Philequity Corner (January 9, 2017)
By Wilson Sy

Santa Arrives Late

In 2016's final Philequity Corner article, we asked – where is Santa? Was he stuck in traffic? Did he remove us from his list? Did he forsake the Philippine stock market? With the index down 19% from the high right before Christmas, it looked like this would be the year that Santa skipped the Philippines. Fortunately for investors, it looks like Santa Claus was simply late.

Back to the 7200 level

Even though Santa missed the Philippines during *noche buena*, he made up for it by giving us a festive *media noche*. Starting from December 27, the first trading day after Christmas, up to last Friday, the PSEi has risen by 10.4%. This nearly 700-point rise brought the stock market to 7,248.20. For the year 2017, the index has gained 5.96% YTD. Instead of a "Merry Christmas", Old Saint Nick gave us a "Happy New Year" instead!

Statistics hold true

On page 195 of our book, Opportunity of a Lifetime, one can see the average monthly returns of the PSEi since 1987. One will see that, among all the months, December has the highest probability of ending in the green. Since our data started in 1987, December has a 70% chance of being positive with an average return of 3.8%. Thus, with the PSEi in the red for most of December 2016, it looked like statistics were not on our side. But lo and behold, the last 3 trading days of the year saw a gain of 4.2%, enough to bring the December return to 0.9%. Once again, even though Santa Claus was late, statistics held true.

January effect

Just like December, January tends to be a good month for stocks as well. In the past 29 years, January has seen a positive return 18 times, or a 62% probability. The average return during this timeframe was 2.6%. Fortunately, the 1st trading week of the year shows that statistics may once again hold true. In fact, the PSEi's 6% jump has far exceeded everyone's expectations. Thus, unless the index experiences a major correction in the next 17 trading days, the January effect will likely will be validated.

Almost 20,000

January 2017 is a banner month for the US. The Dow Jones index reached 19,999.63 - a paltry 0.37 points away from reaching the 20,000 milestone. The S&P 500 gained 1.7% YTD, while the Nasdaq Composite, which includes technology stocks like Apple, Facebook and Google, broke the 5,500 level and is up 2.6% for the year.

Trump effect

One of the most important reasons behind the strength of the US stock market is the victory of Donald Trump. Previously touted as an "orange *swan*" event, equities instead made new all-time highs in the weeks after his victory. In a previous article, we enumerated 14 reasons for the strength US stocks after Trump's victory (see *The Trump Card*, 12 December 2016 and *Year of the Underdogs*, 14 November 2016). Foremost of these are Trump's pro-growth policies. If Trumponomics is successfully implemented by the US which is the leader of the global economy, then these may be followed by Europe and Japan. Economic growth in Europe and Japan may subsequently lift emerging markets (EM).

Global bull market

As the 3 main equity indices in the US are making new all-time highs, other countries have followed suit. In Europe, the FTSE 100 made a new all-time high, while other countries, such as Germany, are close to their historic highs. Japan's Nikkei is up 17% from its November low. Stock markets in countries such as Canada, Australia and many emerging markets are also performing strongly. Clearly, we are witnessing a global bull market.

New highs abroad means higher for us?

Many investors have been wondering why Philippine stocks surged all of a sudden. We enumerate some of the reasons in the succeeding paragraphs. One of the key reasons behind is the performance of developed markets. With developed markets making new highs and significantly outperforming EM in the past 3 months, EM valuations have become cheaper. Foreign funds are now starting to look at EM in search of bargains. Thus, new highs abroad have lifted Philippine stocks as well.

Foreign selling abates

Since the middle of August last year, the Philippine stock market has seen very heavy foreign selling. However, it seems that the practically uninterrupted daily foreign selling has abated for now. In fact, the last 6 trading days saw net foreign buying of about PhP 2 billion. With foreign selling pressure reversing into buying momentum, our stock market was able to stage a dramatic reversal.

Peso holds below 50

Our currency also got a welcome respite from dollar strength. After flirting with the crucial 50/$ level, the peso has since bounced back. At the height of the attack on EM currencies, we believe that the BSP stalwartly defended the 50-level, which stabilized financial markets. If it were not for their staunch defense of the 50-level, we may have seen runaway peso depreciation which could have rattled the financial markets even more. With the dollar strength abating as of late and foreign inflows going into stocks, the peso has now stabilized and strengthened to 49.47.

Technicals starting to improve

For those who follow technical analysis, one will notice that chart patterns are improving. Aside from being oversold, the short term downtrend line for many stocks has been broken. Many traders take this as a buy signal. With locals now filling the void left by foreign funds recently, technicals indicate that it is likely that we have seen the bottom for Philippine stocks.

Forgetting the positives

In the latter part of 2016, investor sentiment for the Philippines turned sour. One of the reasons behind this are the repeated negative headlines in foreign dailies. This distracted investors and they forgot the positive things that are about to happen in our country, such as the lifting of foreign ownership limits, the tax reform package which includes corporate tax cuts, the boost in infrastructure spending, and other pro-growth policies that could bring GDP growth above 7% in the years to come. If negative headlines about the Philippines cease, local and foreign investors can now focus on the country's macroeconomic fundamentals.

Voice of enlightenment from our economic managers

Lost amidst all the political noise are the enlightening and confident statements by the BSP and the government's economic managers led by Finance Secretary Sonny Dominguez. Their 10-point economic agenda is sound. In fact, the corporate tax cuts, fiscal stimulus and infrastructure spending program are very similar to Trump's initiatives. Last week, BSP Governor Tetangco and all 3 economic managers gave interviews. Secretary Dominiguez said that "we would continue to enjoy low interest rates for so long as the country's macroeconomic fundamentals are kept intact." NEDA Director-General and Economic Planning Secretary Ernesto Pernia said that the "Philippine economy can sustain 7% economic growth this year and the next few years." Budget Secretary Ben Diokno echoed these statements, saying that the country will "usher in a golden age of infrastructure with the largest infra spending in history" and that "we are the fastest-growing country in the fastest-growing region." As we can see in the US, pro-growth policies are very strong catalysts for a country's financial markets.

Disconnect

Given these, there seems to be a disconnect between the macrofundamentals of the country and our stock market performance. Despite GDP growth of 7.1%, and pro-growth policies being implemented in the Philippines, as well as stock markets rising globally, the Philippine stock market still fell sharply from its high of 8,118. Over time, we believe that this disconnect will eventually be corrected as the government's economic program starts bearing fruit.

Investing for the long term

It is nearly impossible to predict what will happen in the short term. Global macroeconomic events, as well as political noise both here and in the US have created very high levels of volatility that have unnerved even the toughest of investors. However, we know that the Philippines will continue to grow and that companies here will be able to participate in this growth. Though the market has risen quite sharply and may need a correction or consolidation, we may have seen the low in this correction phase at 6,499. Thus, if one can invest for the long term and ride out the volatility, then the investor can likewise ride on the Philippines' exciting growth story.

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