Philequity Corner by Valentino Sy
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The Big Unwind

Throughout much of 2013, global equities rose on the back of decreasing risks in Europe, China's apparent soft-landing, the resurgence of Japan because of "Abenomics", and the sustained economic recovery in the US. The S&P 500 index and the DJIA registered new all-time highs, while the Nasdaq Composite index went to a 12-year high. In Europe, the Stoxx 50 Index and the German DAX Index made new all-time highs. Meanwhile, the Nikkei climbed to a 5-year high and became the best performing market in the world.

All these happened in an environment of ultra-low interest rates brought about by quantitative easing as investors shrugged of any weak data knowing that the Fed, the ECB, BOJ and other central banks are always there to provide more liquidity.

QE tapering spooks the market

Equities markets started to correct when Bernanke hinted of QE tapering last May 22. In his own words, Bernanke said: *"If we see continued improvement and we have confidence that it is going to be sustained then in the next few meetings we could take a step down in the pace of purchases."*

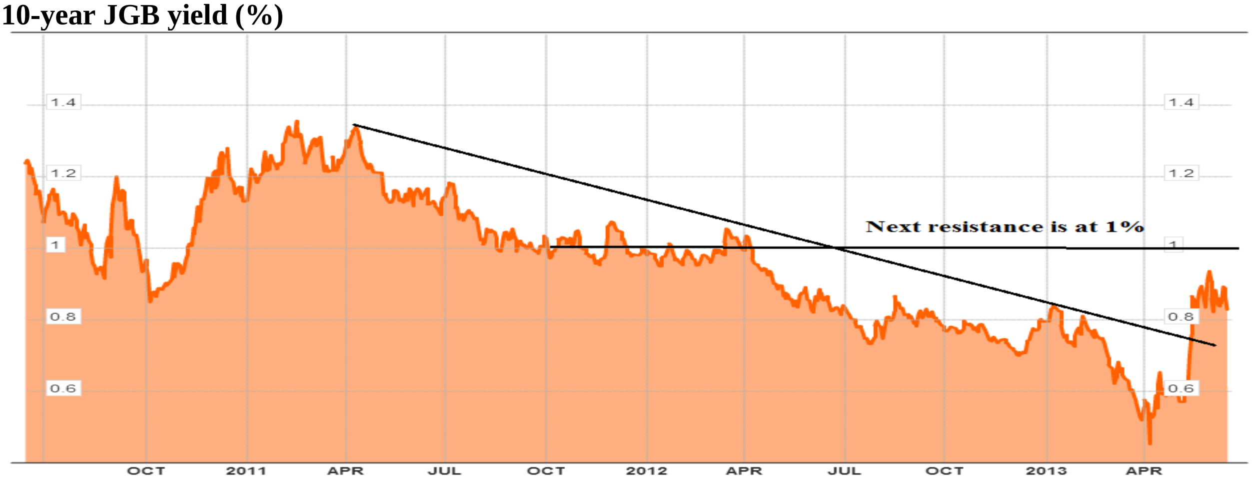
Meanwhile, minutes from the Federal Open Market Committee (FOMC) meeting on April 30-May 1 revealed that a number of participants are willing to taper QE as early as the next meeting on June 18-19 if economic reports show "evidence of sufficiently strong and sustained growth."

Thus, in a case of "good news is bad news", markets worldwide started to sell-off on concerns that the Fed will scale back its stimulus efforts if the US economy and labor market continue to improve.

Spike in US Treasury & JGB yields

Prior to Bernanke's May 22 "Fed tapering" speech and the subsequent sell-off in equities markets, the bond markets were already providing a clue of what was to come. The 10-year JGB yield bottomed out at 0.45% last April 4, 2013. The crucial level for 10-yr JGB yields is 1%. Breaking above that level would mean much higher yields thereafter.

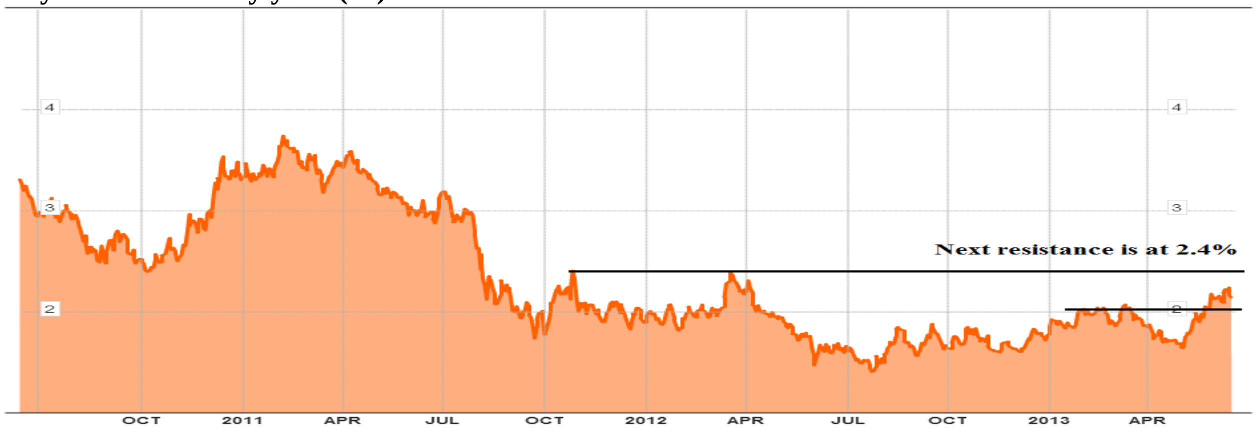
10-year JGB yield (%)



Source: Bloomberg, Wealth Securities Research

Meanwhile, the 10-year US treasury yield hit a floor at 1.61% last May 1, 2013. The next major resistance level is at 2.4%. A break above that level would mean significantly higher rates thereafter.

10-year US Treasury yield (%)



Source: Bloomberg, Wealth Securities Research

Unwinding of the yen-carry trade

Several months back, when the Bank of Japan carried out Abenomics (doubling of monetary base, inflation target of 2% and purposeful depreciation of the yen), investors and fund managers around the world flocked to what was a "no brainer" carry trade – short yen and long Nikkei. This meant borrowing yen which was purposely being weakened by the BOJ, and simultaneously buying Japanese stocks which would benefit from higher inflation and the resurgence of export-driven Japanese economy.

Thus from a low of 8,534 last Oct 2012 the Nikkei zoomed 83 percent to a five-year high of 15,627 last May 22. The USDJPY rate gained 32 percent from 78 to a high of 103.16 over the same period.

This trade worked perfectly until Bernanke's ominous May 22 speech regarding the impending Fed tapering. With bond yields on the rise and the Fed signalling a tapering of QE, the Nikkei has since slumped 19% to 12,686. Meanwhile, the USDJPY rate has since declined 8.6% to 94.31.

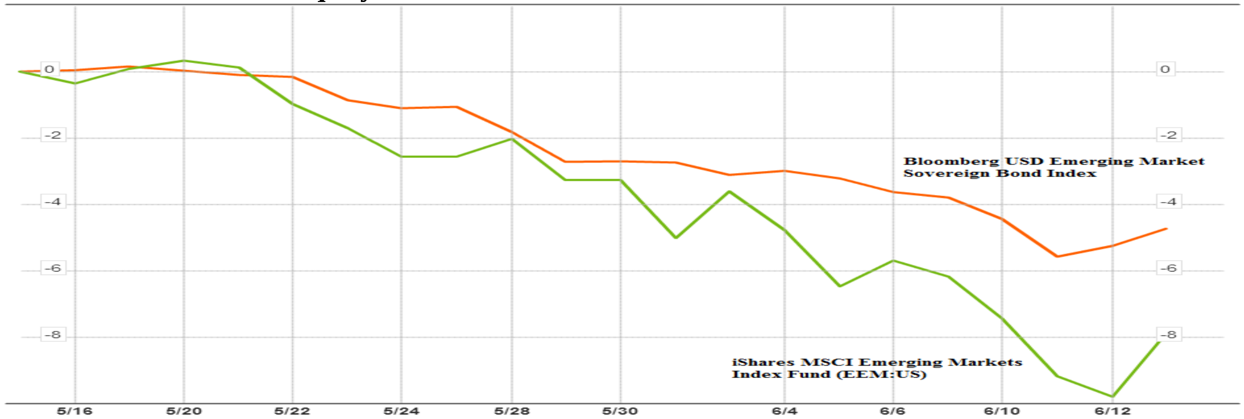
Stockcharts.com, Wealth Securities Research

Deleveraging spreads to emerging markets

The volatility in the JGBs and US treasury has reverberated across the globe. What is happening now is a de-leveraging of funds from emerging markets back to the US and unwinding of trades which caused the sudden appreciation of the yen, the US dollar and the euro against EM currencies.

This forced liquidation is evident on the Bloomberg USD Emerging Market Sovereign Bond Index and the iShares MSCI Emerging Market Index Fund (see chart below) which have declined by 5 percent and 8 percent, respectively, from their May 22 prices.

EM Bond Index & EM Equity Index



Source: Bloomberg, Wealth Securities Research

According to EPFR Global, EM equity funds posted $10.8 billion outflows in the last two weeks ending June 12, 2013. This has halved the YTD EM inflows from $22 billion to $11.8 billion. On the debt side, dedicated EM funds registered $2.5 billion outflows the past week, the largest outflow week since September 2011.

Markets turned topsy-turvy

The markets have turned topsy-turvy. Markets trading at all-time highs (Philippines, Indonesia, Thailand and Turkey) were the hardest hit. Indiscriminate selling from hedge funds that are deleveraging has turned the best performing markets to worst.

		Price		
Country	**Index**	**22-May**	**Current**	**%Chg**
Philippines	PSEi	7,385	6,242	-15.5%
Turkey	XU100	93,179	80,012	-14.1%
Thailand	SET	1,631	1,465	-10.2%
Indonesia	JCI	5,208	4,761	-8.6%

Source: Wealth Securities Research

Window of opportunity

The 15.5% drop in Philippine stocks since Bernanke spoke about QE tapering opens a window of opportunity for investors to pick-up stocks at cheaper valuations.

What is good is that the indiscriminate selling which caused the market to drop and the peso to depreciate sharply has nothing to do with fundamental reasons but because of the unwinding and indiscriminate selling by foreign funds which at some point will end. Fundamentals not only remain the same, but have actually improved.

Hence, while volatility still abounds, investors with long-term view should start nibbling or buying stocks or equity funds in tranches because valuations have become cheaper. At the end of the day - when deleveraging ends and normalcy returns - we believe that fundamentals will prevail.

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