Philequity Corner (January 25, 2011)
By Valentino Sy

Jack Be Nimble, Jack Be Quick

Since November 2010, emerging stock markets have taken the back seat as the US and other developed markets rallied on the back of the Fed's Quantitative Easing Part 2 (QE2) and expectations of a stronger US recovery this year. As noted in an article two months ago (see *Is the Bull Run Over?*, November 14, 2010), global investors started to unwind their long emerging market / short US market positions after the Fed formally announced QE2 in Nov. 4, 2010.

Over the same period, the PSE index has languished, falling 11.7 percent from a new all-time high of 4,413 registered 2 ½ months ago. Net foreign fund inflows which were quite strong in 2010 have turned negative in recent weeks. In fact, foreign funds sold a net of Php2.1 billion last week as the PSE index lost 4.6 percent. Market action has also rotated from the "blue-chip" issues toward special situation stocks like the San Miguel Group of Companies, casino stocks like Belle Resources and Leisure & Resorts World Corporation, and the more speculative "2nd and 3rd line" stocks where foreign participation is limited.

As global investors shift their focus back to developed markets, we foresee further volatility for the PSEi within the 3,850 to 4,250 range. The next few weeks is expected to be a traders market where trading opportunities should reward the nimble and the quick. Over the long-term, we continue to be bullish on the Philippine market, especially during the latter part of the year when evidence of a stronger US recovery gets more pronounced and when inflation in China and its monetary tightening starts to abate.

The Fed wants stocks to go up

We have always said that it is better to have the Fed on your side. Despite what most economists are saying against the Fed and its policies, we in Philequity always find it rewarding "NOT" to fight the Fed. This is the main thesis of our bullish outlook for US stocks this year.

In a letter to Washington Post back in November 4, 2010, Bernanke implicitly stated that he wants stocks to go up. He said that:

"STOCK PRICES ROSE and long term interest rates fell when investors began to anticipate the most recent action (referring to QE2)…

… AND HIGHER STOCK PRICES WILL BOOST CONSUMER WEALTH AND HELP INCREASE CONFIDENCE WHICH CAN ALSO SPUR SPENDING. INCREASED SPENDING WILL LEAD TO HIGHER INCOME AND PROFITS, IN A VIRTUOUS CYCLE, WILL FURTHER SUPPORT ECONOMIC EXPANSION." – Bernanke statement in Washington Post, Nov. 4, 2010

Bernanke's predecessor, Alan Greenspan also concurred. In a speech last December 3, 2010, Greenspan said that:

"I think we are underestimating and continue to underestimate HOW IMPORTANT ASSET PRICES ARE, VERY SPECIFICALLY EQUITY PRICES, NOT ONLY TO SHAREHOLDERS BUT TO THE ECONOMY AS A WHOLE.

The point is important and that it is at the CENTER OF BERNANKE'S EFFORTS. The FED has dramatically expanded its balance sheet in hopes that more liquidity in the economy will HELP DRIVE UP THE PRICES OF RISKIER ASSETS, PARTICULARLY STOCKS." – Greenspan Speech, Dec. 3, 2010

And in a speech in Belingham, Virginia last January 13, 2011, Bernanke said that:

"Interest rates are higher but I think that's mostly because the news is better. It's responding to a STRONGER ECONOMY AND BETTER EXPECTATIONS. So I think the POLICY HAS HELPED." – Bernanke, January 13, 2011

Developed Markets vs. Emerging Markets

The improved economic outlook in the US due to QE2 is being reflected by the markets. Since Bernanke's Washington Post letter in November 4, 2010, the US and other developed markets gained 4.4 percent. In contrast, the MSCI Emerging Markets Index declined by 1.3 percent, while the MSCI EM Asia Index fell 1 percent.

Performance of Developed Markets vs. Emerging Markets since Nov. 4, 2010

Developed Markets	Index	Price as of 11/4/2010	Price as of 1/1/2011	%Change
Japan	NIKKEI	9,358.78	10,274.52	9.8%
US	S&P 500	1,221.06	1,283.35	5.1%
Germany	DAX	6,734.69	7,062.42	4.9%
Netherlands	AEX	345.15	361.05	4.6%
US	NASDAQ	2,577.34	2,689.54	4.4%
US	DJIA	11,434.84	11,871.84	3.8%
Sweden	OMX 30	1,109.37	1,150.84	3.7%
Italy	MIB	21,469.19	22,093.85	2.9%
France	CAC	3,916.78	4,017.45	2.6%
Spain	IBEX	10,602.80	10,829.10	2.1%
			Average	**4.4%**
MSCI Emerging Markets Index		1,151.08	1,136.65	**-1.3%**
MSCI EM Asia Index		468.38	463.63	**-1.0%**

Source: Bloomberg

North Asia vs. Southeast Asia

Aside from funds going into developed markets from emerging markets, money is also flowing into North Asia from Southeast Asia. After a strong outperformance of ASEAN markets in 2010, ASEAN equity funds have recorded net outflows equivalent to 5 percent of assets since Mid-November 2010. There appears to be a rotation from the lower beta defensive ASEAN markets into the higher beta and more cyclical North Asian markets, especially those that underperformed in 2010. Expectedly so, since North Asian economies, which relies greatly on exports to the US, would stand to benefit more from a stronger US recovery.

Looking at the table below, ASEAN markets have underperformed North Asian markets by more than 11.6 percent since Bernanke's Washington Post statement in Nov. 4, 2010. Japan, Taiwan and South Korea gained an average of 7.8 percent while ASEAN markets declined 3.8 percent. Only Malaysia registered a positive return of 2.4 percent among the five ASEAN markets.

This is understandable as ASEAN markets were the best performers in 2009 and 2010. In fact, Philequity Fund returned 65 percent in 2009 and 54 percent in 2010.

Performance of North Asia vs. Southeast Asia since Nov. 4, 2010

North Asia	Index	Price as of 11/4/2010	Price as of 1/1/2011	%Change
Japan	NIKKEI	9,358.78	10,274.52	9.8%
Taiwan	TAIEX	8,357.85	8,954.38	7.1%
South Korea	KOSPI	1,942.50	2,069.92	6.6%
			Average	**7.8%**
Southeast Asia				
Malaysia	KLCI	1511.74	1,547.43	2.4%
Singapore	STI	3240.31	3,184.60	-1.7%
Thailand	SET	1031.61	1006.57	-2.4%
Indonesia	JCI	3629.04	3,379.54	-6.9%
Philippines	PSEi	4,397.30	3,951.04	-10.1%
			Average	**-3.8%**

Source: Bloomberg

Strategy for 2011

Inflation concerns and China's tightening are also adding pressure to Philippine stocks in the short run. While we continue to underperform the US and other developed markets over the next few months, we expect our market to recoup later on driven by higher US growth. We believe that most investors are still underestimating the strength of the US recovery this year. Higher US growth and the stabilization of China's markets when they stop tightening and when inflation is under control would be the catalysts for the Philippine and other emerging market stocks to go higher during the latter part of the year.

For traders, the strategy now is to ride the volatility by being quick and nimble in their trades, buying during sell-off and selling during rallies.

For individuals and long-term investors, they can slowly buy by cost averaging or buying slowly every two weeks or every month.

For strategic investors and stock pickers, the strategy is to look for blue chip stocks that are way oversold. They should pick selected fundamentally strong issues especially if it gets to a point that prices are compellingly cheap.

For further stock market research and to view our previous articles, please visit our online trading platform at www.wealthsec.com or call 634-5038. Our archived articles can also be viewed at www.philequity.net.