

**Philequity Corner (March 7, 2011)**  
**By Valentino Sy**

**Tsupiteros' Delight, Investors' Fright**

While 2009 and most of 2010 were banner years for trend followers and long term investors, 2011 has seen the market drop very quickly, move sideways, drop very quickly again, eventually forming a corrective wave. Providing fuel to this sharp correction is the Middle East turmoil, which resulted in a surge in oil prices due to fears of reduced supply, which further aggravated Asia's inflation problem. In addition, price volatility and foreign selling have characterized this dip, with the volatility being exacerbated by the new trading system. An example of this occurred during the pre-close period last February 28 where Enrique Razon, Jr., Chairman and President of ICTSI, lost about PHP 5 BILLION in just ONE SECOND.

**Pre-close period = Posting, bidding but no matching**

For the benefit of our readers who are not that familiar with the new Philippine Stock Exchange (PSE) trading system, the pre-close period is a 3-minute period from 11:57 AM to 12:00 PM where non-cancellable orders can be entered, yet are not matched. As such, one will be able to bear witness to traders piling buy/sell orders, as well as the resulting price swings when a party with a large enough volume is in a hurry to buy or sell. At 12:00:01 PM, orders are matched and the price at which the orders were matched becomes the closing price for the day. Until 12:10 PM, orders can be entered but will only be matched at the closing price determined during the pre-close period.

**How to lose 5 billion in 1 second**

This pre-close period has serious and far-reaching ramifications on price action. Last February 28, we noticed more than a handful of stocks which moved an average of +/- 5.5% from the last traded price prior to the pre-close period as a result of large buy or sell market orders. A number of these stocks and their respective price movements are seen below.

<b>Ticker</b>	<b>Previous Close 2/25</b>	<b>Pre-close</b>	<b>Close 2/28</b>	<b>2/28 vs. 2/25</b>	<b>Close vs. Pre-close</b>	<b>Close 3/1</b>	<b>Close 3/4</b>	<b>3/4 vs. 2/28</b>
LR	6.93	6.59	7.00	1.0%	6.2%	6.90	7.61	8.7%
BPI	53.00	52.50	55.65	5.0%	6.0%	55.30	53.70	-3.5%
SECB	73.00	74.00	77.70	6.4%	5.0%	78.25	78.00	0.4%
<b>ICT</b>	<b>39.60</b>	<b>39.25</b>	<b>36.40</b>	<b>-8.1%</b>	<b>-7.3%</b>	<b>38.85</b>	<b>41.80</b>	<b>14.8%</b>
PX	15.24	14.70	13.74	-9.8%	-6.5%	14.30	14.62	6.4%
MWC	17.04	16.92	16.08	-5.6%	-5.0%	16.72	17.30	7.6%
VLL	2.44	2.38	2.30	-5.7%	-3.4%	2.49	2.61	13.5%

Source: Technistock

Based on Bloomberg's estimate of Ricky Razon's ownership in ICT, we calculated that he lost about PHP 5 billion in the last second of trading last February 28 because of this new PSE trading system.

## WHIPSAW!

It is not only the billionaires who are heavily invested in listed companies that are in danger of suffering a heart attack as a result of such extreme price swings in the stocks they own. Stock market punters were also caught by surprise by this move, causing technical analysis to go haywire, especially for the very nimble and alert traders. If the stocks were closed upward, such as with LR, BPI and SECB, then most people would be pleased. If a trader with very strict trading rules held stocks such as ICT, PX, MWC and VLL, then he would have probably sold when a number of these stocks broke significant support lines (200-day moving average, channel support, etc.). Now, imagine the emotional feedback if one sold the stock at the close only to see it go up by 6% the next day, erasing the loss of the previous day? One word can describe this trading exercise – whipsaw.

### One man's poison is another man's cure...

Going back to the table above, notice that all the stocks which were sold down at the pre-close period rebounded significantly the next day. Some even continued to rally till the end of the week, such as ICT, VLL and PX. This anomaly in the system creates an opportunity for "tsupiteros" who have the guts to buy at the close last February 28. By the way, a *tsupitero* is a short-term trader, a day trader if you may, who takes advantage of temporary price differentials. Essentially, they are like scalpers of the stock market, making small gains on frequent trading. They hold a stock for a very short period of time, sometimes even as short as few minutes. In this instance, even if they sold the next day, they would have pocketed gains of at least 4%. *Tsupiteros* who are more patient and are still holding on to ICT after buying at the close last February 28 would have witnessed their investment increase in value by 14.8% in 4 days.

### Pre-close - To be or not to be?

Depending on which side of the trade a person is, he may or may not profit from this phenomenon. However, regardless if you made money or not, everyone would probably agree that this pre-close period allows for, and creates, unnecessary price volatility which, in cases where the movement is extremely sharp, distorts the actual market value of a particular stock. Adding urgency to the matter is that these are not trader errors, such as the cases of ALI on October 18, 2010 and CEB on December 17, 2010. As such, a number of trading participants, long-term investors and fund managers in the market have strongly proposed that the pre-close period be scrapped in order to avoid wild price swings at the close. On the other hand, the new trading system is a gift for active traders. *Tsupiteros* find extreme delight in wild price swings and volatile trading. Still, no matter how you look at it, price distortion is always detrimental to price discovery.

### The Hong Kong experience – Price bands

In addressing an issue such as this, it is always very helpful to look for a historical precedent. In discussions with the PSE and other trading participants, a similar situation was discussed, except that the setting was in Hong Kong. Last March 8, 2009, the share price of HSBC (0005 HK) plunged 10% during the last 6 seconds of the trading session as a result of Deutsche initiating a sell order with a very large volume. While Deutsche confirmed that they did not intend to push down the price of the stock, it is equally clear that such a price swing can easily be triggered, especially in a relatively small market like the Philippines. One of the initial suggestions to improve Hong Kong's trading system was to limit the rise and fall of stocks to 2% of their regular closing price. The same suggestion was broached during discussions with the PSE. In Hong Kong, however, they chose not to push through with this and,

eventually, the bourse just scrapped the pre-close auction altogether. Recently, a survey was also conducted among the trading participants in order to get their opinion on other ways to improve the current trading system. Whether we will follow the Hong Kong precedent in our country remains to be seen. What we do know is that on Wednesday, March 9, a discussion on the new trading system will be part of the agenda of the PSE Board Meeting.

### **Razon up by PhP 9 billion after losing PhP 5 billion in 1 second**

Whichever way this eventually ends, be it the implementation of price bands, the scrapping of the pre-close period, status quo or otherwise, there is one thing we know for sure – since losing nearly PhP 5B in 1 second, Ricky Razon has gained back all his losses and more, making PhP 9B over the next 4 days. As for the price of ICT, it has gone up from 36.4 last February 28 to 41.80 at the close last Friday, March 4 - a whopping 15% gain.

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