Philequity Corner by Valentino Sy
January 27, 2014

EM Currency Contagion

Last week, emerging market currencies suffered another vicious beating after the Banco Central de la Republica Argentina (BCRA) pulled out its support on the peso, triggering its single biggest day drop against the dollar since the country defaulted on its debt in 2002. The Argentine Peso devalued by 13.2 percent on Thursday spreading turmoil in neighbouring Brazil, Latin America and across the emerging world. By Friday, the Argentine peso, Turkish lira, Russian ruble and the South African rand were among the worst performers reaching multi-year lows.

Global risk sell-off spreads to other asset classes

Continued volatility and fears of contagion in emerging markets prompted investors to sell other risk assets in a broad sell-off last Friday which spooked even the developed world. The Dow Jones Industrial Average fell 318 points or nearly 2 percent, recording its worst week since May 2012. In Europe, the Stoxx 50 index lost 88 points or 2.85 percent, while Japan's Nikkei declined 304 points or nearly 2 percent last Friday alone.

Stampede to safety

While the jury is still out whether last week's sell-off was caused by the weak Chinese Purchasing Managers index (PMI) numbers or the devaluation of the Argentine peso, what is clear is that investors have stampeded to safety prior to the scheduled US Federal Open Market Committee (FOMC) meeting on January 28-29, 2014 when incoming Fed chairwoman Janet Yellen takes over.

US Treasuries headed for its biggest monthly advance since May 2012 as the benchmark 10-year yield fell to 2.72 percent. Meanwhile, the Japanese yen and the Swiss franc rallied 1.9 percent and 1.7 percent, respectively week-on-week, as the sell-off in riskier assets stoked demand for haven assets.

The demand for protection against a US equity sell-off soared as the CBOE VIX Index or the so-called "fear index" jumped 30 percent on Friday and nearly 44 percent for the week.

Incipient signs

Interestingly, the peso showed incipient signs of recovery last week when it fell by a just a muted 0.7 percent when other emerging market currencies where falling sharply (see table below). What is more surprising is that ASEAN currencies declined the least during last week's turmoil. In fact, even the political crisis and escalating social unrest in Thailand failed to bruise the baht which stayed nearly flat against the US dollar last week.

In addition, what we saw last Friday is that our stock market is also resilient. We were expecting it to drop sharply following the Argentine peso devaluation and the global stock market sell-off the prior day. But after falling 74 points or 1.2 percent in early trade, the Philippine market finished strongly and was even up 21 points or 0.3 percent by the close. Meanwhile, Thailand's stock market also finished the day 0.5 percent higher.

EM Currencies	24-Jan	Price 17-Jan	%Chg W-o-W	EM Currencies	24-Jan	Price 17-Jan	%Chg W-o-W
Argentine Peso	8.00	6.80	17.7%	Indian Rupee	62.69	61.55	1.8%
Turkish Lira	2.34	2.23	4.6%	Mexican Peso	13.46	13.25	1.6%
Russian Ruble	34.55	33.56	3.0%	Colombian Peso	1,994.00	1,964.59	1.5%
Brazilian Real	2.40	2.34	2.3%	Malaysian Ringgit	3.33	3.30	1.1%
Chilean Peso	550.60	539.46	2.1%	Indonesian Rupiah	12,181.00	12,091.00	0.7%
South African Rand	11.09	10.87	2.0%	**PHILIPPINE PESO**	**45.31**	**45.02**	**0.7%**
Korean Won	1,080.36	1,059.63	2.0%	Thai Baht	32.84	32.81	0.1%

Source: Bloomberg, Wealth Securities Research

China stock market also higher

Interestingly, China which was the cause of the drop in global stock markets after its disappointing PMI results also ended Friday with positive gains in the stock market. The Shanghai Shenzen CSI 300 index gained 0.6 percent the day after the manufacturing numbers were announced. The index ended higher by 3.1 percent for the week.

The resilient performance of China and Philippine stocks may indicate the start of a recovery and it is an encouraging signal. These are signs that we are already watching which may mean that China and the rest of Asia, including the Philippines, are being differentiated from other emerging countries, especially those in Latin America.

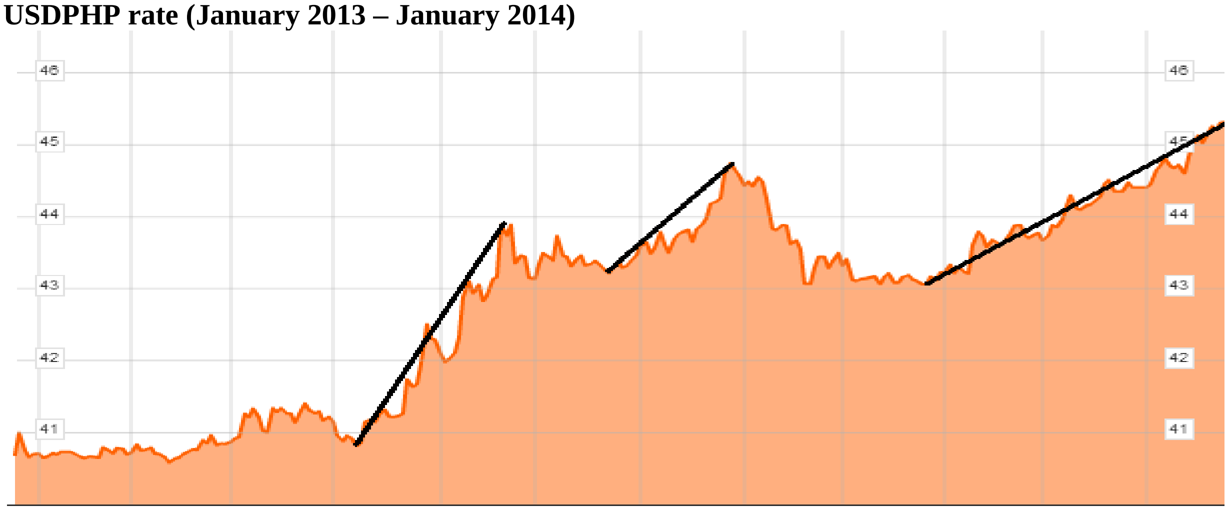
Watching the turn

In addition to the peso's muted drop last week, note that the slope of the peso's decline is becoming less steep since the May 2013 taper speech of Bernanke. Whether the peso and other ASEAN currencies' resilience will be fleeting or not remains to be seen.

In the case of the Philippines, whose fundamentals we believe are firmly intact, we think it is just the unwinding of overweight positions rather than the market placing a negative bet.

We will be closely watching for these subtle changes in character, that the Philippine peso will slowly be differentiated from the genuinely vulnerable currencies like the Argentine peso, Turkish Lira, South African rand and the Brazilian real.

USDPHP rate (January 2013 – January 2014)



Source: Bloomberg.com, Wealth Securities Research

Stronger support at 46 seen

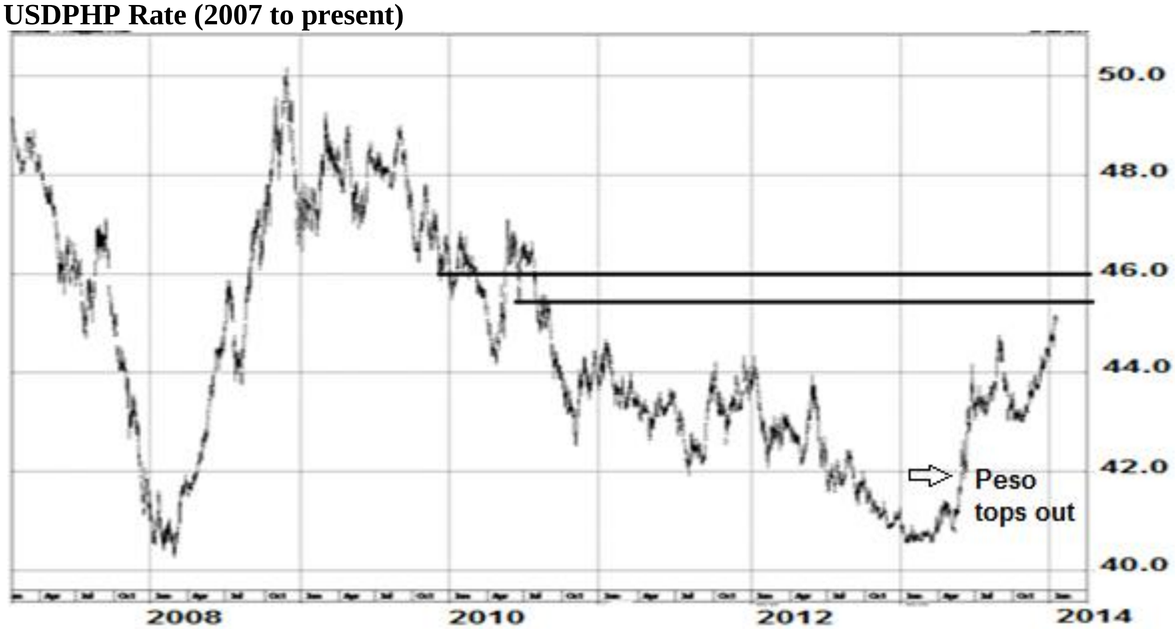
All along, we in Philequity, were saying that the peso topped out at 40.55 when major foreign investment banks were forecasting the peso to reach 37 to 38 last year (see *Win-win for the Peso,* April 8, 2013 and *Peso Tops Out*, May 27, 2013).

Today, foreign banks are now saying that the peso will reach 48. A look at the longer-term chart, however, shows that the peso is nearing strong support at the 45.50 to 46 level. If ASEAN markets continue to show resiliency and if China improves, then we may see a rebound in the peso.

At this point, however, we continue to believe that the country in general is better off with a slightly weaker peso than an overly strong peso. For us in Philequity, the peso at current levels is better than the peso back at 40.

We believe that the peso is now at a new trading range between 43 and 46 where we expect it to consolidate for some time. We also believe that the peso is now at the upper zone of new trading range.

USDPHP Rate (2007 to present)



Source: Technistock, Wealth Securities Research

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