



Philequity Corner (July 31, 2017)
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Back at 8000

After trying to break 8,000 many times, the PSEi finally managed to end the week above that crucial level. We first wrote about the 8000 milestone after it touched it for the first time on March 30, 2015 (see *8000*, 13 April 2015). Unfortunately, the 8000 level has proven to be a formidable resistance, thwarting every attempt at a decisive breakout. Are we ready to surpass it this time around?

Touching 8000

In a previous article, we wrote about the PSEi's attempts to break the 8000 level (see *Flirting with 8,000*, 19 June 2017). The index has touched this level 13 times this year but has failed to convincingly break above it each time. Earlier attempts were met with a sizeable correction.

First weekly close above 8000 since July 2016

For 2017, the index has closed above 8000 on five occasions only. Three of these instances happened last week. Whether this attack of 8000 will be met with yet another correction remains to be seen. However, what is notable is not only did we reach our highs for 2017 last week at 8,106, but this is also the first time the PSEi ended the week above 8000 since July 2016. Note that last week, we were just 31 points away from our all-time high of 8,137.

Why did we reach 8000 again?

Despite negative news flow such as the weakening peso, our first current account deficit in 15 years, the largest trade deficit on record and martial law in Marawi, the PSEi still managed to break 8000. There are many reasons behind this and we enumerate them below:

1. Global bull market

Stock markets around the world have either made new historic highs or are closing in on their previous all-time highs. Thus, Philippine stocks are following suit.

2. Synchronized global economic growth

After 9 years of coordinated central bank action, all regions of the world are now growing in unison. This is driving the global bull market we are experiencing now.

3. Historically low interest rates

Despite economic growth, interest rates still remain low by historical standards. Also, as we said in the last article, interest rates are "likely to remain below levels that prevailed in previous decades" (see *Every Word You Say*, 31 July 2017).

4. Hope in tax reform and infrastructure spending

After Congress passed the tax reform package, markets rallied as it came one step closer to becoming law. The centerpiece of the government's economic agenda, this may be

transformative for the Philippine economy. Moreover, it could usher in the “Golden Age of Infrastructure.”

200 points in 3 days

The impact of tax reform on our economy and stock market cannot be understated. When Congress passed the tax reform package, the PSEi rose as much as 200 points in just 3 days. In fact, it was during this rally that our market closed above 8000 for the first time this year.

“Do I have to kneel?” - Duterte

Hope in tax reform was further bolstered when Duterte made sure to include his push for tax reform in his 2nd State of the Nation Address (SONA) last week. Now that tax reform is in the hands of the Senate, he implored the senators to “support my tax reform in full and pass it with haste.” He even said, *ano ba ang gusto ninyong gawin, lumuhod ako diyan?* (What do you want me to do, kneel before you?). Seeing that the President was enormously determined to see tax reform through, the markets took this as a positive signal. This one line in his very long SONA may well be the most important reason that we broke 8000.

Foreign flows return

In fact, foreign funds may have taken note of Duterte’s willingness to kneel just to get tax reform passed. In the 4 days following Duterte’s SONA, Philippine stocks saw PHP 2.5 billion in net foreign flows. Foreign investors easily carried our market towards the 8000 level.

Green in a sea of red

Other than net foreign inflows, another bullish signal was the PSEi’s move last Friday. As US equities corrected towards the end of last week, Asian markets were in the red last Friday. However, not only did we end the week above 8000, but the Philippines was one of only two Asian markets in the green. Being green in a sea of red is a positive sign.

Investment community on Duterte’s side

Although the investment community did not see eye to eye with Duterte on some occasions, many are now on his side this time. In a statement last week, credit rating agency Fitch said that “low government revenue remains a constraint to the country’s fiscal profile, hence the need to pass the comprehensive tax reform package.” The Makati Business Club said that they “welcome the early passage of the tax measures.” In response to the market’s recent strength, PSE President Ramon Monzon said “the passage of the tax reform bill and the infrastructure program of the government should help sustain the market’s growth momentum in the coming years.” Many businessmen, bankers, economists, stockbrokers, local & foreign portfolio managers and research analysts have also supported our economic managers’ push for tax reform. Many believe that the tax reform will result in more government revenues over the long term and lead to a potential credit rating upgrade in 2018.

Build, Build, Build or Debt, Debt, Debt

In a recent speech, BSP Governor Nestor Espenilla, Jr. said that “on balance, tax reform is good for the

economy.” However, he cautioned that if it is not passed, “Build, Build, Build” would become “Debt, Debt, Debt.” We have to remember though that tax reform must not only be passed, but it must not be watered down as well. DOF Secretary Sonny Dominguez echoed this as he urged lawmakers to pass tax reform in its entirety or else “it won’t work as well.”

Binary

We have to emphasize how important the passage of tax reform is. If it is not passed or a diluted version is implemented, expect the peso to depreciate further as our current account, balance of payments, trade and fiscal deficits worsen. Thus, we are now in a binary situation – if we pass tax reform in full, we will enter a virtuous cycle while the alternative will lead to a vicious cycle downward.

8000 and beyond

Though we ended the week above 8000, we are now nearing our previous historic high of 8,137. Since this is a strong resistance level, our stock market may experience corrections. However, if you believe that the tax reform package will be passed without getting watered down, then these corrections are opportunities to buy. If passed, the peso will get stronger and our stock market will go beyond 8000. In commemoration of our stock market getting back at 8000, we end this article with the lyrics from the song “Back at One” by Brian McKnight:

Back at One

One, you're like a dream come true
Two, just wanna be with you
Three, girl, it's plain to see that you're the only one for me
And four, repeat steps one through three
Five, make you fall in love with me
If ever I believe my work is done
Then I'll start back at one.

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