ALI	6.69%	8.73%	2.04%
BPI	6.41%	7.33%	0.92%
SM	6.01%	10.29%	4.28%
MBT	5.21%	4.25%	-0.96%
AEV	5.19%	-	-5.19%
AC	4.70%	6.41%	1.71%
BDO	4.25%	4.84%	0.59%
EDC	4.06%	4.68%	0.62%
SMPH	3.20%	5.45%	2.25%
JGS	3.15%	-	-3.15%
AP	3.11%	-	-3.11%
AGI	2.95%	-	-2.95%
ICT	2.56%	-	-2.56%
MPI	2.54%	-	-2.54%
MER	2.33%	5.02%	2.69%
JFC	2.33%	4.36%	2.03%
URC	2.11%	-	-2.11%
DMC	1.90%	3.19%	1.29%
CHIB	1.86%	-	-1.86%
MEG	1.76%	2.23%	0.47%
GLO	1.75%	3.60%	1.85%
MWC	1.63%	2.35%	0.72%
PX	1.42%	-	-1.42%
FPH	1.41%	2.11%	0.70%
RLC	1.20%	1.94%	0.74%
ABS	1.20%	-	-1.20%
FLI	1.01%	1.33%	0.32%
FGEN	0.98%	1.60%	0.62%
LC	0.41%	-	-0.41%
LCB	0.27%	-	-0.27%
SECB	-	1.48%	1.48%
PNB	-	1.39%	1.39%
LPZ	-	1.30%	1.30%
RCB	-	1.23%	1.23%
VLL	-	1.06%	1.06%
WEB	-	0.77%	0.77%
AT	-	0.70%	0.70%

Source: iShares, PSE

Differences between PSEi and EPHE

Note that while the PSEi has 30 constituents, the EPHE only has 26. A number of heavily weighted stocks in the PSEi are not included in the EPHE, namely: Aboitiz Equity Ventures, JG Summit, Aboitiz Power, Alliance Global Holdings, ICTSI and Metro Pacific Investments.

In the banking sector, Philippine National Bank, RCBC and Security Bank (to be removed in the PSEi by Nov. 8) are included in the EPHE and not in the PSEi.

In the mining sector, Atlas Mining represents the sector in EPHE while Philex Mining and Lepanto Consolidated are excluded in the Philippine ETF.

Other issues like Lopez Holdings, Vista Land and Philweb are also included in EPHE, but not in the PSEi. Also worth noting is the heavier weighting of SM investments, SM Prime, Ayala Land, Meralco and Jollibee in EPHE while PLDT is relatively underweighted in the Philippines ETF.

Benefits of Indexing

Similar to the Philequity PSE Index Fund, EPHE uses a “passive” or indexing approach to try to achieve its investment objective. The EPHE, like the Philequity PSE Index Fund, does not try to beat the index it tracks and does not seek temporary defensive positions when markets decline or appear to be overvalued.

Indexing eliminates the chance that the fund will significantly outperform the underlying index but it also greatly reduces some of the risks of an actively managed portfolio, such as poor stock selection. Indexing also reduces costs associated with the management of the index because of the low portfolio turnover in comparison to actively managed funds.

In the Philippines, there are no ETFs listed in the exchange. The closest way is to buy a mutual fund such as the Philequity Fund or the Philequity PSE Index Fund being offered by Philequity Management, Inc.

Those who are interested to learn more about mutual funds, index funds and ETFS can call us at 689-8080 or email sales@philequity.net.