Philequity Corner (July 21, 2014)
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Correction Triggers

Last July 7, the PSEi reached the 7,000 milestone – the first time since May 30, 2013. At its peak this year, our benchmark index was up 19% YTD, making it one of the best performing equity indices in the world. However, after reaching 7,000, the market corrected due to several totally unexpected events. These events that triggered corrections were a religious sectarian conflict, a Supreme Court decision, a typhoon named Glenda and a missile attack on a commercial aircraft. Below, we will go through the different events that triggered corrections or consolidations in the PSEi.

7,000, a technical resistance

From April to June, the PSEi had been consolidating within a 200-point range, bouncing between 6,600 and 6,800. It finally broke through this 2 weeks ago, hitting a high of 7,016.71. Many traders who use technical analysis recognize 7,000 as a resistance level which would prompt them to sell. Thus, many short term traders and even institutional funds who follow technicals took profits at this level.

To DAP or not to DAP? That is the constitutional question

However, the bigger correction was brought about by the high court's gavel that would hammer the index from 7,000 all the way back down to 6,800. The main reason behind the 200-point correction was actually the Supreme Court ruling on the country's Disbursement Allocation Program (DAP). Not only would this reduce much-needed government spending, but also lead to lower GDP growth as priority projects get delayed. As a result of this decision, President Aquino gave speech after speech filled with fiery rhetoric on why the Supreme Court is doing more harm than good in stopping the government from helping the people. This led to fears that a constitutional conflict may arise as the executive and judicial branches of government go head to head.

A ratings game

Complicating PNoy's troubles is the large drop in his trust rating, which fell from 70% to 56%. Although he still has the support of majority of Filipinos, this is a stark contrast to his overwhelming popularity during his 1st 4 years in office. If this trend continues, his ability to push for reforms during his last 2 years in office may begin to get affected. This drop in his trust rating, when combined with his conflict with the Supreme Court, has dampened investor sentiment, causing the market to pull back after hitting its high of the year.

Typhoon Glenda

Packing sustained winds of 150 kph and gusts of up to 180 kph, Typhoon Glenda was the strongest typhoon to hit Metro Manila since Milenyo in 2006. More than 1 million Filipinos were affected, with many parts of Luzon, especially Southern Luzon, still suffering from brownouts. Much like Milenyo, uprooted trees were a common sight in the storm's aftermath, with many cars lying crushed underneath them – a testament to Glenda's power. Thus, with Yolanda still fresh in people's minds, many investors decided to lighten up and postpone purchases just in case Glenda wreaks havoc in Metro Manila. Note that Yolanda caused our market to drop nearly a thousand points as the damage to our economy was being counted in the billions of dollars.

A religious sectarian war

If there is anything institutional funds hate, it is political and economic instability, and there is no better anathema for them than war. The religious conflict in the Middle East has continued to escalate, with Shia and Sunni Muslims declaring jihad on each other, at the expense of Iraqi citizens. ISIL even proclaimed that it had formed a caliphate encompassing large swaths of Iraq and Syria. With Iraq accounting for 3.5% of global oil supply, this conflict led to higher oil prices, which stoked both inflation and growth concerns, leading to a sell-off in emerging markets, especially oil-importing countries like the Philippines.

Cold war

Hostilities in the Russian region also took a turn for the worse this year after the annexation of Crimea by Russia. Pro-Russian rebels began an armed uprising in order to conquer more regions in Ukraine and add them to Russian territory. Western countries did not take this open hostility lightly. Subsequently, they unveiled a series of economic sanctions against Russia and its largest companies, including Rosneft, Novatek and Gazprombank. Russia is also one of the world's largest natural gas and oil producers, so these sanctions led to worries about a slowdown not only in Europe, but in the global economy as well. While a full blown conflict is remote, we are keeping a close eye on these military conflicts and their impact on various asset classes.

Missile blows up commercial jet

Even in an all-out war, both sides follow certain rules of engagement, first and foremost of which is not to hurt or involve peaceful civilians. Thus, despite the goal of pro-Russian rebels to gain control of larger swathes of Ukraine, their battle was largely contained to a small region, until recently. Last Thursday, a commercial jet operated by Malaysian Airlines that happened to be flying over the area was shut down by a surface-to-air missile. While it is unclear at this point which side fired the missile, the fact remains that all 298 unarmed civilians of various nationalities on flight MH 17 were killed. This added a whole new dimension to the conflict and caused a vicious sell-off in US and European stock indices. With so many countries involved, the conflict had now become a global one. Given that no clear resolution to this in sight, expect investors, especially those in Europe, to remain jittery.

Temporary setback

We have always said that corrections are very hard to predict. Who would have expected a commercial jet would be shot down over Ukraine, killing all 298 people onboard? This is why we prefer to have a longer term view on the market and stick to fundamentals. As long as one does their homework and invest in liquid stocks that have strong fundamentals and a good business model, these corrections will only have a temporary effect on their portfolio. That said, it is important to monitor these events in order to assess their impact on different companies and country. So far, the market has been surprisingly resilient despite all these unexpected events. In fact, the correction has remained orderly, with the index dropping a mere 0.7% last week.

8,000 intact

Notwithstanding these corrections, our objective for the PSEi is still the same – we expect it to reach 8,000 towards the end of 2015. These unexpected events which triggered corrections are merely a momentary pause on our path to new highs. We will explain the foundation of the bull market and expound on our basis for the 8,000 forecast in our Philequity shareholders meeting on August 16.

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