Philequity Corner (October 29, 2012)
By Valentino Sy

5-peat in the Philippine Stock Market

The Ateneo Blue Eagles recently completed a 5-peat in the UAAP. This is considered a rare and historic feat in this modern era of basketball, where the Final Four set-up is in place.

Following the lead of the Ateneo Blue Eagles, the PSE Index is also on the verge of a 5-peat. Our index bounced strongly from the 2008 US subprime mortgage crisis and has so far delivered 3 straight years of positive returns in 2009, 2010 and 2011. Barring any black swans, 2012 seems to be in the bag as the index is up 23.6% year-to-date (YTD), as shown in the table below.

Calendar Year Returns - PSE Index and Philequity Fund

	2009	2010	2011	2012 YTD	2013
PSE Index	63.0%	37.6%	4.1%	23.6%	?
Philequity Fund	65.1%	54.2%	6.1%	24.2%	?

From the start of 2009 up to the close last Friday, the PSE Index has delivered a cumulative return of 188.5% while the Philequity Fund has yielded cumulative return of 235.3%. Also, the Philequity Fund has delivered an average annual return of 20.0% since its inception in 1994. This means that P1.0M invested in the Philequity Fund in 1994 is now worth P26.6M.

As our stock market is poised to end the year on a positive note, many investors are curious if the PSE Index can deliver a 5-peat or 5 straight years of positive returns.

Preparing for a 5-peat

With the support from the Ateneo community and Ateneo alumni such as Manny Pangilinan, Ateneo's "Drive for Five" started when it designated Norman Black as head coach in 2005. This set the general direction of the team and gradually transformed it into a more consistent contender in the UAAP. Ateneo's coaching staff then focused on the recruitment of talent in order to form a strong and complete team. They also focused on letting the team compete in other non-UAAP tournaments in order to gain more exposure and experience. This allowed the players to stick to the team's game plan even during tough situations against skilled opponents. When all these elements were put in place, it was just matter of time before the Blue Eagles started winning championships.

One Big Five

Ateneans have referred to this historic 5-peat as "One Big Five." This closely sounds like and hews to Ateneo's famous cheer, "One Big Fight." In the Philippine stock market, we also have major milestones related to the number 5. Once upon a time, many thought that it was impossible for the PSE Index to reach the 5,000 mark. We repeatedly shared our views in this column and said that it was a matter of time before our index goes to 5,000 and beyond (*Staying the Course*, January 2, 2012 and *Enter the Dragon*, January 23, 2012). We even printed commemorative shirts, with "5,000" printed on the front and "Stay the Course" printed on the back, for clients and employees. True enough, the PSE Index closed above the 5,000 mark for the 1st time when it closed at 5,016 last March 2, 2012. Even as the 5,000 mark has already been reached, we think that the index can end the year at a double-5 (PSE Index at 5,500).

Central Banks Join Forces

The PSE Index, along with other global equity indices, got a strong boost from the Fed's announcement of the 3rd round of Quantitative Easing (QE3) and the European Central Bank's (ECB) announcement of Outright Monetary Transactions (OMT). Other countries such as China, India, Brazil, Australia and even the Philippines have also repeatedly cut interest rates in order to stimulate loan growth and economic activity. All in all, these are coordinated moves from global central banks to boost asset prices, create consumer confidence and ultimately bolster global economic growth (*The Great Global Monetary Easing*, October 22, 2012). As a result, several global equity indices reached multi-year highs and the PSE Index reached a new all-time high within the past month.

Global Headwinds Weaken

A number of major global macroeconomic headwinds have started to weaken, partly as a result of the coordinated action of global central banks. In Europe, steps to resolve the sovereign debt crisis are being taken with the support of the ECB's OMT. In the US, the housing market appears poised for a rebound while its GDP growth has been relatively stable at 2.0% in 3Q2012. Also, fears of a hard landing in China have been assuaged when recently released economic data were not as bad as feared.

Reasons Behind the Resilience

Other than the Great Global Monetary Easing, there are strong positive catalysts for the Philippine economy and the local stock market. We enumerated most of these catalysts in previous articles (*Peso's Sweet Spot*, January 30, 2012 and *PSEi, All-Time High*, July 18, 2011) and we list them again below. We believe that these are the ingredients for a possible 5-peat for the PSE Index.

1. **Trust in the Aquino administration.** President Noynoy Aquino has so far enjoyed high public approval ratings because of his push for good governance. His team has been focused on implementing the necessary reforms to improve our country's fiscal situation.
2. **Strong fiscal performance.** The Philippine government has built a very strong fiscal position under the leadership of Department of Finance Secretary (DOF) Cesar Purisima. The DOF's efforts have increased government revenues and kept the budget deficit at manageable levels.
3. **Supportive monetary policy.** Last week, the Bangko Sentral ng Pilipinas (BSP) reduced its benchmark interest rate by 0.25% to 3.50%. This is the BSP's 4th interest rate cut this year, for a cumulative reduction of 1.00% in 2012. The recent rate cut aims to provide policy support for the country's growth by encouraging investment and consumption during a period of slowing global demand. Moreover, BSP's monetary easing has resulted in an abundance of liquidity in the system.

4. **OFW remittances and BPO revenues.** OFW remittances amounted to $20.1B in 2011, up 7% year-on-year, while BPO Revenues amounted to $11.0B last year, increasing by 24% year-on-year. These sectors have strongly contributed to the economy by boosting domestic consumption.
5. **Booming domestic consumption.** Domestic consumption comprises ~75% of our country's GDP. This has allowed our economy to continue growing even as global economic growth slows.
6. **Current account surplus and record gross international reserves (GIR).** The contributions of OFW remittances and BPO Revenues boosted our country's 1H2012 current account surplus by 48.5% to $2.8B. This has driven the increase of our country's GIR to $80.8B as of end-August 2012. According to the BSP, our GIR is enough to cover 11.9 months worth of imports and 10.9x the country's short-term external debt. Also, our massive GIR makes us a net creditor to the rest of the world.
7. **Credit rating upgrades.** Our country has received repeated credit rating upgrades from the 3 major credit rating agencies in the past 2 years. We believe that the country will soon be considered investment grade if the government continues to deliver the fiscal reforms that it started.
8. **Low level of investment in equities.** Local banks and investors are generally a conservative lot and usually prefer to invest heavily in deposits and bonds. Record-low interest rates and the continued reduction of tail risks have resulted to a gradual shift of investments from fixed income to equities. Moreover, the low level of investment in equities means that more money parked in fixed income and deposits will continue to shift to equities in the future.

Sin Tax – Another Catalyst

Lawmakers are deliberating the details of the additional taxes that will be imposed on liquor and tobacco products. We strongly believe that the passage of a bill closer to the P40B proposal of the Aquino administration will be positive for the country. **Investors typically reward economies and countries that take concrete steps to improve their finances.** The proposed sin tax will create more confidence in the Philippine economy and encourage the influx of foreign investments. Moreover, the additional revenues generated by the sin tax will strengthen our fiscal position and may prompt credit rating agencies to upgrade our credit rating. This can also be an impetus for the continued increase in Philippine assets, particularly Philippine stocks. All in all, we think that majority of our countrymen will benefit if the sin tax is implemented.

Investment Grade

We are sometimes puzzled by the penchant of sophisticated or wealthy Filipinos to put their money elsewhere rather than in our own country. They are probably used to the times when it was fashionable to invest in foreign countries and currencies, particularly US dollar denominated instruments. On the contrary, we believe that Philippine stocks, Philippine bonds and even the Philippine Peso are much safer investments compared to their foreign counterparts. We have repeatedly urged clients and investors to buy Philippines and stay long Philippine stocks instead of investing elsewhere. With that said, we think that all the necessary ingredients are present for the PSE Index to stage a 5-peat and deliver another positive year in 2013.

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