Philequity Corner (May 15, 2017)
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The Ugly Duckling

In previous articles, we used fairy tales and fables to explain our investment strategies. We applied one of Aesop's fables, The Hare and the Tortoise, to explain how staying the course through slow and steady investing wins the race (see *The Hare and the Tortoise*, 5 April 2010). Investors who followed our advice and invested like a tortoise would have made substantial gains since we wrote about the bottom in 2009.

We also utilized the popular children's fairy tale, Goldilocks and the Three Bears, as a metaphor to better explain economics and our view on financial assets. We first referenced this tale in 2010 when we explained that the global economy is in a "sweet spot that is neither too hot nor too cold", making it conducive to rising stock prices (see *Goldilocks and the Three Bears*, 29 March 2010). We have also used it to describe currencies, such as the peso's "sweet spot" in 2013 (see *The Goldilocks Peso*, 4 November 2013).

Another fairy tale, another analogy

For this article, we are using another fairy tale – The Ugly Duckling. This story was first published in 1843 by acclaimed Danish poet and author Hans Christian Andersen in Copenhagen, Denmark. It has since been reprinted in many children's books and also adapted into movies and musicals.

This tale is about a homely little duckling born in a barn who, due to his unsightly appearance, gets teased, taunted and rejected by every group of animals he joins. Now miserable and alone, he chances upon a flock of swans descending on the lake where he is staying. The ugly duckling, now having fully grown, shows himself to the swans, expecting to be rejected yet again. But lo and behold, he is surprised when the swans accept him as one of their own. Caught by surprise, he looks at his reflection in the water and sees that from an ugly duckling, he has now grown into a beautiful swan!

Ugly no more

On March 3, 2017, Bloomberg published an article titled "Asia's Ugly Duckling of the Year is the Philippine Peso." On that day, the peso was trading at 50.38 to the US dollar, close to its lowest point for the year. Around that time, many investment banks released reports forecasting the peso to reach 51.50 to 52.50 to the dollar by yearend 2017. In fact, the Bloomberg article said that "it could get worse for the peso before it gets better." However, instead of getting worse, the peso bottomed shortly after and has since stabilized below the 50 level despite all the bearish forecasts.

Philippines: From ugly duckling to beautiful swan

Today, we are writing about another ugly duckling – the Philippine stock market. Towards the end of 2016, the PSEi was on track to be one of the worst performing stock markets in Asia. At its lowest point in December, the PSEI had fallen 20% from its recent high despite other Asian equity indices rallying towards their previous historical highs.

However, just like the ugly duckling, the Philippine stock market surprised its detractors and became a beautiful swan. At its high of 8,018 last week, the PSEi was up 17.2% YTD, the best in Asia. As can be seen in the table below, from being the worst performer (ugly duckling), the Philippines became the best-performing stock market in Asia (beautiful swan).

Country	YTD return %
Hong Kong	14.3%
Philippines	14.3%
India	13.4%
Singapore	13.0%
South Korea	12.8%
Vietnam	9.1%
Pakistan	8.2%
Malaysia	8.2%
Taiwan	7.9%
Indonesia	7.1%
Japan	4.0%
Australia	3.0%
Thailand	0.1%
China	-0.7%

Source: *Wealth Securities research*

How did the ugly duckling become a beautiful swan?

Just like the ugly duckling, Philippine stocks were rejected by foreign investors who sold our stock market down heavily in the latter part of 2016. Similar to the ugly duckling, it took some time for our stock market to become a beautiful swan. There were many risks in 2016 going into 2017 that deterred investors, but some catalysts have emerged. Through different articles, we wrote about the reasons why our stock market recovered as they were unfolding. We summarize these below:

1. **High GDP growth expectations**
   NEDA Director-General Ernesto Pernia forecasts that our economy can grow at 7% in the coming years. This bodes well for domestic consumption, corporate earnings and stock prices.
2. **Dutertenomics and the Golden Age of Infrastructure**
   The government's economic managers held a number of forums where they touted their economic program, dubbed "Dutertenomics." We wrote about this and PhP 8.4 trillion infra spending plan extensively in a previous article (see *Build, build build!*, 24 April 2017).
3. **Comprehensive tax reform package**
   To fund the massive infrastructure spending, it is crucial to pass the comprehensive tax reform package. Thus, when the proposal made it through the first reading of the House Committee on Ways and Means, investors became ecstatic (see *Tax Reform – The Next Big Catalyst*, 20 February 2017).
4. **Mergers and acquisitions in the banking sector**
   With speculation rife that RCBC was a takeover target, its stock price spiked, lifting the banking sector and the stock market as a whole with it. (see *The Hunter Games*, 8 May 2017)
5. **Foreign flows return**

After experiencing foreign selling for most of 1Q17, the PSEi saw foreign flows return to the tune of PhP 13 billion in the past 6 weeks (see *PSE Index breaks out after long consolidation*, 10 April 2017).

6. **Global equity rally**
   Stock markets the world over are rallying, with some indices even reaching new highs this year. The strong performance of US stocks lifted equities in Europe, Japan, and emerging markets, including the Philippines (see *20000*, 6 February 2017).
7. **Pause in dollar strength**
   Dollar strength has been the bane of Philippine stocks and the peso. Thus, with Trump talking down the dollar and the euro strengthening against it, emerging market currencies gained strength. This caused our peso to appreciate, bringing our stock market higher with it (see *The US dollar is "too strong" – Trump*, 23 January 2017).
8. **Moderate rise in interest rates**
   Although Fed Chairman Janet Yellen has stated that US interest rates have to rise, her recent statements were more dovish than expected. This signaled a moderate pace of policy tightening to ensure that global growth is not derailed – a bullish signal for stocks (see *When doves cry*, 27 March 2017).
9. **Investor-friendly outcome of French elections**
   With a pro-business and pro-Europe Emmanuel Macron winning, one significant risk was removed from the horizon – the potential disintegration of the Eurozone. Macron's victory was welcomed by investors and markets went from "risk off" to "risk on" (see *French Connection*, 1 May 2017).

Knocking on 8,000

As a result of all these reasons, our stock market was able reach the 8,000 level for the first time in nine months. Although the stock market may experience bumps and pauses along the way, this ugly duckling that transformed into a beautiful swan should continue to shine and remain on its path towards our previous all-time high of 8,137.

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Congratulations to incoming BSP Governor Nestor Espenilla! We wish you all the best as you take the helm of one of our country's most important financial institutions.