

Philequity Corner (November 25, 2013)

By Valentino Sy

Yolanda - a Black Swan

Back in 82 AD, Roman satirist Juvenal used the phrase "*rara avis in terris nigroque simillima cygno*". He was comparing a rare bird to a black swan, neither of which were real. This phrase got absorbed by many European languages and the phrase "black swan" became a popular metaphor for something which could not possibly exist since swans are known to be white. It was not until the end of the 17th century that Europeans got their first glimpse of a black swan, which was discovered in Western Australia.

What is a black swan event?

In 2007, Nassim Taleb used this metaphor in his book *The Black Swan: The Impact of the Highly Improbable*. His theory is that most consequential events in history come from the unexpected. He defined a black swan event as a large impact, unpredictable and rare incident beyond the realm of normal expectations. In a previous article (see *Black Swans and Minsky Moments*, 29 September 2008), we wrote how Taleb's Black Swan theory applied to well-known financial debacles, such as the Wall Street Crash of 1929 (which eventually led to the Great Depression) and the 1997 Asian Financial Crisis. The most recent global black swan events would be the 2008 US Financial Crisis that nearly caused the entire banking system of the US to collapse, as well as the European Sovereign Debt Crisis that almost caused the breakup of the European Union.

Strongest Storm in History

Packing winds with speeds of up to 315 kph, Yolanda was the strongest storm in recorded history to ever make landfall. It killed at least 5,235 people as of this writing, making it one of the deadliest storms in Philippine history. More than 10 million people were affected by this typhoon, exceeding 10% of the Philippine population. The widespread devastation has so far caused at least PhP 12 billion in economic damage, with some foreign research firms expecting this to balloon to \$12-15 billion over time. 552,419 houses have been destroyed, with at least 560,000 more damaged. Entire towns were flattened by Yolanda, with some people comparing its impact with the Haiti earthquake and the tsunamis that hit Japan and Indonesia. Some meteorologists have said that the last time a storm this strong hit our country was more than a century ago. It is the rarity, power and resulting destruction brought about by Yolanda that made it a true black swan event.

Sentiment can change

Change in sentiment can alter the fortunes of individuals, corporations and even countries. The same can be said about the Philippines. Before this crisis, foreign funds were just looking at the positive side of our country – its honest President fighting graft, nice beaches and strong tourism potential, high GDP growth, stable Philippine peso, current account surplus, robust domestic consumption, growing remittances, blooming BPO sector, etc.

Vulnerability Exposed

Scenes of massive destruction flashing on international channels, like CNN and The Weather Channel

spooked foreigners who believed that Yolanda wreaked havoc on major parts of the country. Images like this exposed the vulnerability of our country. It showed that we are a typhoon prone country. Since we are sitting on the Pacific Ring of Fire, it means that we are also in an earthquake and volcano zone. With investors making a second assessment of the country, they started realizing the Philippines' weaknesses – widespread poverty, uneven economic growth, large unemployment/underemployment, high population growth rate, graft-ridden political system uncovered by the Napoles scandal, regulatory risk, anti-mining policies, slow roll-out of PPP, etc. Among other reasons, it is this change in sentiment which led to massive selling by foreign funds.

Dumping the darlings

This year, when QE tapering was announced, both Indonesia and India were exposed as countries that would suffer significantly from an increase in US interest rates. Once the darlings of the investment community, the equity markets of both countries fell by double-digit percentages in just a month's time as investors dumped their stocks. This goes to show that a change in sentiment from positive to negative can happen very swiftly, with disastrous consequences.

A string of disasters

Prior to Yolanda, there was already a string of disasters. These are the Bohol earthquake, Zamboanga Siege and several strong typhoons. With the ongoing pork barrel investigation as a backdrop, it was just too much for our market to bear. As we wrote in last week's article (see *Eye of the Storm*, 18 November 2013), these can be compared to the waves of a storm surge. A single one may not be able to affect our market, but if many of them occur one after the other, it is only a matter of time before our market corrects. Ultimately, Yolanda was the black swan that broke the camel's back.

Lightning rod for misfortunes

If sentiment for countries can change, what more for corporations? Unfortunately, this is what happened to EDC and FGEN, victims of a series of unfortunate events. The Bacman geothermal plant, once touted to be EDC's main growth catalyst, has broken down time and again for various reasons. Its Upper Mahiao plant in Leyte was also no stranger to natural disasters, being the victim of both a landslide and Yolanda. Even FGEN's San Lorenzo plant caught fire this year. This has caused EDC and its parent, FGEN, to trade at significant discounts to their peers. We cannot fathom how EDC seems to be a lightning rod for misfortunes. Maybe it is high time that the Lopezes hire a feng shui expert to reverse the streak of bad luck their companies are experiencing.

Black swan breaks support

Yearend forecasts of many funds were also thrown out the window because of Yolanda. Without Yolanda, the PSEi might have been at 6,500 to 6,800 now. Instead, we are just at the 6,000 level despite the US, Europe, Japan and China stock markets rallying. While they are hitting new highs, the PSEi instead broke several support levels. Since Yolanda struck, our stock market has lost about PhP 1.3 trillion of its market capitalization.

Turning the tide

In last week's article, we said that President Benigno Aquino, Jr. should see this disaster as an opportunity to show how effective the government is in responding to a crisis. We also said that this could well be his defining moment. With the whole world watching, it is crucial that the government does its best in ensuring that reconstruction, rehabilitation and recovery efforts proceed as quickly and smoothly as possible. If it succeeds, the current negative sentiment may well reverse and restore investor confidence in our country, otherwise, we may be demoted once again to a "poor man of Asia." This is President Aquino's chance to turn the tide of negative investor sentiment against his government and the country.

PPP Timely Liftoff

Last week, it was reported that the government has approved key revisions to the terms of major PPP projects. Among the changes are longer concession periods and the assumption of real property tax liabilities for the LRT and airport projects. As a result, the Mactan airport project bidding is pushing through on November 28. This may also lead to the successful auction of the LRT and MRT projects. We welcome this decision and believe that the government should demonstrate its willingness to share its profits with private investors. With a timely successful launching of PPP projects, investor confidence may rebound and lead to more investments in the Philippines.

The sun will come out tomorrow

Last week, our fund manager attended a recent event where Lea Salonga was the guest performer. She sang Tomorrow, the encore song of the Broadway play and movie Annie and dedicated it to the victims of Yolanda victims. The event's host and the guests gave substantial donations for the relief efforts in the Visayas. We are touched by the outpouring of support that we are witnessing, with everyone from the very rich nations to the common *tao* giving whatever they can to help the less fortunate.

It is imperative that the country recover from this unprecedented disaster. As has happened in the past, we will eventually recover, and so will the stock market. Thus, we believe it is apt to end this article with lyrics from the song Tomorrow:

*The sun'll come out tomorrow
Bet your bottom dollar that tomorrow there'll be sun
Just thinkin' about tomorrow
Clears away the cobwebs and the sorrow till' there's none*

*When I'm stuck with a day that's gray and lonely
I just stick out my chin and grin and say oh*

*The sun'll come out tomorrow
So you got to hang on till' tomorrow, come what may!*

*Tomorrow, tomorrow
I love you, tomorrow
You're always a day away!*

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