Philequity Corner (July 1, 2013)
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5-6-7-8

This article is not about the start of a military cadence. It is also not about the starting count of a song or a count of dance steps. Moreover, it is not the title of the dance song "5-6-7-8" of the British pop group called Steps. Instead, this article is about the intraday low that the PSE Index recently reached. In this most recent correction, the PSE Index reached an intraday low of 5,678 last June 25. This recent low is a number that is very easy to remember. It is much like the S&P 500's ominous bottom of 666 which we correctly called during the last bear market (*666*, March 23, 2009).

The Bear Scare

After reaching an all-time intraday high of 7,404 on May 15, the index paused from its ascent and eventually started correcting on May 22. From the peak of the run-up to the trough of the correction, we saw the index drop 23%. At the trough, we saw all the year-to-date gains of the PSE Index (which was 27% at the peak) get erased. We also saw our index turn from the best performer to the worst performer in the span of one month. Since the index dropped more than 20% in a month, there have been rampant market talks and numerous news headlines about how the Philippine stock market entered bear market territory. The fear and panic was so widespread that many probably forgot or disregarded the fact that our country's fundamentals are the strongest in recent memory.

Picture Perfect Peso

We accurately called the top of the peso at 40 even when most foreign houses said that the peso would go to 37.5 or even 35 (*The Peso Tops Out*, May 27, 2013). After the peso topped at 40, we said that the peso would likely go back to the 42-44 range (*Peso Back to the Sweet Spot*, June 3, 2013). The peso then quickly moved and touched the 44 mark, hitting an intraday bottom of 44.17 on June 21. We explained in our article last week that this move was caused by dollar strength and not peso weakness. We also said that the 44 level is a strong resistance and the weakness of the peso should stop there (*It's the Strong Dollar, Stupid*, June 24, 2013). The peso has since retraced back to the 43 mark, showing that the recent sharp depreciation was overdone. Moreover, it is likely that the peso established a bottom at the 44 mark. The back and forth moves of the peso and our timely calls on it all happened within a month.

Peso Bottom Signals Market Bottom

We noticed that there is a correlation between the peso and the stock market. If the peso strengthens, the stock market also strengthens. If the peso weakens, the stock market also weakens. If the 44 level is indeed a resistance and the bottom for the peso, then it stands to reason that the stock market was also nearing the bottom.

Bottom Signals

Throughout this correction, we intently looked for signs of a possible turn in the stock market. Below, we enumerate signals that reinforced our view that 5,678 may indeed be the bottom of this correction.

1) **Sentiment Bottoms.** Last June 24 and June 25, fear, panic and anxiety were so widespread. Investors, traders and even market observers were all scared while the sellers sold continuously. It was a time when there was a lack of strong buying in the market. This usually characterizes market bottoms, as it is usually the scariest time to buy when the market is bottoming. As the saying goes, "The night is darkest just before the dawn."
2) **Experts Move In.** At the scariest point of this correction, we got calls from two of the country's richest and most prominent businessmen and three well-respected veterans of the local capital markets. These are people that we respect and admire. They all felt that we may have hit the bottom. They all invested in Philequity Fund near the bottom of the market.
3) **Headlines Galore.** Various dailies printed front page headlines saying that our stock market was already in bear territory. These types of headlines can be very good and accurate contrarian indicators. Often times, the opposite of the headlines come true: rampant bullish headlines precede sharp corrections while repeated bearish headlines come before sharp rebounds.
4) **Technical Signals**. We saw technical indicators and patterns that characterize market bottoms. Wealth Securities released a Technical Analysis Report a day after the market hit bottom. In that report, Wealth Securities stated that the market may have hit bottom. They showed the PSE Index chart and cited that recent market bottoms took place when the 20-day Rate of Change indicator touched 85. This means that prices were down by 15% from the levels twenty days prior. This was also the case when the index hit 5,678.
5) **Capitulation**. Market bottoms are characterized by capitulation. This is a time when the buyers seem to be giving up and the sellers just want to get out regardless of price. This sharp and swift downmove to 5,678 was clearly caused by capitulation.
6) **The V formation.** The V formation is characterized by a sharp downmove followed by an equally steep rebound. This is the formation that appeared when our index rallied strongly after hitting 5,678. V formations are chart patterns that typically signal market bottoms.
7) **Peso Stabilizes.** After reaching the recent low of 44.17, the peso quickly stabilized at the 43 level. The peso actually bottomed-out before the PSE Index did. This was a sign that foreign outflows had subsided, indicating that the market was nearing bottom.
8) **Supermoves and Supermoons.** There are theories that full moons and supermoons affect people and investors in strange ways. Exaggerated moves in the stock market usually happen during full moons and supermoons (*Supermoon*, March 21, 2011). These are times when investors become irrational, impulsive and erratic. Looking back, the scariest drops of the market happened during a combination of the supermoon and the summer solstice (longest day of the year). If the fall in the market was caused by irrational behavior, then it means that 5,678 was actually a good time to buy.
9) **Numerology.** Whether or not one believes in numerology, there seems to be some sort of numerical coincidence in our daily affairs and even in the stock market. It seems that numbers of great significance turn out to be numbers that are either ominous or easy to remember. For instance, during the last bear market, the S&P 500 bottomed at 666 on March 6, 2009 (*666 on 3-6-9*, April 13, 2009). This time around, our stock market may have hit bottom at another memorable number. 5-6-7-8 is a chronological number that is used for songs and dances. 5,678 will probably be remembered as an important bottom of a painful correction that occurred in a very powerful bull market.
10) **End of Forced Liquidation.** We were aware that the foreign selling was indiscriminate. These were market orders that resulted from forced liquidation of exchange-traded funds (ETFs) like the MSCI

Emerging Markets (EEM) and the MSCI Philippines (EPHE). The foreign sellers did not consider that our country's fundamentals are actually improving. Instead, they had to comply with the mandated exposure reductions on the EM equity model portfolios that they religiously follow. We were confident that forced liquidation and indiscriminate selling that was not triggered by a change in fundamentals would eventually end (*The Big Unwind*, June 17, 2013).

11) **Foreign Flows Reverse**. For the most part, we experienced heavy net foreign selling since May 22. From the start of June until the bottom on June 25, net foreign selling amounted to P16.6B. After the bottom was reached, foreign flows quickly reversed to heavy net buying. Net foreign buying amounted to P1.2B in June 26, P1.6B in June 27 and P3.5B in June 28. All in all, we experienced net foreign buying of P6.3B in the last three days of the month.
12) **Compelling Valuations.** The drop was so steep that our index actually started trading at more reasonable valuations. At the bottom, our index traded at ~17x 2013 PE and ~15x 2014 PE. More importantly, our price-to-earnings growth (PEG) multiple was ~1x. This means that we were actually cheap considering the strength, quality and consistency of our earnings growth.

Vote of Confidence

We would like to share with our readers that throughout this correction, Philequity Fund did not experience any significant redemptions. In contrast, despite the heavy selloff and the panic, Philequity Fund actually experienced significant inflows from high net worth individuals and some of the country's biggest institutions and corporates. These reinforced our view that the selloff was overdone. Moreover, this showed the utmost confidence of investors in the Philippine growth story.

5678 –The Bottom

As with previous corrections, our index bounced back very strongly from this most recent correction. Last Wednesday, June 26, our index posted its biggest 1-day percentage gain (5.7%) since November 2008 and its all-time biggest 1-day points gain (330 points). Our index has so far rebounded 14% since the bottom and closed the month of June at 6,465.

Moving forward, it is likely that our stock market will continue to be volatile. If indeed 5,678 is the bottom, then the preferred strategy is to buy on dips or buy in tranches during this volatile period.

Despite the fear and panic that this correction brought, our country's fundamentals are better than ever and are still improving. Barring any black swans locally or globally, we are convinced that this bull market will continue. And this is when research will show its importance. Understanding the reasons behind corrections and appreciating the underpinnings of this bull market will give investors more confidence in trading the stock market during volatile and turbulent times.

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