



Philequity Corner (June 5, 2017)
By Wilson Sy

Stock market cheers tax reform passage by House

Last week, in a landslide 246 to 9 vote, the much awaited first package of the comprehensive tax reform program was finally passed by the House of Representatives. The passage of the centerpiece of the Duterte administration's economic agenda was welcomed by analysts, economists, investors and businessmen.

PSEi gains 1.15% in one day, best in Asia

The day after Congress passed the bill, the PSEi rose 1.15% to 7,927. This made the PSEi the best performing stock market in Asia last Thursday. This sharp rise was also accompanied by heavy trading volume of PhP 17.1 billion, more than double the average daily value traded, with foreign funds net buying PhP 570M worth of stocks. The next trading day saw a continuation of this heavy volume with value turnover at PhP 10.9 billion and net foreign buying of PhP 1.7 billion.

EPHE outperforms PSEi, rising 3% in just 2 days

This bullishness in Philippine stocks is much more obvious in EPHE, the US-listed ETF for the Philippines. In 2 days, it gained 2.9%, outperforming even the PSEi – a reflection of the confidence of foreign investors in our stock market. This also indicates that we may see more foreign inflows in the coming days.

8,000 again before correcting because of casino casualties

Last Friday, our stock market managed to touch the 8,000 level again, rising to as high as 8,002 before correcting when news of the carnage in Resorts World Manila filtered into the market. If it were not for that, the PSEi may have held above 8,000 instead of ending the week at 7,907.

Peso appreciates sharply

It was not only our stock market that benefitted from tax reform, but the Philippine peso as well. After staying quite close to the 50 level for the past months, the peso appreciated sharply last Friday as foreign funds poured into Philippine assets. In just one day, the peso gained 0.46% against the dollar, ending the day at 49.51.

Tax reform boosts Philippine stocks

With investors turning bullish and gobbling up Philippine stocks, events unfolded just as PSE President and CEO Ramon Monzon stated. Last week, he said that tax reform “will be a very big impetus to the stock market going up.” Some foreign fund managers echoed the same sentiment. In a TV interview, Alan Richardson, ASEAN fund manager of Samsung Asset Management, said they have upgraded Philippines from underweight to overweight. He added that the consumer and property sector will benefit the most from tax reform.

Consumer stocks outperform

Though the PSEi gained 1.15% last Thursday, we noted that some stocks outperformed significantly. The top 10 performers among liquid stocks are proxies for consumer spending, such as WLCON (+7.8%), JFC (+5.6%), MAXS (+4.9%), BLOOM (+4.8%), PGOLD (+4.5%), PIZZA (+3.5%) and MRP (+2.9%). However, casino stocks BLOOM and MRP fell the next day because of the incident at Resorts World. Though not liquid, the best performing consumer stock last June 1 was SEVN (+10.4%). TEL (+5.1%) and ALI (+2.9%) are index heavyweights so they will be the first recipients of foreign inflows, in addition to the telco and property sectors benefitting from stronger domestic consumption. EW (+4.7%) is the bank with the highest percentage of consumer loans in its loan portfolio, hence its outperformance last Thursday. Consumer stocks outperformed because the cut in personal income taxes will directly benefit consumers, especially middle wage earners.

Potential credit rating upgrade

With investor sentiment now tilted in favor of the bulls, it is now the turn of the credit rating agencies to make an assessment of our fiscal health. If tax reform is finally passed by both houses, many are saying that a credit rating upgrade is quite likely. Outgoing BSP Governor Amando Tetangco, Jr. said this “will soon finally translate to a long overdue upgrade from Fitch.” Michael Wan, economist at Credit Suisse, said that “we expect Fitch to upgrade the Philippines if the bill eventually passes as it is written.” When this happens, it will be a big boost to our country’s economy as the government and corporates will have lower borrowing costs moving forward.

Good timing

One of the main concerns regarding the tax reform package was that it would have an inflationary effect because of the excise taxes on fuel. However, if we look at the price of crude oil, there is no better time to raise excise taxes than now. As one can see in the chart below, from a high of \$147/barrel in 2008, crude oil prices are just \$48/barrel, down 2/3 from their high. With oil prices at multi-year lows, now is the perfect opportunity to raise excise taxes without significantly stoking inflation and hurting the consumer.

Crude oil price chart, 2007-2017



Source: macrotrends.net

Tax reform - a step in the right direction

Though the tax reform package still has to hurdle the Senate and then the bicameral body as a whole, analysts have already been hailing it as a step in the right direction. In a research report, Nomura said that this is “a positive step” and “the decisive result underscores the strong priority that Duterte places on the economic reform agenda.” In reply to criticism that the excise tax on fuel and sugary drinks is anti-poor, Credit Suisse said it is “positive for private consumption in 2018, with tax cuts and cash transfers more than offsetting tax hikes. This contrasts with prevailing market consensus that the reform is negative for consumption.”

E-VAT in 2005 – gain of 9% in 2 weeks

In Chapter 5 of the book, Opportunity of a Lifetime, we discussed how fiscal reform was crucial to our country’s bull market. We explained that in the aftermath of the Asian Financial crisis up to the early 2000s, the Philippines was branded the sick man of Asia. However, the passage of E-VAT in 2005 sparked the secular bull market we are experiencing now. When E-VAT was signed by GMA, our stock market rose 9% in just 2 weeks. Now, we are in the midst of another “make or break” moment for our country. If the complete comprehensive tax reform package is passed as is and not watered down, we may see a resurgence in Philippine stocks similar to what we saw in 2005.

Congratulations!

Though the tax reform package has not yet been passed by both houses, congratulations are in order. We would like to congratulate Finance Secretary Sonny Dominguez and Undersecretary Karl Kendrick Chua for crafting and promoting this bill despite heavy opposition on many sides. We would also like to congratulate our congressmen for passing and sending the bill to the Senate. Now, we all have to be vigilant and make sure that the final version of the tax reform package is not only passed by both houses, but also kept as is and not watered down.

All-time high within reach

At last week’s close, the PSEi’s all-time high of 8,137 is less than 3% away. Though we may be in the midst of martial law in Mindanao and mourning over the casino tragedy, hope that tax reform may finally become a reality has put our historic high within reach. If all goes well, we believe that our stock market will eventually break this level and make new all-time highs.

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