

Philequity Corner (January 28, 2013)

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Secular Bull Market

The PSE Index continued to spearhead a global bull run as it closed at 6,167.64 last week. So far, the PSE Index has a year-to-date return of 6.11%. Since our market has made a spectacular run-up, many clients and readers have been asking us if Philippine stocks can still continue to perform strongly. In this article, we discuss why we think this secular bull market will go on and why we remain bullish in the long-term.

What is a bull market?

A bull market is a market that displays heightened and frenetic trading activity which consequently results to continuously rising prices. This strong up-move is supported by solid fundamentals as well as growing investor optimism and confidence. Moreover, there is a general expectation that the economy and corporates will continue to deliver strong results. The opposite of a bull market is a bear market. A bear market is characterized by dull and lethargic trading which results to a sustained decline in prices.

What is a secular trend?

Unlike cyclical trends which are relatively temporary, a secular trend is one that is supported by a structural growth story and is expected to stay in place for many years. A secular trend is expected to continue for a long time because the reasons that support it are long-lasting changes that have been built or established over an extended period of time.

What is cyclical growth?

Cyclical growth refers to growth that is tied to the ups and downs of the business cycle. As a result, this type of growth may come and go as it can be easily derailed by a slowdown in business activity or a change in global economic conditions.

What is structural growth?

Structural growth is driven by something fundamental which is embedded in a company or country. As a result, structural growth tends to be more permanent and is not easily altered by external factors.

What are the structural changes that strengthened the country's economy?

Over the years, several important structural changes have transformed our country. We give credit to past governments for instituting reforms which have served as the foundation for the bull market that we are experiencing now.

- 1. Democracy.** EDSA I, the bloodless revolution that installed Cory Aquino as president, brought about the return of democracy and freedom. This served as an important base for the long-term structural transformation that our country went through.

2. **Deregulation.** The telecom and the oil sectors were among those that were deregulated by the government. This involved the breaking of monopolies which encouraged the emergence of new players in these sectors. This consequently led to an increase in the variety and quality of the goods and services that were being provided. Of paramount importance is the removal of the subsidies for the oil sector and the move to let free market dictate prices.
3. **Privatization.** The government's privatization efforts focused mainly on the power sector, water distribution and tollways. Moreover, companies such as the Philippine National Bank (PNB), Philippine Airlines (PAL), Petron Corporation (PCOR) and Manila Waterworks and Sewerage System (MWSS) were privatized. The privatization of these companies allowed them to raise capital, make significant investments and modernize their operations. More importantly, it spared the government from spending a lot of time and money running inefficient and graft-ridden companies.
4. **Value-Added Tax (VAT).** VAT is a form of consumption tax that is levied on end-buyers. The moves to increase VAT and impose Expanded VAT are historic milestones because they increased the government's revenue base at a time when the country was entering a fiscal crisis.
5. **Fiscal Consolidation.** The deregulation, privatization and tax reforms that were implemented by past administrations all contributed to the country's strong fiscal position. These moves allowed the government to dramatically reduce the country's debt-to-GDP ratio from ~84% in 2004 to the current ~50% level. This has led to credit rating upgrades, investment flows and a stronger peso.
6. **Central Bank Reforms.** After the 1997 Asian Financial Crisis, the Bangko Sentral ng Pilipinas (BSP) moved to improve the regulation and supervision of local banks. This resulted to a significantly stronger and more responsible banking system. While bigger foreign banks have been at the epicenter of the twin crises that we recently experienced, Philippine banks have been relatively insulated from global macroeconomic headwinds and are well-capitalized to support the next level of the country's economic growth (*When Titans Fall*, September 19, 2011).
7. **Rise of the Middle Class.** The strength of the Philippine labor force is seen in the emergence of the OFW and BPO sectors. For 2012, OFW Remittances are expected to reach \$21B while BPO Revenues are estimated to reach \$13B, equivalent to 8.9% and 5.5% of our GDP, respectively. These two sectors have significantly contributed to a rising middle class that spends for property, as well as various goods and services. They have been crucial underpinnings of the strong domestic consumption which we are currently experiencing. In a dinner meeting last weekend, a taipan commented that "the rich do not spend, it is the middle class that does all the spending." This reinforces our thesis that it is our rising middle class that is driving our country's economy forward.

What are the recent catalysts for this secular bull market?

1. **Good Governance.** We have often written about the immense trust and confidence that is bestowed upon the Aquino administration and how it starts with President Noynoy Aquino himself. We are fortunate that the administration is not indebted to anyone, allowing it to persistently pursue reforms that will improve our economy and genuinely benefit our country.
2. **Recent Reforms.** The Aquino administration accomplished a number of important reforms such as implementing the Reproductive Health (RH) and Sin Tax Laws, as well as maintaining the airline taxes imposed on foreign carriers. Moving forward, it will be important for the government to use its fiscal muscle in order to undertake infrastructure projects via Public-Private Partnerships (PPP).
3. **Low Interest Rates.** The BSP lowered its benchmark interest rates 4x last year for a cumulative reduction of 1%. This is in line with the monetary easing of global central banks (*The Great Global*

Monetary Easing, October 22, 2012) and served to insulate domestic demand when global economic growth was slowing.

- 4. Stabilizing Commodity Prices.** Since the Philippines is a major importer of rice and oil, it has been prone to wild swings in commodity prices. It is therefore not surprising that the country suffered a major setback when rice (*Rice Reprise*, May 19, 2008) and oil prices (*Crude Oil – A Clear and Present Danger*, June 9, 2008) spiked-up in 2008. Since then, the Department of Agriculture has made significant progress in pushing the country to attain self-sufficiency in rice. Moreover, the “new normal” in oil prices, driven by recent technological breakthroughs in US oil production, will likely prevent oil price shocks from happening and may lead to more stable oil prices in the future.

Philippines: A Secular Bull Market

The growth of the Philippines was previously viewed as cyclical. However, a series of structural changes have caused our growth profile to gradually strengthen and become more of the structural type. This has allowed our economy to perform strongly even when there is weakness globally. Similarly, this has been the basis of the resilience of our stock market in times when most global markets experienced heightened volatility or sharp downtrends (*PSEi, All-Time High*, July 18, 2011). This is also the reason why our stock market has kept going up since this bull market started in March 2009. As seen in the monthly chart of the PSE Index below, the secular bull market is intact and the dips that we experienced are mere corrections.

While many are concerned that our market just keeps going up and has started to look expensive, they fail to realize that our country has undergone an impressive long-term structural transformation. Considering this, we believe that the structural growth story of the Philippines will continue for many years to come. This is why we think the current stock market run-up is justified (*The Run-up*, January 21, 2013) and why we remain bullish on Philippine stocks in the long-term. With this, we reiterate our next target of 6,700 to 6,800 for the PSE Index.



Sources: Technistock, Wealth Securities

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