Philequity Corner (July 18, 2011)

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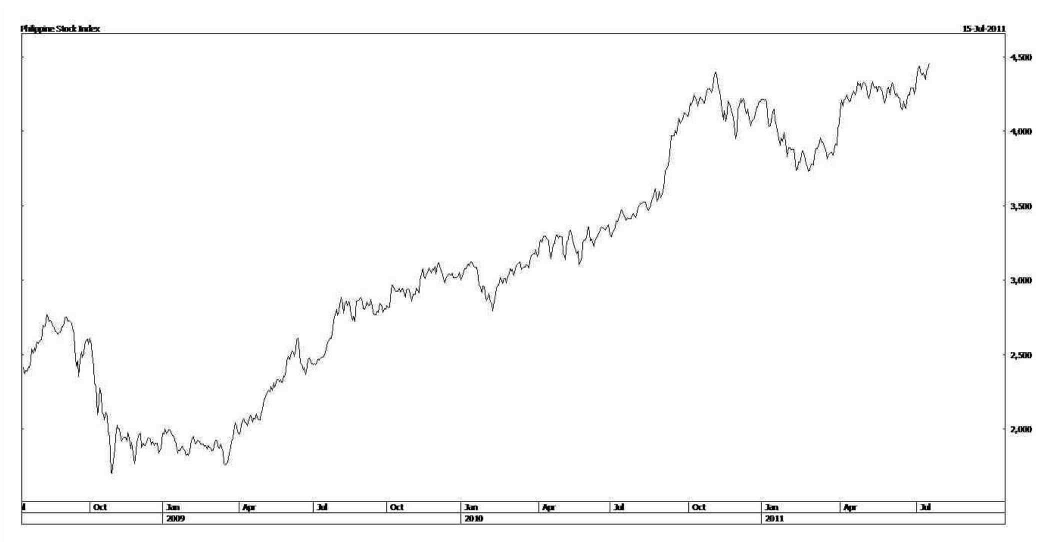
PSEi, all-time high

The Philippine Stock Exchange (PSE) Index established a new all-time high by closing at 4,458.74 last Friday, July 15, 2011. In this article, we outline world macro events that have caused global stock markets to be extremely volatile. On the other hand, we explain why the Philippine stock market continues to be resilient despite global macroeconomic headwinds.



Macroeconomic headwinds

World stock markets have been volatile for 1H2011. This has resulted in frayed nerves and anxious moments for global investors. The following are the events that have caused wild gyrations in the global markets:

1. ***EM (Emerging markets) inflation*.** EM inflation became a serious concern for investors when oil started moving higher. Prices of soft commodities such as wheat, corn, grain, soy bean, sugar, coffee, etc. rapidly went up and established new highs. The movement in commodity prices was driven by supply shocks as well as the rapid growth of EM economies. Record-low interest rates and the QE (quantitative easing) initiatives have likewise contributed to inflation.
2. ***EM monetary policy tightening.*** As a result of rising inflation, Asian central banks have been raising benchmark interest rates and reserve requirements on deposits in order to moderate economic growth and manage inflation. Though this is the appropriate response to inflation, the concern has shifted to the possible economic slowdown that aggressive monetary policy tightening might cause.
3. ***China hard-landing scenario*.** Because of the monetary policy tightening in China, the concern has shifted from inflation to a hard-landing for China. The Chinese economy is a major contributor to the global economy and a rapid slowdown in China's growth might derail global growth.

4. ***MENA (Middle East / North Africa) geopolitical crises.*** The MENA geopolitical crises, such as the ones that hit Egypt and Libya, caused a significant spike in oil prices. There were fears that the contagion might spread to other MENA countries such as Saudi Arabia, a top producer and exporter of oil. Saudi Arabia is also one of the largest employers of OFWs from the Philippines.
5. ***Japan earthquake and tsunami disaster.*** After the MENA crises, the Japan disaster spooked the global markets. Since Japan accounts for ~8.7% of world GDP, a prolonged disruption of Japan's economic activity may likewise disrupt global growth.
6. ***European debt problems.*** Portugal, Ireland and Greece have recently suffered a series of credit rating downgrades because of their weakening fiscal condition. The downgrades have consequently put significant upward pressure on their borrowing costs. There is serious concern that the contagion might spread to Italy and Spain.
7. ***DM (Developed markets) soft patch.*** US GDP growth slowed to 1.9% in 1Q2011 from 3.1% in 4Q2010. EU GDP growth, at 2.5% in 1Q2011, was only slightly higher than that of the US. Moreover, the unemployment rate of US has remained high at 9.2% as of June 2011. The continued slow growth of DM countries has sparked talks about the possibility of a double-dip recession.
8. ***Bernanke out of bullets.*** With the ending of QE-2 last June 30, 2011 and with the widespread perception that QE-3 is counterproductive, investors are worried that Bernanke and the Fed have run out of bullets that can help boost a slow-growing US economy.
9. ***US debt concerns and debt ceiling impasse.*** The impasse on the US debt ceiling has raised the possibility of a US default on its maturing debt obligations and a potential government shutdown. Credit rating agencies have since voiced their negative outlook on US in light of the delays in resolving the debt ceiling impasse and addressing the ballooning budget deficit and debt levels.

Resilience of the Philippine stock market

Despite numerous global shocks that have caused the Philippine stock market to correct, the PSE Index reached an all-time high last Friday. Below, we enumerate the drivers of our stock market's continued strength:

1. ***Trust in the Aquino administration*.** President Noynoy Aquino has so far enjoyed high net satisfaction ratings. His administration has not been rocked by any major scandal and his team has so far been focused on improving the country's fiscal situation.
2. ***OFW remittances and BPO revenues.*** Our GDP has been supported by the steady inflow of OFW remittances which amounted to $18.8B in 2010, equal to 9.4% of GDP. BPO revenues, on the other hand, have grown faster than remittances and have likewise contributed to the economy, bringing in ~$8.9B in 2010, equal to ~4.5% of GDP. As such, the performance of the consumer and property sectors in our local stock market has been strong.
3. ***Strong fiscal performance.*** With the help of strong OFW remittances and BPO revenues, the Philippine government has delivered a strong fiscal performance. Compared with the same period last year, government revenues for the first 5 months of 2011 increased by 16.3% to P582B while expenditures decreased by 10.7% to P591B. This resulted to a 94.1% reduction of the budget deficit, bringing it down to P9.5B as of May 2011. Gross International Reserves remained high at $69.9B as of June 2011 while year-to-date Balance of Payments surplus was at $4.8B as of May 2011.

4. ***Credit rating upgrades.*** The strong fiscal performance of the Philippines has driven rating agencies such as S&P, Moody's and Fitch to upgrade our country's credit rating. As a result, our country is just 1 to 2 upgrades away from attaining investment grade status.
5. ***Public-private partnerships (PPP).*** PPP projects for roll-out in 2011 to 2012 are estimated to amount to $2.5B. Anticipation of the PPP has kept stocks such as DMCI Holdings, Metro Pacific Investments and San Miguel Corp. buoyant as they are expected to bag some of the projects in the program.
6. ***Local M&A – alive and active.*** There were a number of M&A events in 1H2011, namely: the pending acquisition of Digitel by PLDT, the Philex and Manila Mining joint venture, the possible Gold Fields and Lepanto Mining joint venture, and SM's purchase of a 17.9% stake in Atlas Mining. The M&A mania has caused many of the stocks involved to reach all-time highs, thereby keeping the Philippine stock market buoyant.
7. ***Increasing stock market participation from locals.*** Local participation in the stock market has been increasing. Government financial institutions took advantage of the market's swings to increase their exposure to local equities. Local bank UITFs (unit investment trust funds) and Philippine mutual funds have grown to become more active players in the market. Lastly, local retail investors, encouraged by the profits they have made, are becoming more active participants in our market.
8. ***Strength of metal prices.*** Gold reached a record high of $1,594.90 / ounce, while copper and nickel prices continue to be strong. Strong metal prices contributed to the strength of the local mining sector, which has outperformed the rest of the Philippine market.
9. ***Flow of funds from DM to ASEAN.*** ASEAN countries like the Philippines continue to benefit from the influx of foreign funds due to their strong fiscal performance. Like the Philippines, Malaysia and Indonesia's stock markets recently established new highs. Bangko Sentral ng Pilipinas Governor Amando Tetangco, Jr. even remarked that the flow of foreign funds into ASEAN countries like the Philippines may accelerate in the instance of a US credit rating downgrade.

The bull rides on

Though 1H2011 was a rough ride, market dips were mainly caused by external events. To counter this, we advise investors to review their asset allocation, evaluate their risk-reward appetite and maintain an investment level that they can be comfortable with. On stock investing, we recommend that investors focus on companies with strong fundamentals and attractive valuations. A 'buy-on-dips' strategy for the local stock market has been proven to be successful. Investors can also rely on professional fund managers by investing in UITFs and mutual funds, such as the Philequity Fund, in order to avoid getting whipsawed by market corrections. Our Philequity Fund is up 7.8% year-to-date (YTD), compared to the 6.1% YTD performance of the PSE Index.

Despite the volatility in 1H2011, we remain bullish about the continued strength of the Philippine stock market due to the reasons that we cited. We reiterate our target for the PSE Index of 5,000, which is only 12% higher from its current level.

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