

Philequity Corner (September 21, 2015)

By Valentino Sy

The Ghost Vanishes

This year, we experienced another frightening ghost month. It was a time when the volatility that investors witnessed in stocks and currencies was particularly harrowing. Fortunately, the ghost month ended last September 12. Since then, we have seen favorable moves in stocks and currencies. We enumerate these below.

1. On September 14 (the first day after the ghost month), the PSE Index went up by 2.3% while the peso appreciated by 0.3%.
2. Since the ghost month ended, the PSE Index moved 3.2% higher for the week while the peso strengthened by 1.3% after experiencing multi-year lows.
3. The heavy wave of net foreign selling in our stock market has so far abated since the ghost month ended. After experiencing P19.0b of net foreign selling during the ghost month, we experienced P70m of net foreign buying (excluding the Lafarge block sale) last week.

Whether one believes in the ghost month or not, it is clear that market conditions improved since the ghost month ended.

Liftoff postponed

Following the end of ghost month, one of the most anticipated policy meetings of the Fed took place last week. Last Thursday, instead of hiking its benchmark rate for the first time since 2006, the Fed decided to keep the target range for the federal funds rate between 0 to 0.25%. The notable change in the Fed's recent statement is the addition of this sentence: *"Recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term."* Moreover, the Fed *"continues to see the risks to the outlook for economic activity and the labor market as nearly balanced but is monitoring developments abroad."* The Fed's statement reflects its awareness of the global slowdown and US dollar strength and how they affect the US economy.

Risks still abound

The Fed's decision to postpone the liftoff reflects caution on their part. It is an acknowledgement that the global weakness and China's economic slowdown continue to be risks to growth and have to be carefully monitored. Our market is not immune to these risks as seen in the precipitous drop of the PSE Index and the peso last month. However, our economy is better-positioned to maintain its growth trajectory amidst various global headwinds. We thus expect our stock market to remain in consolidation while rebuilding strength. The market may need some time to digest recent developments as it recovers from a terrifying ghost month.

Poe announces candidacy after ghost month

Last Wednesday, Sen. Grace Poe formally announced that she is running for president in 2016. According to an article from Rappler, Sen. Poe believes in Feng Shui and the ghost month. The article quoted Sen. Poe as saying that “Feng Shui is about the proper positioning of things to harness positive energy.” It should be no surprise that she consults Feng Shui experts regarding the timing of her major decisions. It thus appears that she waited for the ghost month to end before she formally announced her candidacy.

Poe backs lower income taxes

Sen. Poe mentioned a number of key issues that she would like to focus on if she wins as president. One of the things that she touched on is lower income taxes. This is a view shared by the Joint Foreign Chambers (JFC), who proposed the reduction of personal and corporate income taxes. However, the group also proposed to increase consumption taxes and excise taxes on fuel in order to prevent any significant deterioration in the country’s fiscal position.

Structural reforms crucial to the secular bull market

In chapter 5 of our book *Opportunity of a Lifetime*, we discussed several reforms that ushered our country’s structural transformation. On page 122 of the book, we enumerated reforms such as the VAT, deregulation, privatization and fiscal consolidation. We explained the transformative effects of these structural reforms and how they have caused our fiscal position to strengthen. These reforms became the crucial underpinnings of the secular bull market that we are experiencing now.

Lower income taxes but higher consumption taxes

While we are also in favor of decreasing personal and corporate income taxes, we believe that this should not result in a deteriorating fiscal position. We thus share the JFC’s view that these should be accompanied by an increase in the country’s consumption taxes, such as the VAT and excise taxes on fuel. Yet, we concede that raising VAT is a very unpopular topic during election times. We therefore understand that the issue of tax reform may be best tackled by our next president, whoever he or she may be. The imposition of higher VAT may also be done on a staggered basis (i.e. +0.5% per year) to mitigate any potential shock to Filipino consumers. The VAT hikes may also be initiated with reference to our country’s fiscal position (i.e. VAT increases to be done only if our fiscal position deteriorates).

Handled properly, we believe that tax reform can be an important catalyst for the next leg of our secular bull market.

Beware of populist policies

Populist policies may again be espoused by politicians now that the election season has started. We are specifically concerned about fiscally irresponsible politicians who advocate lower income taxes without any plans for compensating revenue measures. As we have seen in the cases of Brazil and Greece,

populist policies may sometimes win votes but they also wreak damage on the economy and dampen investor sentiment (*Promises, Promises*, September 7, 2015). We thus advise our readers to be more discerning in understanding proposed populist policies and their impact to our country.

September to Remember

Volatility has somewhat subsided since the ghost month ended. Barring any black swans or unexpected negative events, we may have seen the low of our stock market this year. Also, as we discussed in Chapter 10 of our book, statistics tell us that our stock market is usually weak during the months of August and September but performs strongly in December and January. However, the specter of a turbulent market may still be lurking in the background, as various headwinds and risks continue to persist. Nevertheless, as we said in our article last week (*The Philippines, Best House in a Sliding Neighborhood*, September 14, 2015), we expect the PSE Index and the peso to be one of the first to recover when things start to stabilize. We witnessed this with the strong bounce of the PSE Index and the peso last week.

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