

Philequity Corner (May 21, 2012)

By Valentino Sy

Something Fishy

The current stand-off in the Scarborough Shoal started when the Philippine Navy apprehended Chinese fishermen for engaging in “illegal fishing and harvesting of endangered marine species.” Since then, this issue has quickly escalated into a sovereignty dispute with China. Moreover, similar to all other disputes that China had with other countries, it did not hesitate to use its economic clout. In last week’s article (*Bananas, Pineapples and the Stock market*, 14 May 2012), we discussed the economic implications of the Scarborough standoff with China.

PSEi Surrenders

Previously, the Philippines was relatively unaffected by negative events because most of these came from outside the country, such as the Greek debt problem and the European sovereign debt crisis. Despite negative global macroeconomic news, the PSE Index has continued to perform strongly. This time around, the event occurred right at our doorstep, with much severe consequences. If the threat of a possible military war with China, a legitimate military superpower, was not enough, we also have to contend with a potential trade war with the 2nd biggest economy in the world. As a result, the PSE Index dropped 8.9% from a close of 5,297.55 in May 4, 2012 to 4,864.23 last Wednesday, May 16, 2012.

695 Billion Pesos Lost in Stock Market Value

While the local stock market was poised for a correction because of its overbought condition and the resurgence of the Greek debt problem, the speed and the magnitude of the drop from the peak was quite alarming. China’s imposition of a travel ban and trade sanctions was a black swan event that most local investors did not anticipate. As such, the conflict caused one of the biggest drops in recent memory, with many stocks dropping as much as 10 to 15% over a short period of time. Translated in peso terms, listed local companies lost a total of P695.7B in market capitalization over 8 trading days.

What’s in Scarborough?

Now that this otherwise quiet fishing area is the subject of a conflict, some of us may wonder what makes these lumps of soil worth fighting for. A shoal is simply defined as a sandbar. The Scarborough Shoal itself is a chain of sandbars, atolls and reefs covering an area of 150 km. It is 220 km away from Zambales and 800 km Southeast of Hong Kong.

However, there is more to Scarborough than just sandbars, fish and giant clams. The dispute is not only limited to the Scarborough Shoal but also encompasses sea areas to the south of China and to the west of the Philippines. This includes the Recto Bank, where Service Contract 72 (SC 72) is located. Indirectly owned by Philex Petroleum (PXP), SC 72 contains the Sampaguita field which is estimated to be even

bigger than the Malampaya gas field. While this has been a boon to PXP's stock price, the presence of these gas blocks has only served to fan the flames of tension between China and the Philippines.

Thoughts from the Philequity Board Meeting

Last Monday, May 14, 2012, Philequity held a Board Meeting. The China-Philippines conflict was one of the topics discussed. Below are thoughts from some of our Board members:

1. It is best to resolve the issue quietly, diplomatically and away from the media. As we quoted the Koran in last week's article, "If you have nothing good to say, remain silent." Considering this, it is better to engage in diplomatic discussions to lessen the tension and eventually resolve the China-Philippines conflict.
2. Economic and trade issues must be separated from the sovereignty dispute. In fact, it might be best to set aside the sovereign issue for now. Both parties should focus on finding a mutually beneficial formula that will allow them to defuse the heated situation. The fishing ban from both sides may be a good start, as both parties attempt to calm the row and resolve the issue diplomatically.
3. In resolving this tiff, the government should consult Filipino businessmen with Chinese roots or those who have extensive businesses in China. Washington Sycip, founder of SGV, Lucio Tan of the LT Group of Companies, Henry Sy of the SM Group, John Gokongwei of JG Summit Holdings, Tony Tan Caktiong of Jollibee, George Ty of Metrobank, Ramon Ang of San Miguel and Carlos Chan of the Oishi Group come to mind. They would probably know how to handle the situation better since they deal with their Chinese counterparts on a regular basis. They may be in a good position to mediate or bridge the communication gap between China and the Philippines. Considering this, the appointment of Domingo Lee and Cesar Zalamea as special envoys to China is a step in the right direction.
4. Both sides can find a way to jointly explore, harness and share the disputed resources, especially oil and gas. Our guest at the Board Meeting said that this is something that has previously been done by other Asian countries, so there should be nothing barring China and the Philippines from doing the same.

Sun Tzu's Thoughts on War

Since there is concern that the China-Philippines tiff might escalate into a military or trade war, it might be smart to refer to the wisdom of Sun Tzu for some insights. Sun Tzu was an ancient Chinese military general who also happened to be a great strategist and philosopher. Sun Tzu left us with some useful quotes from his book "The Art of War." Below are some of the relevant passages:

1. He who wishes to fight must first count the cost.
2. He who knows when to fight and when not to fight will be victorious.
3. The enlightened ruler is heedful, and the good general full of caution.
4. He who is prudent and lies in wait for an enemy who is not will be victorious.

5. The general who advances without coveted fame and retreats without fearing disgrace, whose only thought is to protect the country and do good service for his sovereign is the jewel of his kingdom.
6. There is no instance of a country having benefit from a prolonged warfare.

Sharing the Bounties

Last Thursday, President Noynoy Aquino clarified his position on the Scarborough issue. He said that it is beyond his mandate to cede the country's claims on the disputed areas as he cannot go against the Constitution. He emphasized though that the country will be willing to explore a win-win solution that will benefit both China and the Philippines. Moreover, he said that the country will be open to sharing the resources in the disputed areas with other countries in the region.

We are heartened by our president's statement that the Philippines should not instigate conflict and should actually explore ways and means to resolve this tiff. His statement is a signal that a diplomatic discussion about the issue might be forthcoming.

Scarborough Fair

A trade war with the world's 2nd biggest economy will obviously be a big loss for a country like the Philippines. This was clearly demonstrated in the local stock market, when news of the Chinese tourist and fruit export bans sparked a massive selloff that wiped out almost P700B in market value in the span of a few days. Since the dispute was started by fishing in the Scarborough Shoal, we'd like to leave you with the song "Scarborough Fair", a traditional ballad of Great Britain that was performed by Simon and Garfunkel. The song itself has implicit anti-war messages. Below is the 1st stanza of the song:

*Are you going to Scarborough Fair?
Parsley, sage, rosemary, and thyme.
Remember me to one who lives there,
She once was a true love of mine.*

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