Philequity Corner by Valentino Sy
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The Best House in a Bad Neighborhood

Since May 22, when talks about "Fed tapering" arose, interest rates across the globe started to shoot up. Capital which freely flowed to emerging markets because of the Great Global Monetary Easing (see The Great Global Monetary Easing, Oct 22, 2012) began to reverse course, causing a vicious correction in emerging market stocks, bonds and currencies.

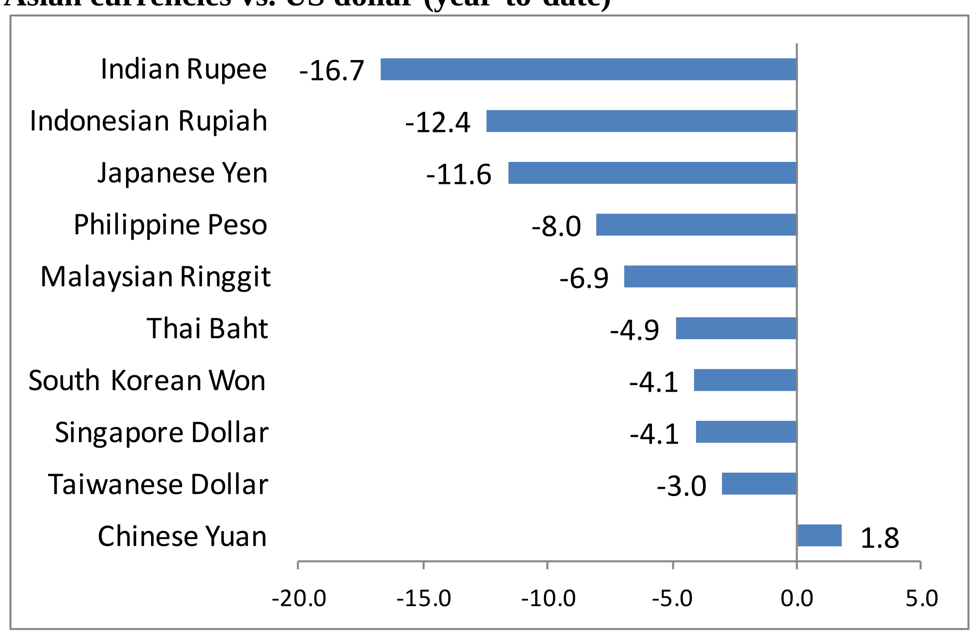
In Asia, the vulnerability of economies with huge current account deficits such as India and Indonesia was exposed. With higher global borrowing costs, capital flows becoming less abundant and the prospect of tapering starting as early as the next FOMC meeting (September 17-18), the pressure on these deficit economies has intensified.

No one was spared

The geographical location of the Philippines and not its fiscal, monetary and economic performance has made it "the best house in a bad neighbourhood." With the Philippines being located in South East Asia, the peso and the Philippine stock market fell despite the stellar economic performance of the Philippine economy.

As you can see from the table below, almost all stock markets and currencies in the region were affected due to the imminent tapering. Being the best house in a bad neighbourhood, the Philippines was not spared when hedge funds and other foreign investors started deleveraging and selling across the board.

Asian currencies vs. US dollar (year-to-date)



Source: Bloomberg, Wealth Securities, Inc.

Market Performance (year-to-date %)

ASIA EX-JAPAN	Index	Current Price	% Change year-to-date	%Change ytd ($terms)
India	SENSEX	18,619.7	(4.2)	(21.2)
Indonesia	JCI	4,195.1	(2.8)	(16.3)
Thailand	SET	1,294.3	(7.0)	(11.5)
Singapore	STI	3,028.9	(4.4)	(8.3)
South Korea	KOSPI	1,926.4	(3.5)	(7.6)
China	CSI 300	2,313.9	(8.3)	(6.6)
Malaysia	KLCI	1,727.6	2.3	(4.8)
Philippines	PSEi	6,075.2	4.5	(3.8)
Taiwan	TAIEX	8,021.4	4.2	1.1

Source: Bloomberg, Wealth Securities, Inc.

India: slowing growth & high current account deficit

The Indian rupee fell to a record low of 68.845 last week against the US dollar. It is the worst performing Asian currency year to date (down 16.7 percent) and it remains pressured by intensifying capital outflows and slowing economic growth. India is the most reliant on capital inflows to offset its persistent current account deficit which stood at 4.9 percent of GDP in calendar year 2013 (ending March). In absolute numbers, India's current account deficit is the 3rd largest in the world.

GDP figures for the 2nd quarter of 2013 show that India grew at its weakest pace since the global financial crisis. Output expanded by 4.4 percent which is well below the already muted forecasts of 4.7 percent and a far cry from the 8 to 9 percent growth it was accustomed during the past decade.

Indonesia: surging inflation & falling commodity prices

Among ASEAN currencies, the Indonesian rupiah fared the worst, down 12.4 percent year-to-date. Indonesia suffers from high inflation which hit a 4-year high of 8.61 percent in July. Its record current account deficit of $9.8 billion (or 4.4 percent of GDP in 1Q13) is now at the levels last seen during the 1997 Asian financial crisis. Bank Indonesia's foreign exchange reserves shrank $20.1 billion over a period of seven months to end at $92.7 billion in July – the fastest decline among central banks in Asia.

Thailand: weak current account & economic contraction

After India and Indonesia, Thailand has the weakest current account in Asia ex-Japan. Thailand's economy is also now in recession (defined as two consecutive quarters of negative growth), after contracting by 0.3 percent in the 2nd quarter of 2013, following a revised 1.7 percent decline in economic output in the 1st quarter of 2013. As a result, the Thai baht is currently down 4.9 percent year-to-date, a fall of over 11 percent from its peak - at one point being the strongest currency in Asia up 6.6 percent in April.

Malaysia: high risk of capital outflows

The Malaysian ringgit fell to its lowest level in three years and is down 6.9 percent year-to-date. While Malaysia still has a current account surplus according to latest numbers, it is the smallest surplus recorded since 1999. Malaysia's risk of capital outflows is among the highest in the region since foreigners hold almost 50 percent of its government bonds.

Singapore: perceived safe haven

Unlike the countries mentioned above, Singapore is perceived to the least vulnerable to a contagion. The Singapore dollar is among those holding up well, along with the Taiwanese dollar and the Chinese yuan. Singapore's current account balance remains very solid at 19 percent of GDP as of 2012. Nevertheless, its equities market has not been immune to outflows, falling 4.4 percent year-to-date (or equivalent to a decline of 8.3 percent in dollar terms).

Philippines: stellar growth & healthy external balances

The Philippines posted a robust 2nd quarter GDP growth of 7.5 percent, matching the pace of China as the two fastest growing economies in Asia. It has sustained an annual growth of above 7 percent for four quarters in a row. Similar to Singapore, external balances remain healthy with a current account surplus amounting to 5.3 percent of GDP in the 1st quarter of 2013. Despite this, the Philippines has not been immune to the global funds outflow. The peso is down 8 percent year-to-date and is nearing a three-year low.

However, due to much stronger fundamentals than many of its neighbours, the Philippine stock market remains the best performing market in Asia ex-Japan with a 4.5 percent return year-to-date.

Hedge funds vs. Pension funds

The sharp fall of equity prices in the last three months sent the MSCI Southeast Asia index into bear market territory, down 21 percent from its May 8 high. According to Bloomberg, hedge funds and other foreign investors sold a net of $2.2 billion of Thai, Indonesian and Philippine stocks in August alone. This has prompted state pension funds in Indonesia and Thailand to announce in public that they are boosting their share holdings.

Last week, foreign investors sold a net of 11.7 billion worth of Philippine stocks when the PSE index fell below 6,000 for the 2nd time in three months. While there were no official announcements, it is highly likely our local pension funds and GFIs took advantage of this great buying opportunity. At 5,600 to 6,000, the market P/E is at 14x to 15x earnings.

The best will be the first to recover

Similar to what is happening now in Asia no one was spared during the European crisis. Germany had a stellar economic performance, and yet it became the best house in a bad neighbourhood during that time.

The German DAX fell 30 percent in the 3rd quarter of 2011. But when the risks of a sovereign debt crisis started to abate, Germany was the first to recover. The DAX eventually rose 70 percent from their 2011 lows to record new highs.

Similarly, we believe the Philippines, given its stronger fundamentals relative to its neighbors, will recover first once the market stabilizes. We also expect the PSE index to be one of the first to record new highs.

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