Philequity Corner (February 4, 2013)
By Valentino Sy

The Impressive Run-up Continues

Two weeks ago, we wrote about the run-up of the PSE Index (*The Run-up*, January 21, 2013). This started on December 18, 2012 when the index was only at 5,623.85. Even after we wrote about it, the PSE Index continued its run-up and ended last week at a new all-time high of 6,318.61. The PSE Index has so far yielded a year-to-date return of 8.7%. With this, the impressive run-up of our index has delivered a whopping 12.4% in just 1 ½ months.

Source: Stockcharts.com

Even though the PSE Index was down 0.5% on the last day of January 2013, it ended the month 7.4% up. In the table below, we show that the performance of our index for January 2013 was one of its strongest starts in recent years. Moreover, the table shows that in the last 10 years, a positive return for the index in the month of January has always led to a positive return for the whole year.

PSE Index Returns - January vs. Whole Year											
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
January	3.8%	4.6%	10.8%	2.4%	8.6%	-9.8%	-2.6%	-3.3%	-7.6%	7.1%	7.4%
Whole Year	41.6%	26.4%	15.0%	42.3%	21.4%	-48.3%	63.0%	37.6%	4.1%	33.0%	?

Source: Bloomberg

Why is the Philippine stock market experiencing a run-up?

The PSE Index is experiencing a run-up because investors, both foreign and local, are becoming more interested about the Philippine growth story. While our growth profile before was inconsistent and cyclical, it has gradually strengthened and has become more of the structural type. This is due to the long-term structural transformation that our country went through over the past years (*Secular Bull Market*, January 28, 2013). We believe that our country has all the necessary ingredients needed to deliver higher economic and corporate earnings growth for many years to come. In addition, record low interest rates in the country have caused investors to shift from fixed income to equities. In fact, our Philequity Fund has experienced record inflows for the month of January.

What are the recent catalysts for this continuing run-up?

1. **Enlightened foreign ownership rules.** The issue on the restrictive foreign ownership limits on local stocks caused our market to correct before. Though the Securities and Exchange Commission (SEC) has yet to finalize the guidelines for this, we laud SEC Chairperson Teresita Herbosa for clarifying that the regulator looks to impose a more enlightened ruling that balances the protection of local business interests and the promotion of a healthy investment climate.
2. **Special Deposit Account (SDA) rate cut.** The Bangko Sentral ng Pilipinas (BSP) recently reduced the interest rate that it pays to its SDA depositors to 3%, cutting it by 50 basis points. The BSP's SDA facility currently houses ~P1.7T in deposits. The BSP's move to reduce the SDA rate has already caused a shift from SDAs to local stocks. This shift will likely persist in the near to medium term.
3. **GSIS to increase equities exposure.** Last week, GSIS President Bernie Vergara said that the fund was looking to increase its exposure to the local stock market to 19% from 15% last year. Since GSIS has P685B in investible funds, the move to increase its equity exposure by 4% may bring additional P27B worth of inflows to our stock market.
4. **PNoy: "All of us will be impressed."** Ahead of the release of the 4Q2012 and FY2012 GDP report, President Noynoy Aquino remarked that everyone will be impressed with the country's GDP growth. And indeed, investors were impressed. The country's 4Q2012 and FY2012 GDP growth came in at 6.8% and 6.6%, respectively. These results exceeded the official target of 5-6%.
5. **Philippines in the radar of foreign fund managers.** Despite our stock market run-up, many foreign fund managers are still not invested in the Philippines. Recently, these fund managers have been coming to our country in droves, looking to invest in our stock market. Last week, JPMorgan brought some of its clients to the Philippines for a country visit and investor forum. JPMorgan has recommended an overweight rating on the Philippines for the past few years and reiterated this overweight call for the Philippines last week.
6. **Positive Contagion.** Recent developments regarding the recovery of the US economy, the strong 4Q2012 GDP of China and the aggressive monetary easing of Japan have all driven their respective stock markets higher and have caused our stock market to also move higher, in tandem with theirs. As the old saying goes, "A rising tide lifts all boats."

What is happening to other global stock markets?

In the past few months, global stock indices such as those of the US, Germany, China, Japan and the ASEAN have all been moving-up and have recently reached multi-year highs or new all-time highs (*Global Bull Market*, January 7, 2013). In fact, last week, the Dow Jones Industrial Index closed above the 14,000 level for the first time since October 2007. Moreover, the S&P 500 Index delivered its best start since 1997 as it ended January 2013 with a 5.0% return.

Why do other global stock markets continue to move higher?

Global equities continue to move higher because the global macroeconomic headwinds that most investors have been concerned about seem to be dissipating. Problems such as the slow growth and the fiscal cliff of the US, the European sovereign debt crisis and the hard-landing scenario for China have all seemed to abate, at least for now. This budding global economic recovery is primarily due to the aggressive and creative intervention of global central banks led by Fed Chairman Ben Bernanke (*The Great Global Monetary Easing*, October 22, 2012).

The bold actions of global central banks, including the BSP, have also pushed interest rates to record lows. These have driven bond yields significantly lower, making stocks relatively cheaper investments compared to bonds. Moreover, the record low interest rates penalize those holding significant amounts of cash and bank deposits, driving them to instead use their money to invest in businesses or buy stocks.

Is the country's high GDP growth sustainable?

Now that the country has proven that it can deliver high GDP growth, the next challenge will be sustaining GDP growth at the 5-7% level (*6000*, January 14, 2013). This will be imperative in bringing a more inclusive type of economic growth that trickles down to the poor. Aside from this, the government must leverage on its strong fiscal position in order to aggressively roll-out infrastructure projects via Public-Private Partnerships (PPP). At this point, investments in infrastructure are very much needed to propel our economic growth to the next level and precipitate the growth of sectors such as manufacturing, tourism and exports. We are fortunate that our current government is aware that there is much to be done and that efforts should be focused in sustaining our high GDP growth.

Will corrections happen?

Although there are numerous reasons for our bullishness, we believe that corrections will always be there as they are part and parcel of a bull market. However, corrections are extremely hard to predict and no one really knows when they will happen or how long and how deep they will last. Because of our stock market's run-up and the relatively short and shallow corrections that we experienced, many investors and professionals have missed the boat trying to anticipate and preempt a significant correction. One cannot keep waiting for corrections when the bull is running its course.

How do we trade this market?

While buying on dips might be preferable, we have not really had any significant corrections recently. Considering this, we recommend buying in tranches and using peso cost averaging in gradually increasing one's exposure to Philippine stocks. We also recommend buying stocks that represent the unique Philippine growth story. These are stocks in the consumer, retail, banking, utilities and property sectors. For those who cannot monitor the market on a daily basis, it might be good to invest your money in a mutual fund that will be handled by a professional fund manager. For those who have followed our advice before and are long Philippine stocks, our advice stays the same: stay the course (*Staying the Course*, January, 2012), keep your winners (*Hold on to your winners*, April 16, 2012) and invest in companies with solid fundamentals and strong earnings growth.

Due to the impressive run-up of the local stock market and the improving global macro picture, we are looking to upgrade our PSE Index target of 6,700 to 6,800. Our views and assumptions for the PSE Index target will be explained in greater detail on our investor briefing on February 19, 2013.

For further stock market research and to view our previous articles, please visit our online trading platform at www.wealthsec.com or call 634-5038. Our archived articles can also be viewed at www.philequity.net.