Philequity Corner (September 19, 2016)
By Wilson Sy

More than words

This week, all eyes will be on the US Federal Reserve's monetary policy meeting. Talk on the impending rate hike this year has been rife, with markets gyrating on every little piece of economic data that is released. With traders firing away at the slightest rustle in the bushes, every word uttered by Fed governors was dissected and have driven markets.

Fear

As we have written before, if you want to know where stocks and currencies are going next, you have to watch the Fed (see *I'll be Watching You*, 13 June 2016). However, even the Fed itself is not entirely sure how to maintain US economic growth without risking its upward path. A rate hike may also exacerbate the growth slowdown in other parts of the world. To put it in perspective, it took more than 7 years of record low interest rates and more than $2 trillion worth of quantitative easing to get the US economy back on its feet. Thus, there are fears that the rate hike may undo all the gains that the Fed has worked hard for in the past years.

Words cause volatility

Words being said by Fed officials and many prominent personalities in the financial industry have caused much volatility in the bond and equity markets. Since Yellen's speech at Jackson Hole where she said that "the case for a rate hike has strengthened in recent months" (see *Is the waiting game over?*, 29 August 2016), markets started to realize that a rate hike may be imminent, leading to sharp gyrations.

Dove to hawk

Fed governors would eventually weigh in on this matter. Shortly after Yellen's speech, Fed Vice Chairman Stanley Fischer said that we are reasonably close to full employment and inflation targets, adding that Yellen's speech is consistent with raising rates within the year. Last September 9, Friday, Boston Fed President Eric Rosengren gave a speech to the South Shore Chamber of Commerce in Massachusetts. Known to be dovish, many were expecting him to say that rates should be kept on hold. Instead, he struck a very hawkish tone and said that it has become increasingly risky to delay the US rate hike. He added that "there are also longer term risks from significantly overshooting the US economy" and that "gradual tightening is likely to be appropriate."

Silence

European Central Bank President Mario Draghi also made headlines when he offered no guidance on the ECB's bond-buying scheme. With no words mentioned about it, markets took it to mean that it would expire on March 2017 and that Europe is likely in the terminal phase of quantitative easing. With more than $10 trillion worth of bonds having negative yields, this asset class was ripe for a sell-off. Draghi's silence did just that as it sparked a global wave of bond selling.

Dow drops 400 points

As a result of Draghi's silence and Rosengren's hawkish tone, the Dow Jones dropped 400 points on September 9. At one point on that day, Fed fund futures priced in a 30% chance of rate hike in September as dovish market participants recalibrated their expectations.

Dow rise 240 points

Traders expecting that the Fed will stand pat this month were not about to throw in the towel. With just 1 day left before the blackout period for Fed officials, Fed Governor Lael Brainard gave a speech at the Chicago Council on Global Affairs. She took an opposite view from Rosengren, saying that interest rates should not rise in September and that markets should get used to the idea that interest rates will stay low for a long time. These dovish words were music to traders' ears. Brainard's words electrified US equities, sending the Dow Jones up 240 points by the end of the day.

Delivering alpha

With Brainard as the last Fed official to speak before their policy meeting, markets were left with a dovish tune. But Fed officials are not the only ones markets listen to when it comes to policy decisions. Traders also pay a lot of attention to CEOs of financial institutions and top asset managers. Last week, CNBC organized the so-called Delivering Alpha conference where it invites the who's who of the investing community.

Figures of speech

Even among the speakers in the conference, there was no consensus on the direction of interest rates. They even used different figures of speech to describe the situation. One of the speakers was Ray Dalio, fund manager of Bridgewater Associates, one of the largest hedge funds in the world. He sees a dangerous situation in debt and says that the Fed should stay on hold because the US economy is too fragile for rate hikes. On the other hand, JP Morgan CEO Jamie Dimon said "Let's just raise rates!" He noted that the 0.25% rate hike is just "a drop in the bucket". Billionaire investor Carl Icahn threw in his own opinion, describing investing in the market now as walking on a ledge – "you might make it to the end, but you fall off that ledge and you're really going to see trouble." On the US rate hike, he said "I don't think it matters, because either way there's a problem."

Negative headlines

Clearly, spoken words can cause volatility. It can also lead to gyrations in the various asset classes. The same is true when it comes to the Philippines. Negative global headline news on President Rodrigo Duterte's anti-U.N. statements, anti-US rhetoric and cuss words have led to high volatility in the domestic financial markets. His words were picked up by many foreign news channels, such as Bloomberg, CNBC and CNN. Prominent international broadsheets carried adverse front page headlines about his statements. The Economist also featured a very unfavorable article about President Duterte, the Wall Street Journal had him on the front page while Time Magazine had President Duterte's war on drugs as its cover story. With so many negative headlines, especially from global news agencies, investor sentiment got dampened. Coupled with uncertainty about the imminent US interest rate hike, the Philippine market has fallen 7.1% from its high. The Philippine peso was the worst performer in Asia, plunging 4% from its post-election high of 46 against the dollar.

Words matter

Words can sway reactions like a pendulum. Words can cause stock markets to go up and down, both internationally and locally. We have written about how spoken words move markets many times before (see *De Do Do Do, De Da Da Da*, 28 March 2016, *Every Move You Make*, 9 November 2015, *The Power of Words*, 29, June 2015).

Beyond words

Investors with a long term view go beyond words. While words do matter, long term investors put more importance on a country's economic and corporate fundamentals over current negative news flow. The government has just begun implementing its economic program as it bids out PhP 179 billion worth of PPP projects, which could usher in the golden age of infrastructure. Decisive action on the part of government and numerous catalysts such as the tax reform package and the REIT policies should improve investor sentiment. Taken together, the government is hoping to bring GDP growth to 7-8%. The government is also planning to spread the growth throughout the country, making it more inclusive.

While recent issues are quite concerning, many fund managers, strategists, economists, analysts and investors with a long term view go beyond current issues & crass words. Instead, they focus on a country's long term macroeconomics and each corporation's fundamentals.

To end this article, we will leave you with a portion of the song "More Than Words" by Extreme and also popularized by Westlife:

More Than Words

Saying I love you
Is not the words I want to hear from you
It's not that I want you
Not to say, but if you only knew
How easy it would be to show me how you feel
More than words is all you have to do to make it real
Then you wouldn't have to say that you love me
'Cause I'd already know