



Philequity Corner (November 14, 2016)
By Wilson Sy

Year of the Underdogs

2016 has been the year of the underdogs. It is a year when the unexpected occurred a bit too often. In sports, we have seen many underdogs stage massive upsets. The Chicago Cubs came back from the jaws of defeat to win their first World Series in 108 years. Likewise, the Cleveland Cavaliers overcame a 1-3 deficit to beat the Golden State Warriors and win the NBA Finals. More recently, the Los Angeles Lakers beat the powerhouse Warriors in the regular season. In the UAAP, the Ateneo Blue Eagles, which were given game odds of +20 points, won against the previously unbeaten DLSU Green Archers.

Similarly, the UK shocked the world as it voted for the country's departure from the European Union. Moreover, our country's current president – Rodrigo Duterte – was a virtual unknown and a reluctant candidate before he benefitted from a groundswell of popular and political support. Last week, a bigger upset came when Donald Trump won the US presidency.

Trumping the odds

Upon its first announcement, Trump's candidacy was written-off as a joke by many people. There are many reasons for this. He was a political outsider with zero experience in politics or government. His combative demeanor, along with his penchant for making outlandish remarks, have led many to conclude that he is not fit for public office, more so the US presidency. Moreover, throughout the campaign, various economists tagged his weak grasp of economics.

Yet, Trump went on to beat eleven Republican candidates in the primaries, with many of them being established names in US politics. More importantly, he astounded the whole world when he defeated Hillary Clinton, who has extensive government experience as a former senator and state secretary.

Pollsters are all wrong, again

Unlike in sports, where the ball is round, elections have pre-election polls to rely on. These should have made election results more predictable. However, as we saw in the US election last week, pollsters and oddsmakers who placed Clinton as an overwhelming favorite ended up being all wrong. The astonishing outcome of the US election eerily evokes memories of the UK's Brexit vote.

Shy Trump voters

One explanation for why all the pollsters were wrong in the last election is the existence of 'shy' Trump voters. These are Trump supporters who refused to participate in pre-election surveys, thereby skewing the poll sampling towards likely Clinton supporters.

US should have learned from the Philippines

In the lead-up to the recent Philippine election, we observed a wave of anger, frustration and anti-establishment sentiment among Filipinos. Being an outsider to mainstream politics, Duterte's fiery rhetoric, unabashed contempt for the political establishment and his platform for change resonated with Filipinos across different income classes. This resulted in the groundswell that drove Duterte's rise to the presidency (*Groundswell*, April 18, 2016). With the shocking result of the US election, it appears

that US politicians, strategists and sociologists have failed to learn from the Duterte groundswell and Brexit. Americans have underestimated how an angry citizenry can propel a political outsider and a massive underdog to win the US presidency.

Orange swan

In our article last week (*US election jitters sink global stocks*, November 7, 2016), we said that the market was scared of a Trump victory. True enough, the market reacted violently on news that Trump won. Dow futures fell more than 800 points while the Mexican peso fell by as much as 13% en route to an all-time low. The Nikkei dropped by more than 5% while gold surged by 5%. This was a knee-jerk reaction from the market, which priced-in a black swan event and the worst case scenario. It seemed as though the world had turned upside-down. An orange swan has emerged.

Miraculous reversal in US stocks

Notwithstanding the shocking drop of US futures, US stocks made a stunning reversal when trading started. Sellers were whipsawed as the Dow completed an epic 1,000-point swing. The Dow ended up 257 points higher on Wednesday. Last Friday, the Dow closed at a new all-time high of 18,848. Amidst worst case expectations from a Trump win, traders and investors sifted through his agenda as president and identified potential winners. This caused banking, pharma and infra stocks to go up. Moreover, long-term Treasury yields moved higher on rising inflation expectations and plans to increase government debt to support Trump's fiscal stimulus program.

EM stocks and currencies plunge

While US stocks moved higher after Trump's victory, EM stocks and currencies moved sharply down. The prospective implementation of protectionist policies and potentially faster increases in US interest rates are seen as negative catalysts for EM stocks and currencies. In the table below, we show the drop in EM exchange traded funds (ETFs), stock indices and currencies in the three days after Trump's win. The table also shows the performance of EPHE, the PSEi and the Philippine peso.

3-day drop after Trump's win

	ETF	Return	Index	Return	Currency	Return
Mexico	EWX	-17.9%	MEXBOL	-7.2%	MXN	-13.8%
Brazil	EWZ	-13.4%	IBOV	-7.8%	BRL	-7.4%
Indonesia	EIDO	-12.4%	JCI	-4.4%	IDR	-2.3%
Malaysia	EWM	-11.2%	FBMKLCI	-1.8%	MYR	-3.3%
Philippines	EPHE	-9.1%	PSEI	-4.6%	PHP	-0.7%
South Korea	EWY	-6.2%	KOSPI	-0.9%	KRW	-2.6%
Thailand	THD	-4.9%	SET	-1.0%	THB	-1.3%
India	INDY	-4.2%	SENSEX	-2.8%	INR	-0.9%

Source: Bloomberg

From the table above, the sharp drops in the Mexican Peso and Brazilian Real stand out. Meanwhile, the big currency declines in Malaysia and Indonesia have prompted their central banks to intervene.

Duterte and Trump – a similar agenda

In last week's article, we said that Duterte and Trump share many parallels and common traits. On top of these, both leaders intend to pursue similar economic agenda. In a nutshell, both plan to build more roads and cut taxes. Duterte vowed to usher in a golden age of infrastructure and build badly-needed roads, rails, airports and sea ports. The goal is to decongest Metro Manila and stimulate economic activity in provincial areas. Moreover, Duterte plans to implement a comprehensive tax reform package which will involve cutting corporate and personal income taxes. For his part, Trump said that his government will rebuild highways, bridges, tunnels, schools and hospitals. Similarly, Trump intends to implement cuts in various taxes. Both Duterte and Trump will rely on fiscal stimulus, infrastructure spending and tax reform to supplement monetary policy and promote economic growth.

Birds of the same feather can work together

President Duterte congratulated US President-elect Trump right after his win. He also stated that he will not pick a fight with Trump. Duterte said, "He is now president of the most powerful country in the world. What we share in common is the passion to serve." Aside from this, Duterte said that he and Trump are similar, as both of them like to curse. In social media, there are memes going around about Duterte and Trump becoming BFFs. Considering everything that they have in common, they might get along after all. We thus hope that the Duterte government can work harmoniously with the Trump government. This will be critical in mitigating the potential negative impact of prospective US policies to the Philippine economy.

Signs of the times

If there is anything to learn from the year of the underdogs, it is that we should never discount the unexpected and never underestimate the underdogs. The reaction of financial markets to Trump's win has been extremely wild thus far, as investors scramble to price-in a wildly unexpected outcome. With everything that has happened so far this year, we believe that investing has just become a lot more challenging but also more interesting.

Time and again, we have said that the direction of the stock market and other asset classes can be affected by politics. It is therefore crucial to listen to the signs of the times. For years, we have advocated Fed watching and following central bank action. With the occurrence of Brexit, the Duterte groundswell and Trump's underdog victory, it is now incumbent upon investors to also follow and grasp developments in the realm of politics and sociology. It is likewise important to comprehend the politics of anger and the recent anti-establishment wave in different countries. An informed understanding of the changing times should serve as an essential guide for one's investment decisions.

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