Philequity Corner (September 17, 2012)
By Valentino Sy

Central Banks Winning

In our Philequity Corner article two months ago, we showed how PNOY has performed since he took over as chief executive of the country using tables and graphs (see *SONA in tables and graphs*, July 30, 2012). Today, we use graphs to show how global markets performed after global central banks pledged more quantitative easing with the objective of turning the global economy around.

The dynamic duo

It appears that the central banks are winning as global asset prices have rebounded strongly in the past seven weeks. Note that July 27 was the turning point when ECB President Mario Draghi said that "he will do whatever it takes to preserve the euro." Draghi pledged that the ECB will step in and buy massive amounts of Spanish and Italian debt to help lower borrowing costs and preserve the euro.

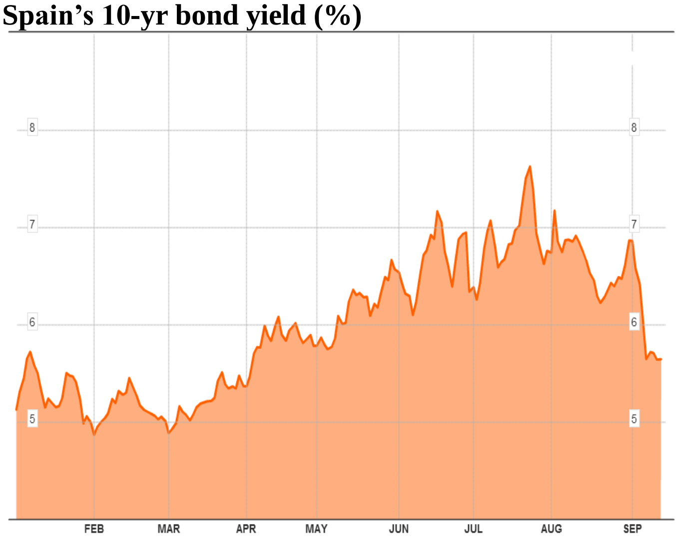
The ECB's easing move was backed up by the US Fed last week when Chairman Ben Bernanke announced a third round of quantitative easing (QE3) during their Federal Open Market Committee (FOMC) meeting. QE3 comes in the form of $40 billion monthly purchases of mortgage-backed securities.

Central Bank actions lift asset prices

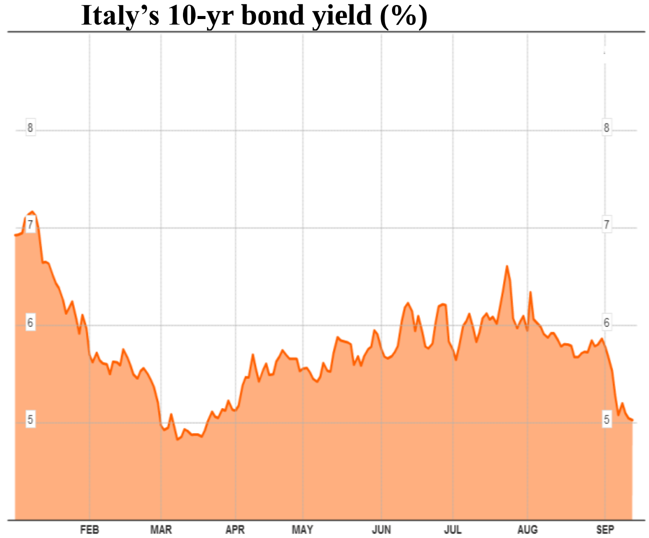
The philosophy behind quantitative easing is that it lifts asset prices and allows troubled banks and even troubled nations such as the PIIGS (Portugal, Ireland, Italy, Greece and Spain) to remain afloat. Bernanke and Draghi believe that confidence in the economy will return if asset prices are up. By printing money and using this cheap money to buy bonds, they hope to keep the economy together until it regains traction and recovers.

Draghi's pledge "to do whatever it takes" has caused the yields of the sovereign bonds of Spain and Italy to decline substantially. More importantly, Spain's and Italy's 10-yr bond yields are now way below 7 percent, a level which is considered unsustainable.

Spain's 10-yr bond yield (%)



Italy's 10-yr bond yield (%)



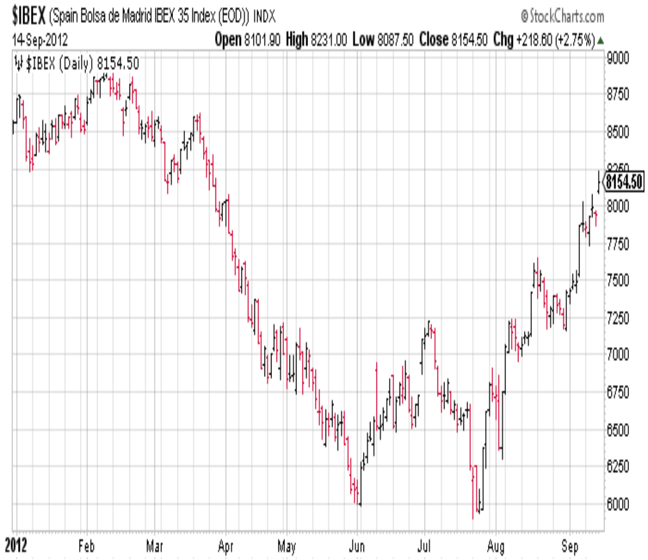
Source: Bloomberg

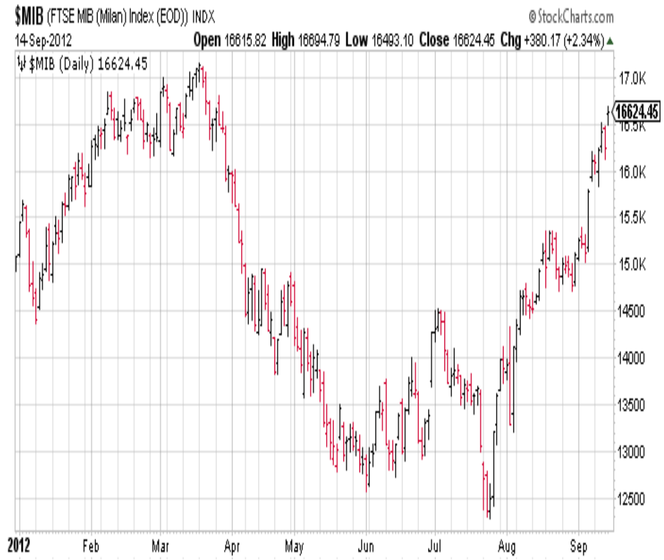
High risk, high reward

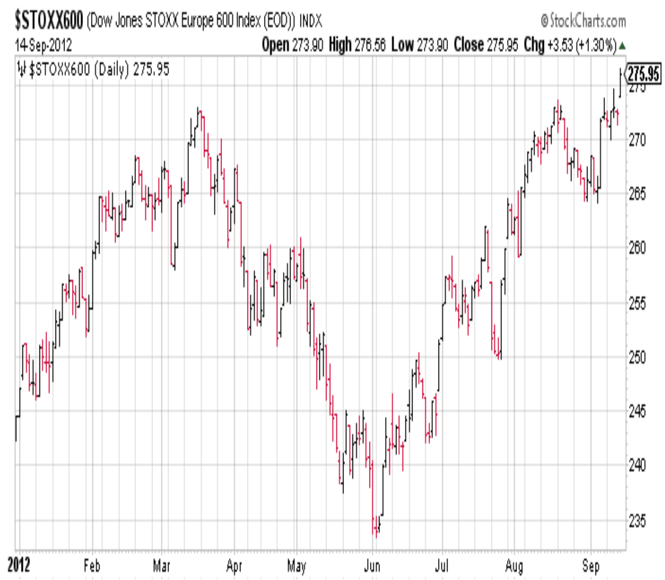
We have always reminded our readers of the wise saying "*don't fight the Fed*" because they have a lot of tools in their arsenal (see our article *Whatever It Takes*, August 27, 2012). This point was proven once more as risk assets rallied sharply following the Bernanke-Draghi tag team of all-out monetary easing.

The best traders and fund managers are always looking for opportunities that will earn them the highest rewards. So after Draghi and Bernanke signaled “risk-on”, astute market players shifted their focus on higher risk assets.

In this new “risk-on” environment, the higher risk markets such as Spain, Italy and Greece gained the most. In fact, Spain’s IBEX index and Italy’s MIBTEL index have rallied 38.1 percent and 35.2 percent, respectively, from their August bottoms. Greece’s ATHEX index which bottomed out in early July is already up 57.6 percent from the low. Meanwhile, the bigger capitalization STOXX Europe 600 index which is considered safer increased by only 18.2 percent.







Source: www.stockcharts.com

This is the same reason why cyclical stocks (financials, technology, materials) in the US grabbed the limelight in recent weeks while the defensives (pharmaceuticals, consumer staples and utilities) have lagged. This is also why the our PSE Index (which is considered safe or low-risk) has consolidated and gained by only 4 percent the past seven weeks while other riskier markets rallied sharply.

After the “whatever it takes” speech of Draghi, the euro has rebounded from its two-year low of 1.2062 registered on July 25 and has since gained 8.8 percent to close at 1.3128 last week.

EUR:USD Rate (January 2012 to present)

Source: Yahoo Finance

Markets are forward looking

Whether the economy ultimately improves and jobs eventually recover remain to be seen. But what we know is that the market is smart and forward looking even as the economy lags. What the charts above tell us is that the markets are already anticipating better times ahead even if the economy is not yet improving.

Fortunately for us, if the Europe Union and the euro are eventually saved, the Philippine economy will not get dragged down and stock market will resume its upward trajectory.

In fact, with the European and US markets leading the way, it appears now that the Philippine stock market is near the end its consolidation phase and is poised to move higher. Incidentally, September 15 is the last day of the Chinese Ghost Month. As we have discussed in this column before (see *The Friendly Ghost*, August 20, 2012), the Philippine stock market historically shows improvement in the months following the Chinese Ghost Month. Stock prices continue to rally and register its best performance during the Christmas season.

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