Philequity Corner (February 26, 2018)
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Resistance, breakout, correction

Last Saturday, we held our investor forum at the Meralco Theater. We shared our market outlook while also outlining the reasons behind the wild swings of stocks recently. Below, we summarize the salient points of our presentation.

Resistance of 8,000 – decisively broken

In our briefing, we showed how difficult it was for the PSEi to stage a definitive breakout past the 8,000 barrier. It took the PSEi more than two years to convincingly pierce past 8,000 after first touching it on March 30, 2015. Because of the length of the consolidation, the PSEi's eventual breakout became more powerful. This caused a fast and furious stock market rally which allowed the index to reach 9,000 in a fairly short amount of time.

Touchdown 9,000

The PSEi furiously climbed to the next round number resistance and touched 9,000 for the first time on January 26, 2018. From an intraday low of 7,995 on September 7, the index traversed more than 1,000 points in only five months. The PSEi touched an all-time intraday high of 9,078 and established an all-time closing high of 9,059 on January 29. A few days after, the market unexpectedly collapsed, sinking to an intraday low of 8,380 on February 6. From peak to trough, our index declined 7.7% in just six trading days. The market closed at 8,468 last Friday.

The steep plunge

The PSEi's sharp drop followed a steep plunge in US stocks which was triggered by higher than expected wage increases and faster inflation. Bond prices declined as yields spiked. Meanwhile, equities suddenly fell on concerns that rising inflation would prompt the Fed to hike rates at a faster pace. The stock market plummet was exacerbated by the proliferation of algorithmic trading, excessive use of leverage and a meltdown in inverse volatility trades and esoteric derivative products (*When the dog bites*, February 19, 2018).

Is the bull market over?

The steepness and swiftness of the recent market correction caused some panic and anxiety among investors. In fact, some are wondering if the bull market is now over. Two weeks from now, the bull market will be nine years old. This will make it the longest and strongest bull market in Philippine stock market history. For the US, this bull market will be their second longest. As such, there are concerns about the age of the bull market and if it has already run its course. There are also fears that the bull market will end as interest rates go up while inflation rises. Lastly, some are worried that the bull market is now over because stocks have already reached expensive valuations.

Bull markets do not die of old age

Bull markets do not die of old age. Bull markets end because of an economic recession or a severe financial crisis. By looking at the health of the global economy and the strong earnings growth of corporates, one can see that the bull market is alive and kicking. Below, we enumerate the catalysts that continue to drive the ongoing bull market.

1. **Synchronized global growth.** Among major economies, it is not only the US that is growing. Other countries such as Europe, Japan and China have all delivered stronger economic performance.
2. **Sustained corporate earnings growth.** Earnings growth for the S&P 500 is expected to come in at high double-digit levels while our research team expects PSEi earnings growth of 12% for 2018.
3. **Fiscal reforms.** The implementation of lower corporate taxes in the US fueled a run-up in the stock market. Similarly, the implementation of Package 2 of tax reform may drive the PSEi higher.
4. **Infrastructure spending.** The government has promised that infrastructure spending will reach P8.7t in President Duterte's six-year term. If the government successfully implements its infrastructure agenda, our country's GDP growth may rise above 7%.

Is 9,000 the next resistance?

The PSEi touched 9,000 for only two days before experiencing a sharp plunge. Since first touching 8,000, more than two years passed before the PSEi decisively broke past the round number resistance. Many are therefore wondering if 9,000 will be a similarly formidable resistance.

In our presentation, we showed that the PSEi has experienced four significant pullbacks since 2011. The four corrections had an average drawdown of 22% while the descent from peak to trough took four months on average. Meanwhile, the average recovery time for the past four corrections was 12.5 months. Clearly, the PSEi can bounce back from corrections although the pullbacks may be quite sharp.

Short-term pain, long-term gain

Since stocks cannot keep going up continuously, it is necessary for the market to consolidate and digest its gains, especially after periods of fast or uninterrupted rallies. This is the reason why corrections occur regularly in a bull market. As we can see from the market's most recent pullback, corrections are often unexpected and can sometimes be scary. While the recent drop was quite steep, it is important to note that it is still a correction and not the end of the bull market.

Going forward, the market may continue to experience turbulence and volatility due to concerns on inflation and interest rate hikes. However, these will not undo the strength of underlying fundamentals. The global economy is on more solid footing as major economies are growing simultaneously. Meanwhile, our country's fundamentals remain healthy and corporate earnings continue to grow. Considering these, we believe that the secular bull market in Philippine stocks is intact.

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