Philequity Corner (August 19, 2019)
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Protests, political upheavals, and inversions

Last Monday, Hong Kong airport was locked down when it was overrun by protesters. Images of the airport shutdown caused US futures to reverse course, eventually leading to sharp drops in US stocks. There were fears that Hong Kong's economy may be paralyzed by the protest, exacerbating a slowing global economy already reeling from the US-China trade war.

Extradition bill fuels Hong Kong protest movement

The Hong Kong protests were triggered by deliberations on the extradition bill. The controversial measure pushed for the transfer of criminal suspects to mainland China for trial. The reluctance of the government to scrap the bill fueled anger among Hong Kong residents. This galvanized support for the protest movement which grew larger and larger.

Black vs. white

The growing number of protesters started to wear black to identify themselves. The protesters carefully targeted key locations such as subways, the parliament, financial centers, and tourist spots. Their goal was to disrupt the Hong Kong economy. Some speculate that the black shirts are supported by big business or the US government. The black shirts were countered by a group of mobsters wearing white. Though fewer in number, the white shirts were more aggressive in inciting physical violence. In many cases, the white shirts carried wooden sticks which they used to hit and discourage the protesters. The battle of black vs. white in Hong Kong reminds us of how colors can be used in protest movements. In Thailand, the reds and the yellows tussled for political control. This also reminds us of the yellow movement which led the 1986 EDSA Revolution.

Political upheavals on the rise

Elsewhere in the world, political upheavals have taken place due to the mounting frustration of citizens with their governments. Italy's bond market plummeted on news that Deputy Prime Minister Matteo Salvini has led opinion polls on the back of populist rhetoric. If elected, his agenda will worsen the country's ballooning budget deficit. Last Monday, Argentina's stock market crashed 48% in US dollar terms on news that President Mauricio Macri lost by a wide margin in the primaries. Meanwhile, the ascent of populist Boris Johnson as UK's Prime Minister raises the risk of a disorderly Brexit which spells disaster for the UK and Europe. The growing dissatisfaction of citizens, combined with tepid economic progress or downturns in many countries, have given rise to political upheavals. This came in the form of left-leaning socialists like Venezuelan President Nicolas Maduro or ultra-right authoritarian leaders such as Brazilian President Jair Bolsonaro.

Inverted yield curve raises recession fears

The Dow plummeted 800 points last Wednesday when the yield on the 10-year US Treasury slipped below the 2-year yield. The move has spooked investors because this particular inversion is a harbinger of an incoming recession. All US economic recessions in the past 50 years have been preceded by this.

However, the impact may not be immediate. Recessions occur 22 months, on average, after the yield curve inverts. And markets tend to rally by an average of 15% in the 18 months following the inversion.

Inversion is a symptom of global economic slowdown

The inversion of the 10-year and 2-year yields is a symptom of a pronounced global economic slowdown or possibly an imminent recession. The drop of Treasury yields to historic lows signifies weakness in credit demand and deceleration in business activity. This comes at a time when signs of a broad-based slowdown are flashing globally.

1. China's exports fell 1.3% and imports dropped 7.3% as the country continued to feel the pinch of the trade war.
2. Germany's economy contracted 0.1% in 2Q19 on weak manufacturing activity.
3. The 10-year bond yields of Germany, Japan, Switzerland, and France have fallen to negative territory.
4. The yield on 30-year US Treasuries fell to an all-time low, piercing below 2.0% for the first time in history.

The savage drops in the stock market, the inversion of the yield curve, and the drop of bond yields to historic lows resulted from the slowdown which is currently being experienced by many major economies. These have prodded the Fed and other central banks to further cut their policy rates in order to prop up growth.

No man is an island

The Philippines was not spared from the global rout. On Tuesday last week, the PSEi fell more than 2% to a low of 7,622. Meanwhile, the peso has depreciated 2.5% in the past two weeks due to the turmoil in global markets. Market sentiment was shaken by a spate of bad news involving protests, political upheavals, and inversions amid broad-based signs that the global economy is indeed slowing down. Given the move of the peso and the PSEi, it is quite clear that no man is an island and that no country can be spared by the global slowdown. In our upcoming investor briefing, we will show how our currency and stock market have moved in consonance with developments in the global economy and the US-China trade war.

Philequity Investor Briefing on August 31

This is a tough market to trade because there are too many factors that can drive its direction. These may be too complex to tackle in a single column. Instead, we will discuss these in our upcoming briefing. We highly encourage our investors and readers to attend the Philequity Investor Briefing on August 31, 2019, 9:30 am at the Meralco Main Theatre. We will explain in detail the connections between the protests, political upheavals, and inversions, as well as other drivers of the stock market. Mr. David Leechiu, our guest speaker, will share his views on the country's property sector. Registration is required so please confirm your attendance early.

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