



Philequity Corner (March 28, 2016)
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De Do Do Do, De Da Da Da

After a gruesome January which had many saying the bear market is upon us, the PSEi has since recovered. Now up 5.8% YTD, the PSEi has risen 21% from the bottom of 6,084, a clear sign that the bull market is still intact. In fact, the PSEi even reached the 7,400 level last week.

Central banks defend

Astounding as it is, this recovery would not be possible without the participation and coordinated action of central banks around the world. In a previous article (see *Central Banks Strike Back*, 1 February 2016), global central bank leaders released statements one after the other, seemingly on cue. As the Federal Reserve, European Central Bank and Bank of Japan laid out their plans, equities staged a blistering rally.

2 not 4

In the Fed's last monetary policy statement, the committee recognized that "global and financial developments continue to pose risks." This dovish statement, with its recognition of risks, led to market expectations of 2 rate hikes this year instead of 4.

Dollar strength takes a pause, stocks recover

The Fed statement had far-reaching consequences, namely:

1. The dovish stance of the Fed led to the dollar softening. The US dollar fell as much as 5% from its recent high.
2. Global stock markets recovered as dollar strength took a pause
3. Dollar weakness caused battered emerging market currencies and equities to rally
4. Crude oil and industrial metal prices rose as the dollar fell
5. Foreign fund flowed into emerging markets, including the Philippines. The PSEi and the Philippine peso climbed as a result.

Three Fed members open their mouths

Clearly, the pause in dollar strength was crucial to the strength in equities over the past 2 months. Since the central banks acted in unison, many stock markets had already risen by double digit percentages. Then, out of the blue, 3 Fed members opened their mouths, with disastrous consequences. See below part of the statements they made over the past week:

1. Atlanta Fed President Dennis Lockhart – "With the 2% inflation target possible in the medium term, another rate hike may come as soon as April."

2. Richmond Fed President Jeffrey Lacker – “Inflation is likely to increase significantly and get closer to the Fed’s target as oil bottoms out.”
3. St. Louis Fed President James Bullard – “Relatively minor downgrades to economic forecasts suggest that the next rate increase may not be far off.”

Fortunately, of these 3, only Bullard is a voting member in the Fed this year. However, despite these statements being given in an unofficial capacity, it still had a significant impact on markets.

US Dollar resumes strength

The hawkish statements of these 3 Fed governors caused the US dollar to strengthen again. In fact, the US dollar has been rallying for 5 straight days already. Markets became nervous and many equity indices ended the previous week in the red. This “mini-revolt” in the Fed, as brought about by 3 members speaking out unofficially, essentially negated some of the things that the Fed and other central banks have been doing.

Conflicting signals

In our presentations, we highlighted that one of the reasons behind the weakness in equities last year was policy divergence. As the US raised interest rates, other major economies around the world are actually cutting rates, resulting in a much stronger US dollar. Thus, we welcomed the Fed’s dovishness as something bullish for equities (see *Peso stabilizes below 47*, 21 March 2016). Unfortunately, the statements of these 3 Fed governors point towards continuing policy divergence. Conflicting signals like these confuse the market.

Every word you say

The effect of the recent pronouncements from some of the Fed members goes to show that investors, traders and economists still hang on to every word that any member of the Fed says. In a previous article (see *Every Move You Make*, 9 November 2015), we said that every move that the Fed made affected stock markets the world over. Recent events have shown that, until now, every step that the Fed makes will continue to move markets. Thus, this coming Friday is crucial as US nonfarm payrolls report will be coming out. If this number is above forecast, it signals strength in the US economy and may cause some Fed officials to be all the more hawkish, to the detriment of risk assets.

War without borders

Another factor may also hound risk assets – terrorism. Last week, Belgium suffered from a spate of bombings, killing dozens and injuring many more. This tends to sap bullishness for equities, especially in the short term. With the emergence of ISIS and its ability to stage terror attacks even in the heart of Europe, the world is now engaged in a war without borders.

Risks remain

Clearly, risks still remain. Terrorists strike when least expected. The spectre of slowing global growth still hangs over us, hence the valiant efforts of central banks to combat it. China is still muddling along and is doing its best to stabilize and rebalance its decelerating economy. With some outspoken Fed members

speaking in public and giving conflicting signals at a time when many economies are still weak, we can expect stock markets to experience more turbulence in the near term. This type of divergence is not what we need. As their logic and eloquence escape us, only chaos is left in the mind of investors. Instead, what we need is policy convergence and we have seen its impact on equity markets in the past 2 months.

A Song for Fed Members and Politicians

We hope that majority of the Fed members will be more enlightened and consider the global ramifications of their actions and statements. As it is, markets are already confused and nervous with the previous statements of some Fed governors. In a previous article, we left you with a song from the Police - Every Breath You Take. We will once again end with another song from them - De Do Do Do, De Da Da Da. The lyrics and message of this song can be conveyed not only to some of the Fed members but also to many politicians, especially in this election period.

De Do Do Do, De Da Da Da

Don't think me unkind
Words are hard to find
They're only cheques I've left unsigned
From the banks of chaos in my mind
And when their eloquence escapes me
Their logic ties me up and rapes me

De do do do, de da da da
Is all I want to say to you
De do do do, de da da da
Their innocence will pull me through
De do do do, de da da da
Is all I want to say to you
De do do do, de da da da
They're meaningless and all that's true

Poets, priests and politicians
Have words to thank for their positions
Words that scream for your submission
And no one's jamming their transmission
'Cos when their eloquence escapes you
Their logic ties you up and rapes you

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