

Philequity Corner (November 24, 2014)

By Valentino Sy

Agree to Disagree

China recently hosted the Asia-Pacific Economic Cooperation (APEC) summit in Beijing. APEC is an organization that aims to promote sustainable growth via economic cooperation among member countries. What was more important for us than the meeting itself is a sideline talk between Chinese President Xi Jinping and President Noynoy Aquino (PNoy). We believe that this is something that investors have not fully appreciated yet, though it may have important implications for our economy and our relationship with China.

Icebreaker

The warm conversation between Xi and PNoy broke an icy standoff that has persisted for years. China and the Philippines are locked in a territorial dispute over certain portions of the South China Sea. Many countries are drawn to the disputed territories as these contain huge oil and natural gas reserves. Moreover, these areas are important because they provide access to world trade routes.

Apart from China and the Philippines, there are many countries such as Vietnam, Malaysia, Brunei and Taiwan, which are also claiming ownership over certain portions of the South China Sea. China cites its historical ownership of the South China Sea while the Philippines cites the 200 nautical mile exclusive economic zone as its claim of ownership. For years, there has been heated rhetoric between Chinese and Philippine leaders. Two years ago, we wrote articles about the conflict when it grabbed local and international headlines (*Bananas, Pineapples and the Stock Market*, May 14, 2012; *Something Fishy*, May 21, 2012).

Meeting of minds

Considering what has happened in the past, we at Philequity are pleased about the sideline talk between Xi and PNoy. The mere fact that the two leaders talked is already a big development. It was reported that there was warmth and sincerity in the conversation, and that both countries will work on finding constructive and amicable solutions to settle the dispute. Lastly, both leaders agreed that the territorial dispute should not overturn the good relations that China and the Philippines have maintained for decades and even generations.

Multi-dimensional relationship

Our country's relationship with China is clearly a multi-dimensional one. And the territorial dispute over the South China Sea is just one aspect of the relationship. There are other areas that should be attended as well, such as those pertaining to trade, investments and tourism. Moreover, we have seen more Filipino businesses expand in China in recent years. Conversely, China's influence over our country has always been prevalent, as evidenced by the country's strong Filipino-Chinese community.

We therefore cannot underscore how important it is to maintain good relations with China, as it is one of our country's top trading partners, both in terms of imports and exports. Further, China is the biggest economy in Asia and the 2nd biggest in the world. Notwithstanding the concerns over its economy, China's influence on the rest of the world continues to grow.

From rivalry to partnership

Like China and the Philippines, the Sy and Ayala groups have been involved in a bitter dispute over the control of Ortigas & Company (OCLP). The Sy and Ayala groups were attracted to OCLP's rich landbank and were involved in a well-publicized battle for control. Gaining control of OCLP would significantly boost the landbank of both groups.

Recently, however, both groups agreed to settle, terminate all pending court cases and share the boardroom with each other. They have since agreed to jointly develop OCLP's landbank, which includes areas such as the Greenhills shopping complex, Capitol Commons and the Tiendesitas commercial hub. In fact, there is talk that the budding partnership may pave the way for other joint ventures between the Sy and Ayala groups in the future. In the end, both parties agreed to work around their differences in order to find a mutually beneficial solution.

Sy and Ayala partnership – a model to follow

The budding partnership of the Sy and Ayala groups is something that can also be emulated and applied to international disputes. Instead of relying on a court resolution, both groups agreed to settle the issue between themselves. A court resolution with an uncertain outcome would have dragged on for many years. But because of the recent settlement, the Sy and Ayala groups may now start reaping the benefits of their shared control of OCLP.

In our Philequity board meeting last Friday, we said that the Sy-Ayala partnership is a template that the Philippines can follow in resolving the territorial dispute with China. Instead of taking a belligerent stance against each other, the Philippines and China can explore sharing the access and resources associated with the disputed areas. Taking it a step further, Philippine and Chinese corporates, together with large multinationals, may forge partnerships to jointly harness the vast natural resources which are believed to be in the area. This will allow both countries to start benefiting from their shared control of the disputed areas.

Agree to disagree

1. As a starter, China and the Philippines should acknowledge that there is a disagreement on the ownership of certain portions of the South China Sea which will not be easily resolved.
2. Even if there is no near-term solution to the dispute, it should not deter them from cooperating in other important endeavors.
3. We also have to understand that national leaders cannot publicly concede their positions on issues of sovereignty because they would lose their mandate from the citizenry.

4. Hence, territorial disputes and issues of sovereignty would be best resolved through high-level diplomatic discussions and face-to-face meetings.
5. Differences therefore should be set aside and emphasis should be put on what the two nations can agree on.

Though investors may not have fully appreciated the sideline talk between Xi and PNoy, we believe that it may have positive implications, moving forward. This has not been highlighted yet by many, but it is actually one of the recent catalysts behind our continued bullishness on Philippine stocks and the economy. We believe that maintaining good relations with China will continue to be positive for trade, investments and tourism, especially in light of moves to bolster economic integration between Asian countries. In the stock market, we see the property, mining and gaming sectors as the main beneficiaries.

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