Philequity Corner (May 23, 2010)
By Valentino Sy

Philippines, Best Performing Stock Market in the World

Thanks to the generally peaceful elections and the widely accepted election of Noynoy Aquino as the next Philippine president, Philippine stocks are still up 4.1 percent year-to-date. This is despite the horrendous performance of stock markets worldwide.

Below is a table which shows the performance of stock markets year-to-date (YTD), week-on-week (W-o-W) and from their peaks-to-date.

DEVELOPED MARKETS Country	Index	Current Price	% Returns YTD	% Returns W-o-W	% Returns from peak
Canada	TSE 300	11,521.35	-1.9%	-4.1%	-6.5%
Germany	DAX	5,829.25	-2.2%	-3.8%	-8.1%
US	DJIA	10,193.39	-2.3%	-4.0%	-9.5%
US	S&P 500	1,087.69	-2.5%	-4.2%	-10.8%
US	Nasdaq Composite	2,229.04	-1.8%	-5.0%	-12.1%
UK	FTSE	5,062.93	-6.5%	-3.8%	-13.2%
Japan	Nikkei 225	9,784.54	-7.2%	-6.5%	-14.2%
Australia	S&P/ASX 200	4,305.40	-11.6%	-6.6%	-14.3%
France	CAC 40	3,430.74	-12.8%	-3.6%	-16.1%
Portugal	PSI	2,427.71	-16.4%	-2.6%	-19.6%
Italy	Mibtel	19,535.91	-16.0%	-1.2%	-20.5%
Spain	Ibex 35	9,407.30	-21.2%	1.0%	-23.1%
Greece	Athens Comp	1,595.10	-27.4%	-3.8%	-45.6%
Average			**-10.0%**	**-3.7%**	**-16.4%**
ASIAN MARKETS					
Malaysia	KLCI	1,285.73	1.0%	-4.0%	-4.8%
Philippines	PSEi	3,179.36	4.1%	-4.5%	-4.9%
Thailand	SET	765.54	4.2%	-0.4%	-6.7%
India	BSE SENSEX 30	16,445.61	-5.8%	-3.2%	-8.9%
South Korea	KOSPI	1,600.18	-4.9%	-5.6%	-9.0%
Singapore	STI	2,701.20	-6.8%	-5.4%	-11.1%
Indonesia	JCI	2,623.22	3.5%	-8.2%	-12.5%
Taiwan	TAIEX	7,237.71	-11.6%	-6.9%	-13.8%
Hong Kong	Hang Seng	19,545.83	-10.6%	-3.0%	-15.4%
China	Shanghai SE	2,583.52	-21.2%	-4.2%	-25.7%
Average			**-4.8%**	**-4.5%**	**-11.3%**

Source: Bloomberg

As you can see, the Philippine market is only down 5 percent from its recent peak, whereas the benchmark S&P 500 index is down 11 percent. Not surprisingly, the markets of Greece, Spain and Italy (which are the most fiscally troubled countries in the EU) are down 46 percent, 23 percent and 21 percent, respectively from their recent highs. Meanwhile, the stock market of China, which is trying to cool its economy and address a domestic asset bubble, is down 26 percent from its peak.

Year-to-date, only the Southeast Asian countries such as the Philippines, Thailand, Indonesia and Malaysia are showing gains in stocks. Most other markets are negative. In fact, developed markets have declined an average of 10 percent year-to-date, while Asian markets are down 4.8 percent year-to-date on the average.

It is also interesting to note that several markets are now down more than 20 percent from their peaks, which technically put them in bear market territory already.

Fear of contagion and economic slowdown

We mentioned in a past article (see *The Ipis Theory*, February 22, 2010) that the real issue is contagion – not just the cost of bailing out Greece, but that of other troubled European countries waiting in the wings. Portugal and Spain just suffered downgrades in their credit ratings last week. Investors are worried that Europe may face not only a double-dip recession but also its second banking crisis in just two years.

With the Greek crisis escalating, EU/IMF officials responded with $1 trillion shock-and-awe bailout designed to ease market fears and prevent contagion from spreading.

In addition, the European Central Bank (ECB) finally took a step it had been trying to avoid – buying up government bonds in the market. The ECB also announced it will resume some of the emergency liquidity measures it had put place post-Lehman, measures that the ECB was starting to scale back.

Meanwhile, the US Fed reopened unlimited currency swap lines with the ECB and several other central banks to ease fears of a US dollar shortage as investors dump riskier assets and move back to the greenback.

EU in doubt

The sovereign debt problems in several Eurozone countries have left future of the EU in doubt. The threat of contagion has forced the EU to override its own statutes and treaty agreements to offer bailouts. The crisis has also put into question EU's monetary system and its currency, the euro, which has collapsed by as much as 15 percent this year.

EU has a single central bank, the ECB, and therefore one single monetary policy. However, different member countries are allowed to set each its own fiscal policy (taxation, public spending, subsidies, etc.). This is creates a difficult situation because sometimes the monetary and fiscal policies of one country may not be in agreement. And as a result there has been a financial disconnect and a wide disparity of wealth among EU countries.

US financial reforms & the China bubble

Aside from the sovereign debt problems in Europe, another factor that weighed down on the markets last week is the long-awaited US financial reform bill. Markets plunged steeply on Thursday when the Senate passed the bill as investors brace for a massive new load of financial regulations and controls.

Meanwhile, China which has led the world's recovery post-Lehman is facing a problem of rising inflation, escalating real estate prices and climbing bank bad loans. The Chinese government are now taking actions to slow growth and cool inflation. This has taken its toll on the markets as stocks are now down 21 percent in China year-to-date, 11 percent in Hong Kong and 12 percent in Taiwan over the same period. There is now concern that China's slowdown will spread further throughout the region.

Hedge funds de-risking

Given the threats of a sovereign debt crisis in Europe, stricter US financial regulation and emerging bubble in China, hedge funds are now de-risking. Hedge fund selling was further intensified last week when Germany announced that they were banning naked short-selling. This is also very evident in the local market during the last 10 trading days where foreign funds sold a net of P4 billion.

Asian Financial Crisis - History repeats itself

What happened in Europe is eerily similar to what happened to Asia in 1997. Similar to what happened during the Asian crisis in 1997 and the US subprime/credit crisis in 2008, hedge funds are the first to run at the first signs of danger. Hedge funds are also known to attack when they smell blood. We won't be surprised if they are again found shorting the European stocks, just like what they did to US and Asian stocks in previous crises. It may take another coordinated move by the central banks and governments to fend off their assault.

Asset allocation and risk tolerance

We advise investors to review their asset allocation. While we continue to be positive on stocks in the long-term, investors should approach the market with caution given the recent bouts of heightened volatility. Just like what we said before, no one knows how long or how deep the pullbacks will be.

Asset allocation is based on each individual's risk tolerance. If you are over-leveraged or you have a low-risk tolerance and cannot stomach a volatile market, it may be appropriate to raise cash and reallocate into fixed income investments.

If you are underweight equities or you don't have any equity position at all, now is the time for stock-picking. You can also slowly buy into stocks or equity funds that you are really comfortable investing in for the long-term.

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