

**Philequity Corner (October 21, 2013)**

**By Valentino Sy**

### **The Philippine Stock Market – A Safe Haven**

After the rollercoaster ride caused by the US government shutdown and debt ceiling problems, the US stock market closed last week at a new all-time high. What was noticeable during the preceding decline of the US and other global stock markets was the resilience of the Philippine stock market. It was a time when concerns of a possible US debt default loomed while local catastrophes and adversities surfaced. Notwithstanding, our stock market continued to perform strongly and even started rising. Through all these, the strong fundamentals of our economy and corporates have continued to shine. This is why the Philippine stock market now appears as a safe haven.

### **Zamboanga Insurgency, Super Typhoons, 7.2 Earthquake and the Napoles Scam**

Aside from the US political impasse, our country had to deal with various disasters, both natural and man-made. We dealt with a Moro National Liberation Front (MNLF) insurgency in Zamboanga that lasted for three weeks. We also had to deal with super typhoons and an earthquake that ravaged Cebu and Bohol. Aside from these, the country had to stomach the Napoles pork barrel scam and heavy allegations of legislative corruption. Despite all these, our stock market remained strong and still continued moving higher.

### **Surprising Strength**

The S&P 500 jumped 1.2% when the Fed announced its “No Taper” decision on September 18 (*No Taper!*, September 23, 2013). After that, the benchmark started to pull back because of concerns over the US political impasse. This continued even after the US government shutdown started on October 1.

Like the S&P 500, the PSE Index gained sharply when the “No Taper” decision was announced. Our index also started falling as concerns over the US political situation grew. However, on October 1, our stock market turned and actually started to rise while the US stock market was dropping.

Some may find the resilience of our stock market surprising, especially considering the fact that our country was called “The Sick Man of Asia” not too long ago.

### **No Longer The Sick Man of Asia**

Not too long ago, our country encountered all sorts of problems. We were plagued with various political problems such as corruption scandals and impeachment trials of our country’s highest officials. We dealt with destabilizing events such as coups and military insurgencies. We also experienced a paralyzing fiscal crisis that threatened our credit standing. Back then, our economy clearly lacked the focus despite its tremendous potential. We were behind everyone else in the region in terms of implementing structural reforms. Consequently, our economic and stock market performance lagged compared to our Asian neighbors. This is why our country was called “The Sick Man of Asia.” Despite the problems that our country encountered, past governments continued working diligently to implement reforms that changed our country’s fate.

## Structural Transformation

Past leaders implemented meaningful changes and reforms that served as the foundation of the strong economic and stock market performance that we are witnessing now. We enumerate these below.

1. **Democracy.** Our country's return to democracy in 1986 also marked the return of freedom. It served as an important base for the structural transformation that our country was going to embark on.
2. **Deregulation.** The deregulation of the telco and oil sectors involved breaking monopolies and allowing new players to enter. More importantly, this allowed the government to eliminate oil subsidies and let the market dictate prices.
3. **Privatization.** These efforts focused on privatizing the power sector, water distribution concessions and tollways. The move allowed private companies to make significant investments and modernize operations. It also spared the government from running inefficient and graft-ridden companies.
4. **Value-Added Tax (VAT).** The moves to increase VAT and implement expanded VAT are important milestones in our country's history. These allowed the government to increase its revenue base at a time when the country was dealing with a fiscal crisis.
5. **Fiscal Consolidation.** The deregulation, privatization and tax reform efforts of past administrations allowed our government to increase its revenues and manage its expenses. All these contributed in lowering our country's debt-to-GDP ratio from a high of 70+% in 2004 to the current level of ~50%.
6. **Current Account Surplus.** Our country enjoys a current account surplus because of the dollar inflows from OFW remittances and BPO revenues. This separates us from countries like India and Indonesia which suffer from chronic current account deficits.
7. **Buildup of Gross International Reserves (GIR).** Our country also experienced a massive GIR buildup. Our GIR grew more than four times, from only ~\$20B in 2004 to \$83B as of August 2013. Our reserves back our currency and serve to insulate our economy from external shocks.

## Structural Reforms: A Model for Asia

Though there is still much room for improvement, our country has already implemented a good number of structural reforms. What we are seeing now is that other Asian countries are undertaking reforms that are similar to what we implemented before. We enumerate some examples of these below.

1. **Japan:** As part of the Abe administration's third arrow, the Japanese government is raising its sales tax from 5% to 8%. This will be Japan's first sales tax increase since 1997.
2. **Malaysia:** The country is set to impose the goods and services tax (GST). With this, the government aims to rationalize its tax regime and raise additional tax revenues.
3. **Indonesia:** The government raised fuel prices in order to cut oil subsidy costs. It is also looking at increasing import taxes on luxury goods such as cars, private planes and yachts.
4. **India:** The country's new Central Bank Governor, Raghuram Rajan, is expected to introduce policies that would help curb persistent inflation. Aside from this, the government raised import taxes on gold from 10% to 15%. It is also looking at gradual fuel price increases to reduce subsidy costs.

It seems that our country is ahead in terms of structural reforms considering the fact that our neighbors are now doing what we did years ago. This explains why our economy has continued to perform strongly and why our stock market has proven to be resilient amidst global headwinds and local adversities.

### **A Blessing Amidst the Furor**

After implementing a good number of important structural reforms, our country is now focused on calling for another important change – stop corruption and introduce political reform. The pork barrel scam has exposed the kind of corruption that is happening in some of the highest offices in the land. It also exposed the flaws in legislative processes. Handled correctly, we believe that these investigations will lead to positive results. So far, it has led to widespread indignation and increased vigilance among the citizenry. There is also a consensus within the government that genuine change is needed. Pursuing these investigations and convicting guilty entities may go a long way in weeding-out or mitigating government corruption in the future. Moreover, it gives President Noynoy Aquino (PNoy) a chance to rise above the situation and solidify his legacy of eradicating corruption.

### **Back to 7,000**

As we pointed out in past articles, our stock market reached an important bottom of 5,678 on June 25 (5-6-7-8, July 1, 2013). This bottom was successfully retested when our market bounced off an intraday bottom of 5,562 on August 28. Consequently, a double bottom has formed for the PSE Index. In technical analysis, a double bottom is a powerful chart formation that signals a strong bullish reversal.

Aside from this, we have observed that our stock market did not drop despite all the negative news and events that may have precipitated a correction. We saw the market overcome global headwinds such as the US government shutdown and debt ceiling problems. Moreover, our stock market continued rising despite local adversities such as the MNLF insurgency, super typhoons, a strong earthquake and the pork barrel scandal. All these events failed to break our stock market's strong upward trajectory.

Through all these, we saw that our stock market simply refused to go down despite all the bad news. We are mindful of risks to this upward move, such as another avalanche of placements or a knee-jerk correction after a strong surge in stock prices. However, a market that does not go down because of bad news is poised to rise. It is clear that the path of least resistance for our stock market is up. With that said, we see the PSE Index moving towards 6,800 to 7,000.

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