Philequity Corner (April 23, 2018)
By Wilson Sy

Why is the Philippine stock market dropping?

After staging a decisive breakout past 8,000, the PSEi touched an intraday all-time high of 9,078 on January 29. Since then, the PSEi has plunged 14.9% from its all-time high, closing at 7,727 last Friday. The index is now down 9.7% year-to-date. Factoring in peso depreciation, the PSEi has dipped 13.6% year-to-date in US dollar terms. Why have Philippine stocks fallen so sharply?

Return of volatility in global stocks

In a recent article, we explained that the PSEi's drop was partly a result of heightened volatility in global markets (*Return of Volatility*, April 2, 2018). This was caused by a potential trade war between the US and China (*Trade wars*, March 26, 2018), political noise in the US, the sharp drop in tech stocks, geopolitical tensions arising from the war in Syria and concerns on the Fed's interest rate hikes. These events determined the direction of global markets, which in turn, drove the PSEi's downmove.

Anatomy of the PSEi's drop

Aside from global developments that have caused the Philippine stock market to drop, there are also domestic factors that contributed to the PSEi's weakness. We list some of these below.

1. **Heavy net foreign selling.** Year-to-date net foreign selling has amounted to P39b. Heavy foreign selling has significantly contributed to the PSEi's drop as foreign funds accounted for 49% of the stock market's value traded for the year.
2. **Large stock right offerings.** The total value of stock right offerings (by Metrobank, BPI, Robinson's Land, IMI and PSE) has amounted to P138b year-to-date. This is equivalent to 22% of total value traded for the year, thereby sapping liquidity from the stock market.
3. **Technical breakdown.** The PSEi has broken through several crucial technical support levels during its recent drop. This has caused many technical analysts to sell their Philippine holdings or postpone their buying.
4. **Downgrades by foreign banks.** Prominent foreign banks such as JPMorgan and Morgan Stanley have recently downgraded their ratings on the Philippine stock market. These have induced strong net foreign selling as both are widely-followed banks with big client bases.

View of foreign analysts and economists

The heavy foreign selling was partly caused by the underweight/downgrade calls of major foreign houses on the Philippine stock market. Below, we enumerate some of the reasons cited by foreign analysts and economists for their downgrade of Philippine equities.

1. **Peso deprecation vs. the dollar and other currencies.** Year-to-date, the peso is down 4.5% vs. the US dollar and 6.8% vs. the euro. The weakness of the peso vs. the dollar, other major currencies and Asian peers is considered a risk by foreign fund managers who measure their performance in US dollar or euro terms.

2. **Above forecast inflation.** Inflation recently rose above the BSP's target range, thus raising concerns that rising inflation may crimp consumer spending and dampen economic growth. Note that the peso depreciation is contributing to our country's accelerating inflation.
3. **Concerns that the Philippine economy is overheating.** Last week, the World Bank released a report which stated that "in an environment of increasing fiscal spending and continued high credit growth, the risk of the economy overheating is increasing."
4. **No rate hike from the BSP.** Some foreign economists believe that the BSP is behind the curve as it has abstained from raising interest rates despite above forecast inflation. This has incited fears that the central bank may have to take a steeper and faster rate hiking path to tame rising inflation.
5. **Wider fiscal and current account deficit.** Though these have been well-telegraphed and properly explained by the government, offshore economists have commented that our economy's twin deficits may induce further weakness in our country's currency and bond markets.
6. **Political noise.** Equity strategists from foreign houses have flagged many local developments that contribute to political noise and rising uncertainty in the Philippine stock market. Potential International Criminal Court (ICC) investigations on extra-judicial killings (EJKs), recent statements by the EU Parliament on EJKs, potential removal of the country's Chief Justice and recount of the vice presidential election have been identified by foreign fund managers as political risks.

Espenilla counters

Last Friday, BSP Governor Nestor Espenilla, Jr. replied to concerns on inflation, peso depreciation and monetary policy. According to an article from Bloomberg, Espenilla explained that "the sum of BSP actions remain appropriate for the situation." Espenilla added, "We have to look at the fundamental drivers and not be too quick to play the blame game." The central bank chief likewise said that "corrections happen as a reality check... that's healthy and makes for sustainability." Lastly, Espenilla stated that "corporate fundamentals are the key drivers of the stock market."

Pernia's reply

Likewise, the country's chief economist, Secretary Ernesto Pernia responded to concerns that the Philippine economy is overheating. Pernia was quoted as saying, "As we tread a high growth trajectory, risks are typically present on both domestic and external fronts. Nevertheless, we remain vigilant in monitoring these developments. And we already have the platform to effectively address these concerns."

Monitor the risks, watch the fundamentals

The PSEi has dropped significantly since end-January and is clearly in correction mode. Thus, it is crucial for investors to monitor the prevalence of global and local risks. It is likewise important to assess how these risks will affect economic growth, corporate fundamentals and investor sentiment. Ultimately, the direction of the Philippine stock market will be dictated by the global macro outlook, local macroeconomic fundamentals and corporate earnings growth.

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