

Philequity Corner (February 24, 2014)
By Valentino Sy

Best House in an Improving Neighborhood

In our presentations to several of our institutional clients in the early part of this year, we said that there were already incipient signs of a turn in the market. Amidst the emerging market turmoil unfolding (see *Darlings No More*, 10 February 2014), which led to sharp drops across the globe, we saw small, noticeable signals showing that the Philippines is bucking the downtrend. Despite all the headline-grabbing news causing global markets to fall, the Philippine stock market refused to go down – a very bullish sign.

Philippines is decoupling

At Philequity, we closely watch for signs of turns in the market. Thus, when the Philippine stock market remained strong in spite of the volatility in emerging markets, we flagged our clients and investors that the Philippines is on the verge of decoupling. See below some of our other observations supporting our call that the Philippines is now being differentiated:

1. From January 17 to 24, when the Dow Jones dropped 3.5%, the PSEi rose 3.4%
2. During the same week, the Philippine peso fell by a mere 0.7% as other Asian and emerging market currencies fell sharply (see table in *EM Currency Contagion*, 27 January 2014)
3. The Philippines did not retest the low even as other emerging market stock indices and currencies retested their lows, creating fears that a South American contagion will affect stock markets worldwide, similar to what happened in the 1997 Asian Financial Crisis
4. Last Thursday, February 20, almost all global markets were down, especially Asia, and yet the Philippines was up significantly
5. Foreign flows coming back – in the past 2 weeks alone, we recorded nearly FIVE BILLION PESOS of net foreign buying in our stock market
6. Year to date, the Philippines is already up 7.3%, the second best performing market in Asia after Indonesia

Neighborhood no longer a drag

Last year, we wrote about how the Philippines was dragged down by its fellow emerging markets because it was located in a bad neighborhood (see *The Best House in a Bad Neighborhood*, 2 September 2013). Another reason we are now decoupling is that our ASEAN neighborhood is finally improving. Indonesia's current account deficit is now just 2% of GDP from a high of 4.4% last year. Although the political situation in Thailand remains unstable, rallies have remained largely peaceful and are unlikely to degenerate into what we see happening in Ukraine. Even India has managed to stem capital outflows by instituting structural reforms and raising rates. It looks the Philippines is now the best house in an improving neighborhood.

Another bullish signal

When bad news occurs and the market does not fall, we take it as a bullish signal. Thailand is a good example of this. Despite all the negative headline news about upheaval and widespread rallies, both its stock market and currency did not go down the past few months. In fact, both are still up for the year.

Differentiating the Philippines

The stark difference in stock market performance between problematic countries and those that have kept their houses in order is a sign that investors are finally distinguishing between the good and the bad. We believe that the Philippine market would eventually recover because not only do we not share our neighbors' problems, but we also have a structural growth story of our own (see *Secular Bull Market*, 28 January 2013). Some of these reasons are enumerated below.

1. Strong domestic consumption
2. Current account surplus
3. Large foreign exchange reserves
4. Investment grade credit rating
5. High GDP growth (second only to China)
6. Growing OFW remittances and BPO revenues
7. Credible, honest and trusted government under PNoy leadership

Best to Worst to Best

These factors made the Philippines one of the best performing stock markets in the world in the 1st half of last year. However, with QE tapering, EM turmoil, and finally, Yolanda, we became one of the worst performing equity indices in the second half of 2013. Yet, our structural growth story remained unchanged. Because of these, the Philippines is once again among the best performers with a 7.3% YTD return, just right behind Indonesia's 8.7% gain.

Consensus is bearish

With our market so bullish, it is interesting to note that consensus is actually quite bearish on the stock market. Most local funds and stockbrokers are looking at tepid stock market performance during the 1st half of the year, with a rally occurring only in the 2nd half. With so many people bearish, we at Philequity gained conviction in our contrarian view. As the world's best investor, Warren Buffett, has eloquently said, "Be fearful when others are greedy and greedy when others are fearful." The performance in the first 2 months of the year has proven most houses wrong in their short term bearish call.

JP Morgan upgrades Indonesia and the Philippines

Last week, another vote was cast against the consensus when JP Morgan upgraded Indonesia and Philippines to overweight from neutral. In our case, they cited our strong GDP growth and reasonable valuation. Right after the report was released, foreign funds stampeded back into the Philippines.

Philippine stocks forming a base

After a very volatile 2nd half last year with Yolanda dealing the final blow, we believe that the Philippines has finally carved a bottom. The index and many other stocks have already formed a base, retesting

strong support levels then rallying significantly from there while making higher lows. For those who follow technical analysis, this is a very bullish sign for the market.

Why we are bullish

We are inviting clients of Philequity and Wealth Securities to our investors' briefing on March 8, 2:30 PM at the Meralco Theater. We will explain in more detail why we remained positive on the market in spite of all the bad news and why we remain bullish moving forward. We will talk about our valuation relative to our neighbors as well as where we think the Philippine stock market is headed for the rest of the year.

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