Philequity Corner (September 5, 2016)
By Wilson Sy

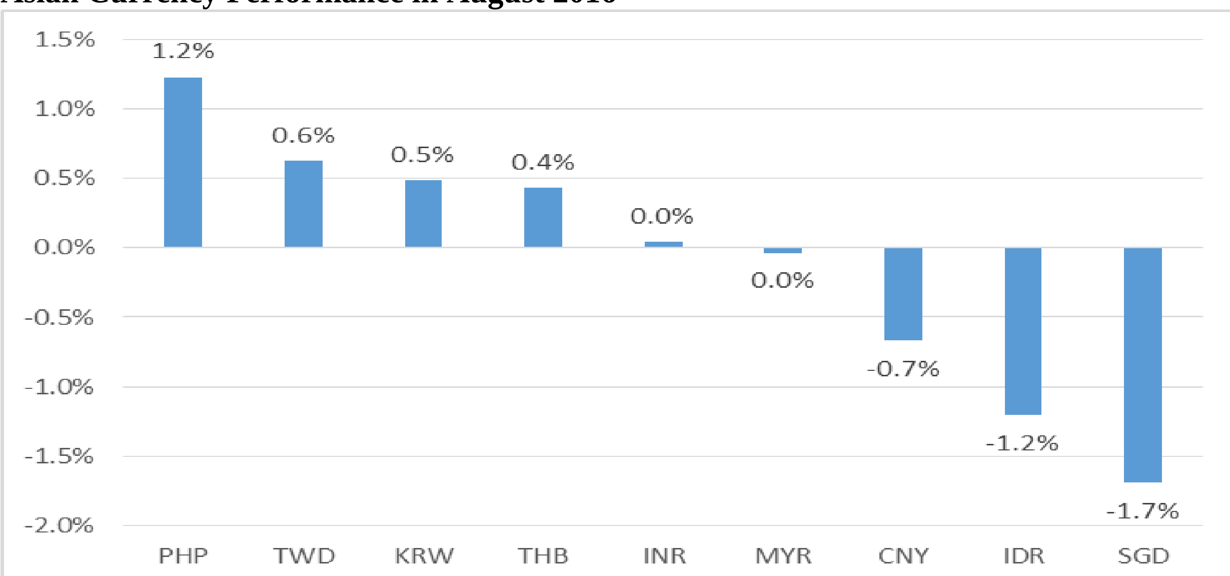
Is the strong US dollar back?

Last month, we wrote about how EM currencies have rebounded sharply after the brutal sell-off at the start of the year. With more $10 trillion of global sovereign debt now yielding negative returns, we mentioned that investors have turned to emerging markets in search for yield, driving EM currencies and the Philippine peso higher (see *Search for yield drives EM currencies higher*, August 15, 2016).

Philippine peso strongest in Asia

The Philippine peso, in fact, posted the best performance among Asian currencies last August. The peso strengthened by 1.2 percent to 46.57 against the US dollar on the back of rising remittances and record foreign exchange reserves which reached $85 billion as of July 2016

Asian Currency Performance in August 2016



Source: Bloomberg, Wealth Securities Research

Stronger case for hiking rates

However, in the wake of Fed Chair Janet Yellen's keynote speech in Jackson Hole, Wyoming, there now appears to be a stronger case for rate hike resumption (see *Is the waiting game over?*, August 29. 2016).

The question in most investors mind right now are: Will there be a rate hike in September or possibly one in December? Will the US dollar resume its strength? What happens then to commodities, EM currencies and EM stocks? What happens to the peso and Philippine stocks?

Hawkish statements

Yellen included one passage in her speech that suggested that indeed "the waiting game is over". It read *"In light of the continued solid performance of the labor market and our outlook of* *economic activity and inflation, I believe the case for an increase in the federal funds rate has strengthened in recent months.*

In addition, tightening hints by other Fed members confirmed Yellen's comments. Vice Chairman Stanley Fischer said in an interview following Yellen's speech that the US economy *"was reasonably close to what is thought of as full employment"* and that inflation was moving in the right direction.

Meanwhile, Cleveland Fed President Loretta Messler told reporters last week: *"If you have a forecast and inflation is moving up to your target and you're at full employment, then it seems like a gradual increase from a very low interest rate that we are at now is pretty compelling to me."*

To hike or not to hike?

So that settles the debate, right? Well, not exactly. The odds of a Fed hike took a turn last Friday after the jobs report missed expectations. Non-farm payrolls came in at 151,000 last month vs. expectations of 180,000.

The odds tracked by the CME Group dropped in all months after the jobs report. The likelihood of a September hike dropped to 21 percent from 27 percent just prior to announcement. The probability of a November hike dropped from 31.6 percent to 29.2 percent. Meanwhile, the odds of a December hike dropped from 57.6 percent to 56.1 percent.

Still wait and see

So far the markets are still in a wait and see attitude. Post-Brexit, the US dollar index is still trading in a range.

Source: Stockcharts.com, Wealth Securities Research

Meanwhile, The US stock market has been very quiet. The S&P 500 index which is hovering at near all-time highs has not moved more than 1% for 40 straight days.

Source: Stockcharts.com, Wealth Securities Research

All eyes on the Fed

Investors will be closely watching the Fed meetings. While investors are awaiting for a rate hike, what is more important is to see how the market reacts if the Fed indeed raises rates during their next meetings.

Watch how the market responds

As news comes out, we want to watch and see how the market responds. We want to see what will happen to the US dollar, to other currencies, commodities and EM stocks in subsequent days and weeks. We want to know if the market has already priced the Fed hikes in.

Will the Davao blast affect the peso?

So far, the peso has remained stable despite the lingering concerns over the next Fed hike. But many are now concerned over the effects of the recent Davao blast on the peso. What we have seen in the past, however, is that terrorist acts can temporarily affect financial markets in the short-term but eventually fundamentals always take hold.

Longer-term, we believe that the Philippines' strong fundamentals will keep the Philippine peso goldilocks-bound (not too hot and not too strong) which is what the BSP, the Philippine economy and the Philippine stock market prefer.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 689-8080 or email ask@philequity.net.