Philequity Corner (August 18, 2014)

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Lessons learned from 20 years of outperformance

Last Saturday, Aug. 16, 2014, Philequity held its annual stockholders' meeting and investor briefing. About 950 attended the briefing, almost filling all the seats at the Meralco Theater. The theme of this presentation was "20 Years of Outperformance."

It took us weeks to prepare this presentation as we wanted to share the investment lessons from our experiences during those times while also giving a flashback of the investment environment through the past 20 years. We also showed how Philequity navigated through the various bear and bull markets in our history and how it has generated outperformance. We even showed actual slides from our previous presentations to the Young Presidents' Organization (YPO), various local institutions and a special briefing that was held in Makati Shangrila to herald the start of the bull market in 2003. Note that these presentations were done in 1999-2003.

And since one of our main advocacies is investor education, we shared the important lessons that we learned from the painful losses during bear markets and the profitable trading strategies that we developed during bull markets. We also received a lot of questions from our audience and this made up for an engaging question and answer forum. Unfortunately, we were not able to answer all these questions due to lack of time. In this article and in future articles, we hope to answer many of these questions. Today, we share our answers to the most pertinent questions that were asked in last Saturday's investor briefing.

1) What will happen after 2016? Will the secular bull market end?

The impending change in government may indeed be a source of anxiety for some. Considering the good things that have happened in the current administration, some fear that all these may end come 2016. More specifically, there is a concern that our country might backslide in terms of reforms or economic performance, especially if it gets a corrupt or incompetent leader.

In one of our past articles, we talked about the credit rating upgrade that our country got from S&P (Beyond 2016, June 9, 2014). The rating agency upgraded our credit rating one notch above investment grade. While the upgrade itself was a momentous event, the reasons cited for the upgrade are particularly noteworthy. Below is an excerpt from S&P's statement where we highlighted the key words and important phrases.

"We raised the ratings because we now believe the ongoing reforms to address shortcomings in structural, administrative, institutional, and governance areas will endure beyond the current administration. In turn, we believe the resulting gains in government revenue generation, spending efficiency, and the improvements in public debt profile and investment environment will at least be preserved in the medium term under the next administration. This is based on our assessment that even though a change of administration after the presidential elections in 2016 represents some uncertainty for reforms, the risks have shifted toward maintaining the impetus and direction of the process, away from a potential reversal or abandonment of advances achieved to date."

2) Given all the things that are happening right now locally and globally, shouldn't the market go down?

Several risks and issues have emerged lately, both locally and globally. Locally, the issue on the Disbursement Acceleration Program (DAP) has been controversial and poses a risk to our country's political and economic situation. Aside from this, our country's economic numbers have been mixed, with 1Q14 GDP growth coming in below expectations as inflation is creeping up. There are also supply-side concerns, such as the elevated prices of basic commodities and the recent port congestion, that may affect our growth prospects.

Globally, geopolitical risks abound. The escalating sectarian conflict in Iraq may bring about higher oil prices. The Russia-Ukraine conflict is another concern. Note that the economic sanctions imposed on Russia have so far dragged economic growth in Europe.

But as we have mentioned many times in the past, corrections are very hard to predict. Near-term events are very much dependent on actions of specific people or certain events that we have no way of forecasting or anticipating. Nonetheless, corrections are part and parcel of a bull market. In our case, a correction may actually be healthy and warranted because of the swift run-up that our stock market has recently experienced.

Considering these, the market should have gone down on the weight of all these concerns. Yet, our stock market continued to move higher and breached 7,000. Many find this perplexing, but the stock market's refusal to go down despite all the local and global risks is a sign of its underlying strength. What is evident is that the bull market is intact and all these concerns have not derailed the bull market.

3) I read a report from Goldman Sachs saying that the market should go down. Should we sell?

Goldman Sachs is an influential investment bank whose calls are widely followed by global investors. Global stock markets corrected upon the release of Goldman's report. In that report, Goldman downgraded US equities to neutral over the next 3 months. Though the headline title may sound bearish, reading the contents of the report would show that Goldman's strategy call was actually bullish.

We highlight the key words from Goldman's report. In the report, Goldman said that "The longer-term case for equities is still strong: we expect sustained economic growth around current levels to drive earnings growth and performance." Moreover, the report stated that "equities are the best positioned asset class over 12 months, where we remain overweight." We agree with Goldman's call that though the near-term picture for equities may be murky, the long-term outlook is still positive.

4) The BSP just raised interest rates. Aren't rising interest rates bad for the stock market?

We wrote an article when the BSP raised the rates on the Special Deposit Account (SDA) facility (Bangko Sentral's Pre-Emptive Strike, June 23, 2014). In that article, we said that if the BSP abstained from doing anything at that point, our stock market would have gone down. Instead, our market moved up as it welcomed the BSP's pre-emptive moves against inflation. The BSP's policy moves this year have so far shown that it is a strong central bank which is capable of reining in inflation. Note that inflation has gradually crept higher because of geopolitical risks abroad and supply-side concerns locally. However, since our country's growth trajectory is clear, it means that our economy would be able to withstand rising interest rates. This is why the BSP's gradual and calibrated transition from monetary easing to tightening has been welcomed by investors.

5) August is the ghost month according to the Chinese calendar. Considering this, should we avoid stocks or sell now?

Based on our studies, the stock market tends to underperform during the months of July, August, September and October. On the other hand, the months of November, December and January are usually the stronger months in terms of stock market performance. Therefore, rather than selling now, one should actually prepare to invest during the ghost month and the succeeding months. We are now at the best months for investing in preparation for the stronger months in the latter part of the year.

6) What do I do with my investments in bonds? Should I sell them?

Investment decisions should always consider one's risk appetite and asset allocation strategy. Moreover, it is important to consider one's exposure level and the tenor of the bonds. In light of rising interest rates, it may not be the best time to allocate a lot of money in buying long-dated bonds. It may be better to buy bonds when interest rates are much higher and are commensurate to the credit risk that one is taking. If one still does not have equity exposure, one may sell a portion of his bond portfolio and shift this to equities, either via stocks or equity mutual funds. We believe that one should always have some form of equity exposure as we think equities will outperform bonds over the long-term.

7) In previous briefings, you showed us a picture of a panda bear and explained how it represents the looming threat in China. Should we still be worried about China?

China has been a concern for the past few years, as there have been legitimate fears of a hard-landing scenario for its economy. Aside from this, the country is plagued with high levels of provincial debt, a potential real estate bubble and stress in the financial system. Despite all these, China has not collapsed.

Recent economic data show that there has been some improvement. Based on this, it seems that the Chinese authoritarian government would be able to pull-off the delicate balancing act of stimulating the economy while containing possible bubbles and managing inflation. Because of these efforts, it appears that China is turning. The Chinese stock market is looking much better now in terms of fundamentals and technicals and is actually poised to move higher. If China turns for the better, it may lead the next leg of the global bull market. Moreover, if the Chinese stock market performs better, it will drive Asian stock markets such as ours higher.

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