Philequity Corner (August 15, 2011)
By Valentino Sy

Bad News, Good News

The recent surge in volatility has been bad news for developed markets. While the Philippine market has corrected because of the global macroeconomic headwinds enumerated below, there are also good news for the Philippines because of numerous factors.

The Bad News:

1) Standard and Poor's historic downgrade of the US credit rating
2) Talks of a double-dip recession in the US has resurfaced
3) European debt crisis spreads to Italy and Spain
4) Possible downgrade of the credit rating of France in the wake of the US downgrade
5) Rumors of bank insolvencies in Europe and in the US
6) Huge technical damage in the stock market with China, Brazil and most of Europe already in bear territories
7) Market volatility hits fever pitch as the VIX registers highest level since May 2010 flash crash

The Good News:

1) The price of crude oil has already declined which is good for the Philippines because we import oil
2) Prices of agricultural commodities such as wheat, corn, etc. have gone down substantially which is good for consumers.
3) The decline in oil and agricultural commodities should help keep Philippine inflation in check
4) Gold – one of the Philippines' major mineral export – have broken to new all-time highs
5) The Philippines, along with other ASEAN countries, are now looked upon as more stable investment destinations
6) ROPs, other Philippine bonds, and the Philippine stock market have been relatively steady amidst the financial carnage in the Western developed world
7) The Philippine peso has stopped appreciating too swiftly which is good for exporters, OFWs and BPOs

The Roller Coaster Dow

Last week was the most volatile week for the markets since late 2008, during the depths of the financial crisis. The Dow Jones Industrial Average (DJIA) gyrated wildly for four straight days, alternately losing and gaining 400+ points before settling down on Friday.

DJIA One-Week Price Movement

Date		Close	Intraday Range	Point	Change Percentage
8-Aug	Monday	10809.85	634.76	-634.76	-5.55%
9-Aug	Tuesday	11239.77	639.94	429.92	3.98%
10-Aug	Wednesday	10719.94	541.51	-519.83	-4.625
11-Aug	Thursday	11143.31	549.05	423.37	3.95%
12-Aug	Friday	11269.02	204.49	125.71	1.13%

Source: Bloomberg, Wealth Research

Monday: The initial trigger was the unprecedented downgrade of the US credit rating by Standard and Poor's. Along with rumors that Bank of America is in trouble, a huge sell off ensued with the DJIA losing 634 points or equivalent to 5.55%, sending shockwaves across the globe. It was the second plunge in three days after the previous Thursday's rout. The Volatility Index (VIX) hit 48, its highest level since the May 2010 flash crash.

Tuesday: The markets whipsawed as new worries surfaced in Europe over the debt crisis possibly escalating to Italy and Spain. Initially stumbling during early trading, the markets recovered strongly at the close after assurances from the European Central Bank and the US Fed's pledge to keep interest rates ultra low for two more years. Opportunity buying also stepped that lifted the DJIA by 439 points at the close, completing a 634-point intraday swing.

Wednesday: The mayhem continued on rumors that some European bank is on the brink of default and that France might be downgraded next. Bank stocks were the focus of the sell-offs. In Italy, the trading of banks such as Intesa Sanpaolo, Banco Popolare were halted several times during the day after posting substantial losses. Meanwhile, France's Societe Generale was down 22.5 percent at one point during the day. In the US, Bank of America scrambled to shore up capital by offering to sell its 10 percent stake China Construction Bank. By the end of the day, the DJIA lost 520 points while gold explodes and touches $1800 per oz. for the first time.

Thursday: The market again bounced back on a fairly positive US jobless claims report, which found the number of Americans filing for unemployment benefits for the first time at 395,000, its lowest level in four months. In Europe, short-selling financial companies were banned in Belgium, Italy, France and Spain. The DJIA surged 423 points as insiders were reported to be buying stocks at the highest rate since March 2009.

Robots Take Over

The increase in price swings last week is being blamed on High Frequency Trading (HFT) – or computer algorithms that buy and sell stocks in nanoseconds. These so-called robot traders work in a way many observers have described as fundamentally unfair, as it involves computers taking a "peek" at trade orders several nanoseconds before they are made. This allows the computers to push the stock price to the highest level investors are willing to pay and in other cases, to push it as far as it can go. Because of the increasing role of HFT, the market's normal moves have become exaggerated.

HFT was also accused for causing the huge drop in the markets in the so-called flash crash of May 2010. Recent data show that HFT now accounts for 56 percent of trades on the New York Stock Exchange and 50 percent of trading in London.

Hedge funds deleveraging

While HFT and computer trading may be contributing to the recent surge in volatility, it isn't solely to blame. Last week's activity was also a classic case of massive hedge fund deleveraging. Hedge funds and other institutions usually raise cash especially in periods of high market volatility in anticipation of margin calls and redemptions.

Leveraged Short-ETFs exacerbating moves

Leveraged short ETFs such as ProShares UltraShort S&P 500 Fund (symbol: SDS), ProShares UltraShort QQQ Fund (QID), ProShares UltraShort Financials (SKF) and Direxion Financial Bear 3X – Triple Leveraged ETF (FAS) which are widely used by hedge funds have further exacerbated the volatility in the markets.

Philippine market more stable

With markets gyrating wildly around the world, the Philippine market was not spared. The PSE index lost 2.4 percent last Monday followed by a decline of 4 percent on Tuesday. Afterwards, the index quickly bounced back the next three trading days to end the week with just a 2.6 percent loss.

Overall, the Philippine market remains one of the more stable markets in the world. While a number of markets (including most of Europe and China) have technically gone into bear market territory, the Philippine market is just off by 5 percent from its all-time high of 4,563 registered last August 2. Despite the recent carnage, the PSEi is still up 2.8 percent year-to-date.

Prescient moves by GSIS prexy Bernie Vergara

Given rampage that happened in the global markets, it was uncanny that GSIS pulled out all their investments outside the country before the financial carnage in the Western developed markets. Long before all this volatility came out, GSIS president Robert Vergara foresaw and gave instructions to sell all of GSIS's international investments and put it back to the Philippines for better returns. With the US and Europe now having all these problems and even the BRIC countries such as Brazil, China and India suffering huge market declines, the call to invest back here in the Philippines has proven to be a prophetic decision.

Market Performance

US	Current Price	Peak-to-Date % Chg	Year-to-Date % Chg
DJIA	11,269.00	-12.5%	-2.7%
Nasdaq	2,507.98	-13.2%	-5.5%
S&P 500	1,178.81	-14.0%	-6.3%
Other major markets			
UK (FTSE)	5,320.03	-12.9%	-9.8%
Australia (ASX)	4,172.60	-16.1%	-12.9%
Japan (NIKKEI)	8,963.72	-17.5%	-13.3%
SPAIN (IBEX)	8,647.30	-22.5%	-13.4%
Germany (DAX)	5,997.74	-21.1%	-14.3%
France (CAC)	3,213.88	-22.8%	-15.5%
Italy (MIB)	15,888.60	-31.7%	-17.7%
Brazil (BOVESPA)	53,473.40	-26.8%	-22.8%
Asia			
Indonesia (JCI)	3,890.53	-7.2%	5.2%
Philippines (PSEi)	4,321.73	-5.0%	2.9%
Thailand (SET)	1,062.07	-7.5%	2.7%
Malaysia (KLCI)	1,483.67	-7.0%	-2.7%
China (CSI 300)	2,875.36	-19.2%	-8.1%
Singapore (STI)	2,850.59	-13.9%	-11.3%
South Korea (KOSPI)	1,793.31	-19.6%	-12.2%
Hong Kong (HANG SENG)	19,620.00	-21.4%	-14.7%
Taiwan (TAIEX)	7,637.02	-16.4%	-15.1%
India (SENSEX)	16,893.63	-19.6%	-17.1%

Source: Bloomberg, Philequity Research

Stock pickers market

While the Philippine market remains one of the strongest in Asia and the world, we expect volatility to continue to pick up in the days and weeks to come. We believe that we are now in a “stock pickers” market. Thus, we are advising our readers to pick only stocks with fundamentals and management that you believe in. Trade the size or amount that will not hurt you. Take advantage of this period to review your asset allocation.

If you are overly leveraged or trading in margin, reduce your positions to a point where you can sleep well. If you are underweight equities or holding too much cash, take this opportunity to hunt for bargains and to gradually build your equity portfolio.

And lastly, if you don’t have the expertise or time to monitor the market, or you don’t have the temperament to handle wild swings, let the professionals handle it by putting your money in a mutual fund.

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