Lessons learned from 20 years of outperformance – Part 2

PHILEQUITY CORNER By Valentino Sy (The Philippine Star) | August 25, 2014

In our article last week, we answered some of the questions that were asked in our recent investor briefing. Unfortunately, we could not answer all the 60+ questions that were asked by the audience during the briefing. In this article, we will try to answer some of those questions as well as other questions that our clients and investors often ask us.

1. When is the right time to buy? I have been waiting for a correction but it hasn't come.

This is one of the most common questions that we encounter, regardless of market condition. In fact, many investors often end up not investing when they become too concerned with timing. In a choppy market, some postpone additional investments in the hope that the market will continue falling and allow them to invest at lower price levels. However, in a rising market, investors often put off initial or additional investments while waiting for a correction to occur.

The problem is that corrections, even for professionals, are very hard to predict. There are many unpredictable factors that may trigger a correction, such as an off-the-cuff remark of a central bank head or a wrong-button-push that launched a missile strike on an unsuspecting civilian airplane. As such, we always stress the importance of taking a long-term view and making investment decisions based on this.

Though one's equity exposure should depend on one's asset allocation strategy and risk appetite, we believe that everyone should have a certain portion of their investments in equities. We encourage investors who still do not have equity exposure or are still underweight equities to start buying on a staggered basis now.

2. How do we buy stocks or mutual funds on a staggered basis?

We have always advocated buying in tranches for people who do not have the time to monitor the stock market religiously. A more specific variant of this buying technique would be peso cost averaging. This would entail buying a fixed peso amount of equities or mutual funds at a regular frequency. This can be done every week, every two weeks, every month or even every quarter.

Peso cost averaging may also be a very useful buying technique in times when the stock market continues to go up and would just not go down. This eliminates the timing aspect of investing and instead allows investors to focus on gradually increasing their exposure to the stock market. We have concrete examples of clients and investors who have successfully applied peso cost averaging and have immensely benefited from it (*Example of a Real-Life Investor*, March 31, 2014).

3. Currently, what gives you confidence to keep buying in tranches or pullbacks?

As we discussed in our previous article, there are many risks that have surfaced lately, both globally and locally. However, our stock market has not gone down significantly despite the emergence of these risks (*Lessons Learned from 20 Years of Outperformance*, Aug.t 18, 2014). And as we pointed out in our recent investor briefing, **a market that refuses to go down on bad news is poised to move higher**. This is what we are seeing with our stock market now and this is clearly a sign of our stock market's inherent strength. This gives us confidence to continue buying in tranches or pullbacks.

Moreover, there are many global stock markets that continue to reach all-time or multi-year highs. There are also some indices that have performed poorly before but are now starting to turn for the better. While this is happening, the secular bull market (*Secular Bull Market*, Jan. 28, 2013) in Philippine stocks remains intact, as our country and corporates continue to deliver strong economic and earnings growth.

4. URC recently announced that they purchased a foreign company. What do you think of this?

This is a phenomenon that has become more common in recent years. We have been seeing more Filipino companies acquiring companies abroad or buying significant stakes in foreign businesses. We summarize these in the table below.

Company	Business / Company Acquired	Country
Universal Robina Corp.	Griffin's Foods	New Zealand
Int'l Container Terminal Services	Port of Melbourne	Australia
Emperador	Whyte & Mackay, vineyards in Spain	Scotland / Spain
PLDT	Rocket Internet	Germany
Energy Development Corp.	Alterra Power Corp.	Canada
Manila Water Corp.	Saigon Water Infrastructure Corp.	Vietnam
Metro Pacific Investments	Don Muang Tollway Public Co.	Thailand
Jollibee Foods Corp.	Jinja Bar & Bistro, Guangxi San Ping Wang, Yonghe King	US / China

The series of structural reforms that were implemented over the past two decades has transformed our country from a perennial laggard to one of the fastest growing economies in the world. Consequently, this economic transformation has also given rise to stronger corporates. This is why Philippine corporates can now acquire foreign companies or buy significant stakes in companies abroad. Ten or 20 years ago, no one would have thought that Philippine companies would be able to do this now. However, we view this as proof that the Philippines indeed has a strong structural growth story.

5. Why is the stock market going up even as certain stocks are going down sharply?

What we are seeing now in our stock market is a divergence between stocks with strong earnings and those with challenging growth prospects. Stocks with clear and strong earnings growth trajectories continue to perform strongly, with some even making new highs. Further, stocks whose weights were increased by the MSCI have also gone up. Note that foreign investors closely follow MSCI indices, and this is why stocks with increased weightings have gone up significantly on the back of strong net foreign buying. However, stocks which have delivered disappointing earnings and have murky earnings outlook were consequently sold down.

This shows that we cannot be complacent with investing even though we are currently in a bull market. Our thesis is that earnings and earnings expectations will drive the movement of local stocks. Hence, we at *Philequity* prefer stocks which have delivered strong earnings growth and can continue to do so. Consequently, we lightened up on stocks which have shown disappointing earnings and those which may encounter challenges to their growth prospects over the mid-term.

6. Why has your flagship Philequity Fund consistently outperformed for the past 20 years?

Philequity was founded by stock brokers in 1994. To date, *Philequity* continues to be guided by one of the oldest and wisest boards in the country, with an average age of 64. Further, most of our directors have been in the stock market for most of their professional careers. Likewise, our two principal fund managers have 40 and 50 years' experience in equities, respectively. This weight of experience has allowed Philequity to properly navigate through the various bear and bull cycles that our market has experienced. This level of experience also gives us an advantage when evaluating how certain global or local events would affect the direction of our stock market.

Aside from this, we at *Philequity* focus more on stock picking instead of timing the market or predicting when the next correction would occur. Time and again, we admit that corrections are extremely hard to predict, even for professionals. Hence, we think that it is more practical to study companies and businesses. We focus on investing in companies that have solid business models and strong fundamentals. If these companies continue to do well, their earnings will continue to grow and consequently, their stock prices will move higher over the long-term.

7. Where is the stock market headed over the long-term?

We mentioned in our presentations that our target for the index is 8,220 by March 2016. Beyond 2016, we believe that our country will continue to reap the benefits of the various structural reforms that have been implemented over the past years (*Beyond 2016*, June 9, 2014). Further, we expect that important structural changes that are crucial to maintaining our growth trajectory – such as improved infrastructure or additional investments in the power sector – will be addressed by the government in the succeeding years. This should pave the way for the gradual development of other important sectors in our economy, such as manufacturing, agriculture, tourism and mining. Considering these, our long-term growth trajectory is intact and we see the PSE Index hitting 10,000 by 2018.

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