

**Philequity Corner (March 4, 2013)**  
**By Valentino Sy**

**The Actor Comedian, The Communist Parliamentarian, The Convicted Playboy and The Professor Technocrat**

Last Tuesday, Italy's market dropped 4.9% and 10-year bond yields rose by 47 basis points in one day. This roiled global markets, causing the Dow Jones index to drop more than 200 points as Italy's election results were being announced. Even the Philippines was not immune. Since the start of the year, we had our first meaningful correction, with the index shedding 1.35% in one day.

**The Worst Case Scenario**

During our joint Philequity and Wealth Securities briefing, we said one of the macroeconomic risks in Europe is the worst case scenario of former Prime Minister Silvio Berlusconi getting enough votes to win a significant number of seats because he promised to undo all the reforms of the previous Prime Minister, Mario Monti. Polls prior to the election showed that this was very unlikely, which is why his strong showing led to a global market sell-off. Now, instead of aiding in the dissipation of global macroeconomic headwinds, Italy has created its own problems.

**All-Star Cast**

As our title suggests, Italy's elections had a cast of characters that have very diverse orientations – capitalist, communist, populist, anti-establishment and even anti-everything. Adding insult to injury, no one had a clear mandate, resulting in the worst case scenario. To better understand the title of our article, we will describe the main protagonists below.

**THE COMEDIAN**

The comedian we are referring to in the title is Beppe Grillo. The 64-year old activist and TV comedian, also known as "The Clown", founded the 5-Star Movement in 2009, which unexpectedly won 25.5% of the vote without being part of any coalition. The party has called for the abolition of provinces and even the exit of Italy from the Eurozone. He has been banned from TV multiple times for incendiary, racist and sexist comments. Interestingly, he has been convicted of manslaughter, says convicts should not be allowed to hold government office and yet still ran for parliament. He has an anti-Germany, anti-government and anti-establishment stance. While he has vowed to "create a new Italy from scrap", he has offered no solution to the current debt crisis.

**THE PLAYBOY**

The playboy is none other than Berlusconi. The former prime minister has been accused of false testimony, bribery, soliciting minors for sex, abuse of office and tax evasion. Frequently seen with numerous underage girls at what he calls "bunga bunga" parties, he settled most of his sexual offenses. He had two wives and reportedly many girlfriends and mistresses. He is now set to marry a 27-year old girl (Berlusconi is 76 years old and has a 46-year old daughter). Of all the allegations against him, he was convicted only for tax evasion and sentenced to 4 years in prison, which was shortened to 1 year. All this has done little to deter his political ambition or even reduce his popularity in Italy, with his coalition only

narrowly losing to Bersani's, with 29.1% of the vote. Berlusconi has promised to undo all of Monti's tax cuts and implement cash refunds.

### **THE COMMUNIST**

Pier Luigi Bersani is the Communist in the group. He started his 23-year career in politics with the Italian Communist Party and is now with the Democratic Party of the Left. Bersani has deep socialist leanings and his ideologies may clash with Monti's pension reform and tax policies, which are more capitalist. While they may have opposing policies and are not a perfect match, Bersani was the lesser evil. His coalition got 29.5% of the vote.

### **THE PROFESSOR**

Last but not the least is Monti, the professor. Also known as Super Mario, the most recent prime minister is an economist who led a government of technocrats amidst the European sovereign debt crisis (see *Italy Defeats Germany*, 2 July 2012). He was accepted by his counterparts in Germany and France. He is also widely respected by the investment community for leading Italy's reforms. However, as austerity measures became unpopular, so did he. Populists took advantage of this and criticized Monti's government, resulting in his party garnering only 10.5% of the vote.

### **Hung, Drawn and Quartered**

Question: What do 2 clowns, 1 communist and 1 professor make?

Answer: A hung parliament.

Peer Steinbrueck, German Chancellor Angela Merkel's challenger in this year's elections, called both Berlusconi and Grillo "clowns", saying that it was appalling that two populist clowns have won.

As a result of Grillo's outstanding performance in the elections, none of the parties garnered enough seats to gain a majority in the Senate. Since both houses of Parliament are needed to pass legislation, even though Bersani's coalition had majority of the seats in the Chamber of Deputies, Italy ended up with a hung Parliament. While ECB President Mario Draghi's Outright Monetary Transactions (OMT) program and pledge to do whatever it takes (see *Whatever It Takes*, 27 August 2012) has lifted markets higher, the strong showing of populist candidates throws a monkey wrench in the Eurozone's path to reform. In our annual briefing, we talked about the positive contagion now sweeping across Europe and the rest of the world. With this worst case scenario as a wild card, we fear that this positive contagion might transform into a negative contagion.

### **Some Good Sense in Japan**

Last week, Japan's stock market surged on news that Haruhiko Kuroda was nominated as the next Bank of Japan (BOJ) governor. ADB President up until his nomination, he is seen as the best fit for the position. His nomination won swift support from hedge funds and traders alike who were weary of Japan's lost decades. More than 10 years ago, Kuroda wrote an opinion piece urging inflation targeting and called for extraordinary measures to get Japan out of its deflation. In one of his interviews, Kuroda said that "although economic theory may provide some insight, some framework, good policies may require something that goes beyond economic theory or analysis – some practical judgment, some good

sense.” In fact, he was ahead of his time because these are similar to the policies Bernanke and Draghi are implementing now.

Up 11.7% YTD, the Nikkei has now risen more than 30% in the past 3 months because of these policies. The yen has also depreciated close to 20% versus the US dollar over that 3-month time period. This goes to show how important it is that a country has a coordinated government and a reform-minded leader.

### **The Philippine Setting**

If you read the title of our article today, you might have thought we were describing Philippine politics and our own colorful set of senators and congressmen. The Filipinos have also been known as the Latinos and Italians of Asia because of our penchant for artistry, music, dancing and acting. We are also more emotional, more romantic and more demonstrative. Filipinos also tend to vote for actors, musicians, and those who show bravado and have a macho image.

Fortunately for the Philippines, the government is single-minded in its path to reform as led by its reformist President, President Benigno “P-Noy” Aquino, Jr. and his cabinet. We clearly saw what happened to Italy with its fragmented government and anti-reform, populist orientation. Learning from the experiences of Italy and Japan, it is apparent that investors like to put money in countries that have a clear path to reform. P-Noy’s platform against corruption and for fiscal responsibility along with a stable government has also contributed to our stock market’s rise, with the PSEi now up 14.3% YTD. However, we should not be complacent and lose all our hard-earned achievements by backsliding into a path of corruption, populism and irresponsible spending. Thus, we should be careful in choosing our leaders. As we mentioned during our briefing and our past articles (see *Secular Bull Market*, 28 January 2013), these structural economic reforms have led to a secular bull market. The fruits of these reforms, if left unchanged, will go on for years and even decades.

### **Mother Luck Smiles on the Philippines**

Unfortunately for Monti, being a technocrat and an expert in finance does not translate to votes. It is actually popularity and populist moves that translate more to votes. Luckily for the Philippines, P-Noy is in a unique position because he is popular, but remains honest, steadfast and reform-minded. Indeed, Mother Luck (Cory?) is smiling on the Philippines.

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