

Philequity Corner (December 7, 2015)

By Valentino Sy

Dear Santa

2015 has been a difficult year for stocks. Various headwinds have haunted investors throughout the year. The global economy is in the midst of a slowdown which has severely affected the growth prospects of many Asian and EM countries. Consequently, this year has been marked by US dollar strength, pronounced EM currency weakness and sharp declines in EM stocks. The ghost month this year was particularly frightening and it has been a topsy-turvy ride for the stock market since then.

Wish list for the globe

While our country is in better shape compared to most of our neighbors, we cannot keep on swimming against the strong tide of slowing global growth. Below are some of the positive scenarios for the global economy that we hope Santa will bring.

- 1) Gradual rate hike cycle.** Considering the Fed's recent pronouncements and the movement of various asset classes around the globe, the liftoff on December 16 seems imminent. After the liftoff is done, the discussion will focus on the pace of the rate hikes. The Fed has maintained that rate decisions will be data dependent and will be aligned with current economic conditions. Nonetheless, we wish that the Fed's rate hike cycle would be carefully calibrated so as not to upset economic growth and market sentiment.
- 2) A more stable dollar.** This year, the dollar has strengthened significantly against most major and EM currencies. Many, including the Fed, are aware of the risks that a very strong dollar poses not only to US growth but to the global economy as well. We thus hope that the US dollar will follow a more stable path and not strengthen too much.
- 3) Firmer global growth.** The global economy has been dealing with many difficult challenges lately. These include the slowdown in China, divergent monetary policies around the globe, a persistently strong US dollar, as well as commodity price and EM currency weakness. Amidst a backdrop of slowing growth and deflationary pressures, we wish that the global economy would be able to find stronger footing. We take comfort in the fact that global central banks have done their part in preventing their respective economies from backsliding. Still, we continue to look for catalysts that would put global growth in a more stable and predictable trajectory.
- 4) A more stable China.** China is one of the major engines of global growth. As such, the current economic slowdown in China has affected its trading partners and is one of the main reasons for the global slowdown. Moreover, the extreme volatility of China's stock market has contributed to the choppy movement of global equities this year. An orderly moderation of the Chinese economy and a more stable Chinese stock market should bode well for Asian countries like the Philippines.
- 5) Stronger growth from Europe and Japan.** Europe and Japan have also experienced various economic challenges in recent years. The European Central Bank (ECB) and Bank of Japan (BOJ) are in the middle of their respective quantitative easing (QE) programs. If these prove to be successful, more stable growth from Europe and Japan, coupled with a stronger US economy, should lead to stronger global growth and a possible rebound in EM economies.

- 6) **Peace around the globe.** Recently, we saw a rise in peace threats around the globe. These include the recent terror attacks in various parts of the world. Though Christmas is not celebrated by everyone, we hope that tensions would start to die down as we head into the holiday season.

High stakes for the Philippines in 2016

Though not totally immune, our country has been quite resilient to various local and global headwinds. Since 2010, our economy has delivered above-trend growth and our country has started to show its true potential. As our country is in the midst of an economic liftoff, we hope that Santa will continue to shower us with blessings that will make our growth story stronger and more sustainable.

Wish list for the Philippines

- 1) **A president that will not only continue but also improve the country's growth trajectory.** The election scenarios are still muddled and messy since the filing of candidacies has just ended. We look forward to a clearer picture starting next year as the roster of candidates is finalized. Ultimately, we wish that a competent, honest, decisive, dedicated, dynamic, reform-minded and results-oriented leader would be elected next year. We also hope that our next president would get a clear mandate and would be able to inspire the country and galvanize support for the incoming administration's reform agenda. We wish that the next president would be able to implement initiatives that will not only continue but also improve our country's growth story and further strengthen the secular bull market in Philippine stocks, bonds and the peso.
- 2) **Faster infrastructure spending.** With the economy growing above trend in the past five years, a massive infrastructure upgrade has become extremely important. It is not only roads and bridges that have to be built, but also rails, airports and seaports. In order for our country to reach the next level of economic growth, it is imperative that the infrastructure backlog be addressed.
- 3) **Fine-tuning of the PPP program.** The PPP program's goal is to augment government resources by tapping on private sector capital and expertise to deliver the infrastructure requirements of a growing economy. To date, the program has rolled-out many important projects. However, the program has encountered many issues such as those pertaining to its bidding process, the pre-qualification of participant bidders, delays in project roll-outs and other regulatory issues. Despite all these, we still believe in the PPP program's potential in aiding our country's growth. However, there are issues that have to be addressed and the framework would have to be strengthened in order to make the program more effective.
- 4) **Comprehensive tax reform.** There has been a lot of debate about the different issues pertaining to tax reform. One thing is clear – our taxation system needs to be updated to better cater to current times. There is talk of indexing the tax brackets to inflation to prevent 'bracket creep.' Another area of discussion is the lowering of personal income taxes to align ourselves with our Asean neighbors. While these initiatives can make our taxation system more equitable, we believe that the tax reform package should be revenue neutral and should not lead result in fiscal deterioration. Hence, any reduction in income taxes should be matched with compensating revenue measures, such as increases in various excise and consumption taxes.

- 5) **Limited El Nino impact.** We wish the impact of El Nino to the country's agricultural sector would be limited. Though the government has come up with efforts to mitigate the damage from El Nino, losses to the sector are still expected exceed P3b.
- 6) **Sustained OFW remittances and continued growth of BPO sector.** The OFW and BPO sectors are the lynchpins of our economy. For many years now, these two sectors have driven robust domestic consumption, a key ingredient in our country's strong and resilient growth. We wish that OFW remittances would continue to be stable in the face of various global headwinds and risks. We also hope that the explosive growth of the BPO sector would be sustained so that it can continue to generate well-paying jobs for our countrymen.
- 7) **Development of other sectors.** Even as we welcome the strong economic contributions of the OFW and BPO sectors, we hope that the government would make more determined steps to diversify our economy. We look forward to the development of other important sectors, such as tourism, manufacturing and agriculture.
- 8) **A stable peso.** Though the peso has depreciated by 5% year-to-date, it is still one of the best performing currencies globally. Other major and EM currencies have sharply depreciated against the US dollar this year. In fact, the peso has appreciated vs. the euro and many other EM currencies. Even though our country's fundamentals are intact, the peso cannot appreciate when all other Asian and EM currencies are depreciating against a strong dollar. Moving forward, we hope that the peso would continue to be stable and not move sharply in either direction.
- 9) **Gradual rate hike cycle.** We wish that local interest rates will move in a gradual way and remain supportive of the country's economic growth. The BSP has done an excellent job of coming up with the appropriate policy decisions that have insulated domestic demand from global weakness.
- 10) **Stock market to resume upward move.** While this year was marked by extreme volatility, we wish that the stock market would resume its upward trajectory next year. Despite all the headwinds, we are still looking at 10-12% earnings growth for 2016. A more stable global economy and the election of a competent and reform-minded leader are also potential catalysts for the stock market in 2016.

Santa Claus is coming to town

It is Christmas season once again and Santa Claus usually arrives at this time of the year. As we show in page 195 of the book "Opportunity of a Lifetime", statistics show that Santa usually comes to town in December and January. Though it has been a difficult year, it is evident that our strong fundamentals have remained intact despite everything that is happening globally. For this reason, Goldman Sachs upgraded the Philippine stock market to overweight last week with a target of 7,900 for end-2016.

After going through two decades of structural reforms, the basic ingredients for an economic liftoff are in place. This is why our stock market is up 311% since we have identified the bottom of the 2008-2009 bear market (see Chapter 2 of the book "Opportunity of a Lifetime"). Despite the challenges this year, the PSE Index has managed to deliver an average return of ~18% for the past seven years. We also continue to benefit from low oil prices and a benign inflation outlook. We thus hope that our country's next leaders would be able to build on the foundation that has been laid by past and present administrations in order to further solidify our country's structural growth story.

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