



Philequity Corner (April 10, 2017)
By Wilson Sy

PSE Index breaks out after long consolidation

In our article last week (*Connect the Dots*, April 3, 2017), we said that investing is an art and not an exact science. In analyzing the stock market, we discussed the importance of using different fields of study, such as psychology, sociology, history and political science. Technical analysis is another discipline that investors can apply to better understand how markets behave. The breakout of the PSE Index (PSEi) last week is a good example of how technical analysis works.

Technical analysis, explained

Along with fundamentals and macroeconomics, technical analysis is one of the main disciplines that investors use in their trading. It involves the study of chart formations, price action and volume patterns to understand how the security is moving and where it is going. To better define what technical analysis is, we cite a quote from the book *Technical Analysis of Stock Trends* by Edwards and Magee: *“Chart formations are the language of the market, telling us that this stock is in its death throes; that stock is on a rocket to the moon; that a life and death battle is being waged in this issue; and in that other, the buyers have defeated the sellers and are breaking away.”*

History often repeats itself in stock price movements. Thus, technical analysis can be a valuable tool in assessing market conditions and in formulating investment strategies across different time horizons.

The board is the absolute truth

When I was still a young floor trader in the Manila Stock Exchange, we used to conduct trading via blackboards and whiteboards instead of the electronic trading that is being done today. I remember an old adage about investing which I continue to adhere to, which said that “The board is the absolute truth.” This is consistent with a key tenet of technical analysis, which states that almost everything is reflected in the price.

The price is the ultimate summation of all factors that may affect the stock. This is why it is important to make sense of price action, including chart formations and volume patterns. Practicing technical analysis can give one a better idea of how a stock is trading and where it will likely go in the future.

Breakout from the rectangle

The PSE Index is a good example of how technical analysis can be applied and be used as a tool.

After experiencing a sharp correction in the 2nd half of 2016, the PSEi hit an intraday low of 6,499, which was touched on December 23 and 26. The index then surged and touched a high of 7,402 on January 11. In the next three months, the PSEi consolidated in a rectangle pattern between 7,100 to 7,400.

However, last week, the PSEi staged a decisive break from its three-month consolidation and passed the key resistance level of 7,400. Based on a measured move, the PSEi's breakout from the rectangle has a minimum target of 7,700. This target was almost touched when the index reached an intraday high of 7,667 last Friday. A retest of the all-time high at 8,127 is possible if resistance levels at the 7,700 - 7,800 range are surpassed.



Sources: Stockcharts, Wealth Research

Low at 6,499 – confirmed

The technical picture has definitely improved given the PSEi's decisive breakout last week. We recall one of our calls in a past article (*Santa Arrives Late*, January 9, 2017) when we said, "Though the market has risen quite sharply and may need a correction or consolidation, we may have seen the low in this correction phase at 6,499." The PSEi's recent move reinforces our view that we have seen the low for this correction.

Chart breakout – confirmed by high volume and foreign buying

Last week, the PSEi delivered a weekly return of 3.7%, the biggest since the 4.2% yearend rally in 2016 and the 6% surge in the first week of 2017. We note that this was supported by high volume, as daily value traded averaged P9.6b last week, 37% higher than the daily average of P7b for 2017. In addition, net foreign buying amounted to P8.4b last week, in contrast to P17.5b in net outflows for the quarter ended March 31. It is also worth mentioning that daily net foreign buying (ex blocks) exceeded P1b twice last week – with net foreign buying amounting to P1.3b last Wednesday and P1.6b last Friday. All these confirm the strength of the PSEi's decisive breakout last week.

PSEi rallies after lagging peers

While the PSEi was trading in a range in the past three months, a number of Asian indices – such as India's Sensex, Jakarta Composite Index (JCI) and Stock Exchange of Thailand (SET) – have made new all-

time highs or are trading near those levels. Despite forecasts that the Philippines will be one of the fastest growing economies in the world this year and next year, the PSEi continued lagging while most other markets were rallying. Considering these, it is only normal for the PSEi to catch-up with its peers.

Watch out for global risks and corrections

Despite the recent improvement in the PSEi's chart and strong net foreign buying last week, we continue to monitor global risks that may affect the performance of Philippine stocks and assets. These include geopolitical risks, such as the recent US bomb attack on Syria, tensions emanating from North Korea and the upcoming French election. Other risks that we are monitoring are the unwinding of the Fed's massive balance sheet, the lofty valuations of US stocks which may trigger a sharp correction, and a potential slowdown in US growth. Likewise, we continue to study the PSEi's technical picture. The PSEi's steep rise last week has pushed it near the short-term technical target and resistance level of 7,700, which makes it prone to a possible correction.

Fundamentals and technicals align

Though the breakout of the PSE Index was driven by an improvement in technical conditions, there are also fundamental reasons that support it. In a past article (*When Doves Cry*, March 27, 2017), we discussed that the global economy has been slowly improving, with green shoots of growth coming out of different countries such as Europe, Japan and China. In another article, we mentioned that Trump and Duterte have similar pro-growth agendas which focus on tax reform and infrastructure spending (*Year of the Underdogs*, November 14, 2016). Growth should therefore be sustained if governments can implement their respective agendas. Meanwhile, the peso has stabilized near the 50 level as US dollar strength has recently abated (*Reversion to the Mean*, March 20, 2017). Thus, it is apparent that the recent upturn in technical conditions has aligned with improving fundamentals. Moreover, it appears that recent political noise has not been disruptive to the performance of the economy and various asset classes. As BSP Governor Amando Tetangco, Jr. said last Friday, "There seems to be a decoupling of economic performance and political noise. The economy has continued to perform well."

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 689-8080 or email ask@philequity.net.