Philequity Corner (7/2/2012)
By Valentino Sy

Italy Defeats Germany

Last Thursday, Italy beat heavily-favored Germany in the semifinals of the Euro 2012 football tournament. With the win, Italy advanced to the tournament finals against Spain.

Similarly, Italy scored a major upset last Friday in the field of politics and economics. Italy, along with Spain, turned the tide in their favor as they managed to secure a number of important concessions in the EU Summit in Brussels. This came as a positive surprise to most as Germany, the European paymaster, was expected to control the flow of negotiations in the summit. Global investors cheered the developments from the EU Summit, causing US and European stock indices to stage their biggest one-day rally of 2012 last Friday.

The German Goalkeeper Yields

Manuel Neuer, the goalkeeper of the German football team, is considered one of the best young goalkeepers in the world. He showed his potential in this tournament as he helped Germany secure its semifinal slot, before bowing down to the heroics of Italian forward Mario Balotelli.

Like Neuer, German Chancellor Angela Merkel, who is also Germany's 1st female chancellor, has played a very important role in guiding her country through these difficult times. Merkel has been the bastion of German-style fiscal discipline and austerity, which she has strongly imposed onto the highly-indebted European countries. Consistent with her hardline stance, Merkel expressed her strong disapproval of mutually-guaranteed debt in the EU and said that there would be no Eurobonds for as long as she lives.

Since Merkel was widely expected to dominate the EU Summit discussions, it came as a surprise that she was forced to agree to concessions for Italy, Spain and other similarly situated countries. Italian Prime Minister Mario Monti and Spanish Prime Minister Mariano Rajoy both rejected Merkel's calls for additional austerity and demanded immediate support for their stressed bond markets. Without a strong ally by her side, the German Chancellor was finally forced to give-in as French President Francois Hollande expressed his concerns about the strict deficit-control treaty that Germany had sought to impose over the rest of Europe.

Super Marios

The Italian football superstar and the Italian Prime Minister share the first name – Mario. After the strong success of the two against Germany last week, they are now both called "Super Mario" in Italy. This is a reference to the Nintendo game Super Mario Brothers, one of the most popular games of all time.

Italian forward Mario Balotelli scored both of Italy's goals in their last game, leading his team to a 2-1 upset against the heavily-favored German squad. Balotelli's inspiring game against Germany was the most gratifying one of his young career. It enabled him to earn the respect of his countrymen and the admiration of the world after receiving offensive racial remarks for the most part of the tournament.

Like Balotelli, Italian Prime Minister Mario Monti, along with Spanish, French and other European leaders, scored important goals in the EU Summit as they won the following concessions:

1. *The European bailout funds can be used to intervene in government debt markets. There will be no need for additional conditions before a bond market intervention is allowed, for as long as the country complies with the existing economic policy recommendations.*

   This gives the indebted countries some breathing room, as too much austerity might start to choke economic growth. It is also a signal that the European leaders are ready to use the bailout funds to prevent surges in the borrowing costs of Italy and Spain.

2. *The European bailout funds may now be used to directly recapitalize the struggling Spanish banks instead of channeling the funds through the Spanish government.*

   This likewise provides the Spanish government some relief, as Spanish banks can now be bailed-out without the need for the government to take on additional debt. It is expected that the same concession will also be afforded to Italy, if needed. This will eventually pave the way for the establishment of a European banking authority who will be in charge of tighter banking supervision.

3. *The loans granted to Spain from the European bailout funds will not get preferred creditor status.*

   This will allow private bondholders to be on equal footing with the European bailout funds in terms of repayment priority, in the case of default. With this, Spanish and Italian government debt will be more attractive for private investors, at least in the near term.

A Long Road Ahead

To put things in perspective, the developments from last Friday's EU Summit are not breakthroughs. Rather, they are small but concrete steps that move the crisis resolution initiative in the right direction. As we mentioned in a previous article (*The Pain in Spain*, June 18, 2012), a fiscal authority should be created in order to keep the government revenues, spending and deficits of member countries in check. Also, a banking authority would have to be formed, in order to ensure tighter supervision and oversight of banks.

Aside from the concessions granted to Spain and Italy, the EU Summit signals an imminent change in the EU political dynamics. Whereas EU treaties and negotiations had always been dominated by Germany before, it seems that future negotiations will be driven by the consensus between other member states such as France, Italy and Spain. Considering this, we are hopeful that EU authorities will continue to implement significant reforms while being mindful of the conditions of the periphery states.

A Win for the Markets

As football fans around the world cheered for their favorite teams in the Euro 2012, global investors cheered the positive developments from the EU Summit. Last Friday, we saw the S&P 500 gain 2.5% and the Euro Stoxx 50 gain 5.0%. Likewise, the yields on Spain and Italy's 10-year government debt dropped significantly to 6.3% and 5.8%, respectively, after establishing recent highs in June. Similarly, the euro gained 1.8% and closed at 1.2666 against the dollar.

Philippine Stock Market: A World Champion

We continue to be bullish on Philippine stocks. This year, we have written several articles about the strength of the Philippine stock market and the reasons behind it (*Staying the Course*, February 6, 2012 and *5,000*, March 5, 2012). We are also impressed with the resilience of our stock market despite the macroeconomic headwinds from Europe (*Philippines: One of the few bright spots left*, June 4, 2012).

Driven by the solid economic performance of the country and the strong earnings growth of listed local companies, the PSE Index has delivered a 20.0% return year-to-date (YTD) while our own Philequity Fund is up 21.2% YTD. Our local stock market is one of the top performers in the 1st half of 2012, not only in Asia, but also in the whole world, as the table below shows.

Global Stock Indices	YTD
S&P 500	8.3%
Euro Stoxx 50	-2.2%
Hang Seng Index	5.5%
Nikkei 225	6.5%
Jakarta Composite Index	3.5%
Stock Exchange of Thailand	14.3%
Bursa Malaysia KLCI	4.5%
PSE Index	20.0%

Source: Bloomberg

Next Target: 5,800

Our PSE Index is near the technical resistance and our target of 5,300, which we wrote about in our 1st article for 2012 (*Goodbye Rabbit, Hello Dragon!*, January 2, 2012). Considering this, we advise investors to adopt a buy-on-dips strategy. We continue to advocate investing in companies that have solid business models and strong earnings growth.

However, if the recent wave of positive news is sustained with more decisive developments from Europe, we foresee that our index may eventually exceed our 5,300 target. If this happens, we see 5,800 as the next target for the PSE Index. The rationale for our 5,800 target will be discussed in our presentations to existing clients and will also be written in our subsequent articles.

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.