Philequity Corner (May 6, 2013)
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The 2nd Upgrade

Last Thursday, May 2, 2013, our country received its 2nd investment grade (IG) rating from Standard & Poor's (S&P). Like Fitch Ratings, S&P upgraded our credit rating to BBB- from BB+. Though S&P's upgrade was expected to come within 2-3 months, investors welcomed the 2nd upgrade even as it came earlier than expected. S&P's upgrade caused our PSE Index to end the week on a strong note and close at a new all-time high of 7,215.

Fully Upgraded

Before, we stressed the importance of getting our country's 1st IG rating. Being upgraded into IG status is an important milestone that will make people aware of the progress that the country is experiencing. However, in terms of investment flows, we believe that the 2nd upgrade is at least equally as important as the 1st upgrade. After a country is given its 1st IG rating, most foreign funds would usually wait for the 2nd upgrade before they take action. In other words, being fully upgraded to IG status means that the country is IG-rated by at least 2 of the 3 major credit rating agencies.

Mainstream Investment

Since our country has been given the IG status by S&P and Fitch, we will start being considered as a mainstream investment alternative. We will become visible to global investors who have not even heard of the Philippines. Moreover, funds that are restricted to investing in IG countries can now start putting investments in the country. Lastly, funds that are already invested in the country can now allocate a bigger portion of their assets to their Philippine investments.

Rising Star

S&P's recent upgrade leaves Moody's Investors Service as the only major credit rating agency which has not given the IG status to the country. Recently, however, Moody's Analytics, a sister company of Moody's Investors Service, had some good things to say about the Philippines. In one of its reports, Moody's Analytics described the Philippines as one of the few bright spots of a generally sluggish global economy. The think tank said that it expects the country to continue growing between 6.5 to 7.0% over the next 2 years, outperforming most developed and even fast-growing emerging markets. Considering these, we think that an IG upgrade from Moody's might be forthcoming.

A Virtuous Cycle

In a past article, we talked about the tangible benefits of getting the IG status (*Investment Grade*, April 1, 2013). We summarize below some of the things that we mentioned in that article.

1. **Lower borrowing costs.** The IG status is a widely-recognized badge of approval, affirming that the country is a safe and viable investment alternative. This will result to lower borrowing costs for the

government. Since borrowing rates are pegged against the government's borrowing rates, we expect borrowing costs of local corporates, small businesses and consumers to also go down.

2. **More investments.** A combination of lower borrowing costs and increased visibility will encourage investors to increase their investments in the country. If everyone does his part, we expect the country to benefit from an investment-driven growth over the next few years.
3. **Higher income and more spending.** A surge in investments will likely create more jobs. This, along with lower borrowing costs, will result to higher earning power and higher disposable income. Given these, we think that the spending power of Filipinos will only increase moving forward. This will boost the robust domestic consumption that has been the foundation of our strong economy.

Ahead of the Pack

The country's unique structural growth story has reaped praise and recognition from the international community. This is because of the magnificent long-term structural transformation that our country has gone through in the past 2 decades (*Secular Bull Market*, January 28, 2013). Although there is still much to be done, past governments and our current administration have implemented meaningful structural reforms that have significantly strengthened our country's growth profile.

As such, we believe that we are ahead in terms of structural reforms compared to most countries. Countries in Europe and countries such as the US and Japan are doing a lot in attempting to revive their economies while contending with high government debt. Even emerging countries such as China, Korea and Brazil have shown vulnerability because of their heavy dependence on exports and on the state of the global economy. Considering that we are in a relatively good position, we believe that the government should take the opportunity to further strengthen and diversify our economy.

Pulling Away

In various articles and presentations, we said that we are in a global bull market. Most global stock indices continue to trade at all-time or multi-year highs. Against this backdrop, the PSE Index remains ahead of the pack in terms of year-to-date (YTD) performance. This is clearly reflective of the country's stronger structural position compared to its developed and emerging market counterparts. Below are tables showing how the PSE Index has performed versus other global and Asian stock markets.

Major Markets			
Index	**Country**	**2012 Return**	**2013 YTD**
S&P 500	US	13.4%	13.2%
FTSE 100	UK	5.8%	10.6%
CAC 40	France	15.2%	7.5%
DAX	Germany	29.1%	6.7%
Euro Stoxx 50	Europe	13.8%	4.9%
IBEX 35	Spain	-4.7%	4.6%
FTSE MIB	Italy	7.8%	4.0%
MICEX	Russia	5.2%	-4.4%
Bovespa	Brazil	7.4%	-9.0%

Sources: Bloomberg, Wealth Securities

Asian Markets			
Index	**Country**	**2012 Return**	**YTD**
Nikkei 225	Japan	22.9%	31.7%
PSE Index	**Philippines**	**33.0%**	**24.1%**
JCI	Indonesia	12.9%	14.1%
SET	Thailand	35.8%	13.4%
Strait Times	Singapore	19.7%	6.4%
BSE Sensex 30	India	25.0%	0.8%
KLCI	Malaysia	10.3%	0.3%
Hang Seng	Hong Kong	22.9%	0.1%
KOSPI	South Korea	9.4%	-1.6%
SH Composite	China	3.2%	-2.8%

Sources: Bloomberg, Wealth Securities

Valuing Growth

There is a persistent concern among investors and major investment houses that Philippine stocks are already expensive. While it is true that our stock market is not cheap based on Price-to-Earnings (PE), this has been the case for many years already. The fact that the PSE Index has gone up a lot last year and continues to move higher this year shows that our stock market's high PE multiple has not deterred those who would like to invest in our country. Many investors and market players are puzzled by this.

In our view, the PE multiple that is given to a country or a company is based on 2 things: growth and risk. There are stock markets with low PE multiples such as those of China and Korea. These are countries whose economies are heavily dependent on exports. Since global economic growth has been particularly sluggish, the economic prospects of China and Korea are considered relatively risky. Hence, they are cheap for a reason. In contrast, the Philippine economy has been extraordinarily resilient amidst a global economic slowdown. Our strong domestic consumption, which has been the key underpinning of our economy, has kept our economic growth insulated from external weaknesses. Because of this, our growth profile is considered stronger and less risky compared to export-oriented countries such as China and Korea. This is why our stock market is given a higher PE multiple.

A Powerful Bull Market

Although valuation will likely remain a concern for some investors, we think that the trajectory for Philippine stocks is very clear. As we have always said, we believe that we are in a bull market that will last for many years to come. The recent upgrade of S&P, which gave our country its fully upgraded IG status, is an affirmation of our thesis. Considering this, we encourage investors to use corrections as chances to increase their positions or enter the stock market. We firmly believe that this powerful bull market will continue for as long as our country's fundamentals remain intact.

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