Philequity Corner (October 17, 2011)
By Valentino Sy

A Rollercoaster Ride

Since reaching a high of 4,541.23 last August 2, the Philippine Stock Exchange index (PSEi) fell to a low of 3,721.22 last September 26. Half of this 18% drop was eventually erased over the following weeks, with the PSEi eventually closing at 4,153.40 last Friday. The sharp plunge in the index spared no stock, regardless of the strength of its fundamentals. As such, readers and clients alike have been left wondering why the stock market has been moving like a rollercoaster over the past month. Below are the most frequently asked questions along with our take on the matter.

Why did stock markets worldwide drop?
There are five main reasons for the sharp sell-off in global stock markets. First is the European crisis which has intensified with fears of sovereign defaults that could in turn cause Europe's banks to go under. This potential contagion effect has so gripped the market that all asset classes were sold down. The second reason is the recent economic data coming out of the US which point to a possible recession. Note that this was preceded by a debate over the growing budget deficit which failed to produce any long term solution (see *Panic in the Streets*, 8 August 2011). The third reason is the political gridlock in the US and Europe which delayed the resolution of the crises they are facing, pushing both countries closer and closer to the brink of disaster. This showed that the politicians are either inept or have politics in mind rather than finding the right solution. Fourth, the lack of confidence in the ability of their leaders to pull them out of the morass they are in scared off investors who basically just sold anything they could sell. The fifth reason is the slowdown in China's economic growth which is expected to impact the world economy. Production data as well as exports have lead economists to forecast single-digit GDP growth for China. While China is still growing at a relatively quick rate, with the economies of developed countries currently at stall speed, a slowdown in China will worsen the already slowing world economic growth.

Why would problems in Europe, specifically Greece, affect Philippine stocks?
If the sovereign debt crisis worsens, some banks with huge Greek debt exposure may go bankrupt and a credit crisis will become imminent. It will definitely affect commercial credit of banks in the rest of the world and it will also affect global trade. This would be like Lehman all over again. No country in the world will be spared in such a scenario.

Why did the Philippine stock market follow the drop despite the strong fundamentals?
While the fundamentals of Philippine-listed companies are strong and the PSEi has proven to be more resilient than most other stock markets, other Asian stock markets followed Europe and fell like a rock. For instance, Indonesia fell a whopping 9% in one day. As such, if the Philippines did not follow suit, it would be sticking out like a sore thumb. Since the P/E and other valuation metrics of Philippine stocks would be out of line with the world stock markets if it did not drop, the PSEi had to succumb to the global sell-off.

Why did stock markets rebound so quickly?
The main reason for the drop in the past few months was the European crisis. This was compounded by the fact that the European leaders were groping in the dark and it seemed that they did not know how to solve their problems. It was Europe that caused world stock markets to drop. Therefore, it will also be Europe that will cause the stock markets to rise. Thus, when a semblance of a solution to the European

crisis came about, the resulting glimpse of optimism caused the market to immediately rise. Signs that the political leaders are acting together to resolve the crisis have been met with renewed hope by investors. The pronouncement of a G-20 meeting on November 3 to lay out a solution to the European crisis triggered a furious stock market rally worldwide. While a clear solution is not at hand, the fact that Presidents, central bank governors and even finance ministers are working together towards a resolution has been bullish for the stock market.

What is the outline for the solution to the European crisis?
Just as fears of bankruptcies and defaults have caused the market to drop, decisive action towards a solution has likewise led markets upward. A five-point plan is currently being formulated to address the crisis. This plan includes (1) an acceptable arrangement for Greek sovereign debt, (2) the bolstering of the European Financial Stability Facility (EFSF) rescue fund, (3) the recapitalization of banks, (4) a new push to boost competitiveness and (5) consideration of European treaty amendments to tighten economic management. So far, (2) is a done deal while (1) and (3) are in the works. (4) and (5) are more long term in nature and may take the backseat, for now. Optimism that banks will not go bankrupt is crucial at this point and this triggered the market bounce last week. It is precisely the absence of the possibility of a Lehman-like failure that has lured investors back into the market.

Is it time to buy stocks now?
October is usually a good month because of anticipation of the market becoming strong towards the Christmas season and the first quarter of the next year. Sentiment in Europe and the US has improved on optimism that a plan to solve the European crisis will be laid out. We had been buying equities in the past few weeks and would probably buy more if the stock market corrects. A correction would be healthy because of the big run-up in the past few days.

What if no acceptable solution to the European crisis is reached?
Of course, we cannot discount the fact that on November 3, European leaders may not find a solution. This may cause markets to once again give way to the lack of confidence. This will change the macroeconomic picture, as well as the fundamentals of some companies. That is why all eyes must be on Europe since it can make or break the recovery of the stock market.

Technical analysts say that the technical picture is not good. Why should we buy stocks now?
The technical picture provides the timing, but fundamentals give us the reasons to buy. Since the news flow from Europe will determine the direction of the market, the technical outlook can change based on what transpires. If macroeconomic headwinds abate, the technical picture will change and fundamentals will prevail. Since many stocks and even the PSEi are at technical resistance levels, it is best to buy on dips and at support levels. However, if resistance levels are breached, we would also be buyers.

What stocks do you buy?
One should buy stocks with a good business model as well as stocks which will not be affected by the slowdown in the world economy. While it is good to consult your stockbroker, it is better if one does his own homework and studies the companies for himself.

What if you do not have expertise buying stocks?
If one does not have the expertise to buy stocks or is not comfortable buying stocks at all, he can always let a professional fund manager invest his money by buying mutual funds. In buying mutual funds, one method that can be used is peso cost-averaging. It is a technique where one invests equal monetary amounts regularly and periodically over specific time periods, such as weekly or monthly.

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.