Philequity Corner (December 2, 2019)
By Wilson Sy

MSCI rebalancing fuels foreign selloff

Last week, MSCI finally completed the last tranche of its rebalancing exercise. MSCI is the world's leading index provider and is widely followed by foreign funds and institutions. In fact, most foreign funds and ETFs benchmark themselves to MSCI indices. Thus, all eyes were on MSCI when it announced on February 28 of this year that it will be increasing the inclusion factor of China A-shares in its indices in three steps. By its conclusion, 253 large cap and 168 mid cap China A-shares were added to the MSCI Emerging Markets (EM) index. As a result, China's total weight in the EM index is now 33.6%.

Last day sale, last minute selling

On November 26, the last day for rebalancing, huge volumes were transacted in the last minute of active trading. In fact, most of the volume happened at the last second of the pre-close auction. Gross foreign selling on November 26 amounted to a whopping PhP 19.2 billion. Moreover, that day also saw one of the largest value traded for the Philippine stock market this year at PhP 21.2 billion, compared with this year's average daily volume of PhP 4.5 billion. We also saw one of the biggest net foreign selling in a single day at PhP 4.8 billion.

More for China, less for everyone else

The consequence of the inclusion of China A-shares is the reduction in weight of every other member of the MSCI EM index, from the largest members such as South Korea, Taiwan, India and Brazil, to the less significant ones, such as the Philippines. Given the wide following of MSCI, the Philippine stock market experienced heavy foreign selling during the 3 rebalancing periods on May, August and November. All of the selling we saw is actually to purchase China stocks, at the expense of other emerging markets.

AGI and DMC removed from MSCI Philippines index

Another effect of the rebalancing was a decrease in the percentile rank of companies with lower than average market capitalization. If a company's rank falls below a certain percentile, they may be removed from a country's benchmark index. Unfortunately, with the entry of more than 400 Chinese companies into the MSCI EM index, it was announced on November 8 that both AGI and DMC were deleted from the MSCI Philippines index.

Share buybacks and major shareholder purchases cushion the drop

The 2 stocks that dropped the most since MSCI's announcement were DMC and JFC, which both lost 18.5% since November 8. While DMC suffered because of its deletion, JFC's drop was largely because of a negative earnings report. Note also that despite AGI's deletion, it fell far less than its peers. This is because of its very large share buyback program. Other than AGI, other MSCI

Philippines stocks which saw significant buybacks or controlling shareholder purchases are ALI, DMC and ICT.

Out of ASEAN, into US and China

With foreign funds leaving other emerging markets and flocking to China, mainland equities saw a net inflow of $3.1 billion on November 26 – the largest single day net foreign buy in more than 3 years. Amidst the selloff in EM and despite mixed signals regarding trade, US stock markets continued to make new highs. As you can see in the table below, the Philippines is not alone in its tepid performance. In fact, Indonesia and Malaysia are already in the red for the year.

US	YTD %
US (Nasdaq)	31.2%
US (Dow Jones index)	20.7%
US (S&P 500)	25.8%
China (Shanghai)	15.2%

Source: *Wealth Securities research*

Asia Pacific	YTD %
Singapore	3.8%
Philippines	3.7%
Thailand	1.5%
Indonesia	-3.2%
Malaysia	-7.5%

No increase in China's weight in MSCI EM next year

Fortunately, MSCI announced that any further increase in China's weight is not forthcoming. MSCI stated that China has to fix 4 outstanding issues before it will consider increasing A-share weighting further. The issues are (1) a dearth of hedging tools and derivatives, (2) China's short settlement cycle, (3) the onshore market's holiday misalignment with HK and (4) a lack of mechanisms allowing brokers to place a single order on behalf of many clients. This should ease the foreign selling that has been plaguing EM stock markets, including the Philippines.

Trump signs bills backing HK protesters

With just a few weeks before the final tariff deadline on December 15, Trump threw yet another wrench into negotiations. Last week, Trump signed into law 2 bills supporting HK protesters, saying that he did so "out of respect for President Xi, China and the people of HK." This adds to a flurry of mixed signals regarding the signing of a Phase One trade deal. Along with the uncertainty surrounding HK's situation, alternating good and bad news regarding the potential trade deal has caused many investors to look for safe havens. Unfortunately, this meant selling EM exposure and shifting to the US. Combined with MSCI rebalancing, the current environment has put a cap on Philippine and ASEAN stock markets.

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