



Philequity Corner (August 14, 2017)

By Wilson Sy

Breaking out is hard to do

Our title may ring a familiar tune to some, especially to music aficionados. This is because the title of our article sounds very much like the title of Neil Sedaka's hit song, "Breaking up is hard to do." Actually, in this article, we shall discuss the PSEi's repeated failure to stage a convincing breakout past 8,000. We shall also explain the reasons that may drive the PSEi's decisive breakout above 8,000.

Third major attempt at 8,000

The PSEi first touched 8,000 in April 2015. But instead of sustaining its momentum, the index corrected sharply and reached a low of 6,084 in January 2016. Back then, there were concerns about a possible global economic slowdown, precipitated by slowing growth in China. Moreover, the historic drop in oil prices was taken as a signal of a potential recession. The PSEi made another attempt to break past 8,000 in July 2016, but the index failed to sustain the upmove as it pulled back to a low of 6,499 in December 2016. The index again touched 8,000 in May this year and has flirted with the round number milestone in the past few months (*Flirting with 8,000*, June 19, 2017).

PSEi touches 8,000 multiple times

During those three major attempts, the PSEi touched 8,000 many times. The index reached 8,000 eight times in 2015 and 20 times in 2016. So far this year, the index has touched the 8,000 threshold 18 times. Despite these multiple attempts, the PSEi has not staged a convincing breakout past 8,000.

8,000 – a formidable resistance

Below, we enumerate the reasons why the PSEi has failed to break out decisively past 8,000.

- 1. Round number resistance.** The round number resistance of 8,000 has not been broken convincingly. As such, it serves as a difficult psychological and numerical threshold to overcome. This has triggered a lot of selling from local investors whenever the index touches 8,000.
- 2. All-time high of 8,137, a daunting resistance.** The PSEi's all-time high is a tough resistance to break. Technical analysts point to the all-time high of 8,137 as a strong resistance level.
- 3. Breakeven mentality.** Many investors bought at 8,000 when the PSEi attempted to break past that level in 2015 or 2016. There are many who did not want to exit with losses and got stuck with their positions. The heavy resistance at the 8,000 level is partly attributable to investors who sell at breakeven prices after getting stuck with losing positions for a year or two.
- 4. Concerns on the PSEi's valuation at 8,000.** Some investors have commented that the PSEi is expensive at 8,000. The index is now trading at 19.3x 2017E PE, which is in the middle of its 17-22x PE range. While our index is more expensive than its regional peers, the PSEi's composition is different from its regional counterparts, thus warranting higher valuations. Moreover, corporate earnings for index constituents have grown by 6.2% in 2015 and 8.7% in 2016. This means that the PSEi is actually cheaper now compared to its past two attempts at breaking past 8,000.

5. **Triple deficits.** The country's reported macroeconomic numbers have so far acted as dampeners for the continued rise of the PSEi. The current account deficit, balance of payments deficit and concerns about a potentially wider budget deficit have been viewed negatively by some investors.
6. **Peso weakness.** Recently, the peso has reached its lowest level in 11 years. Though this has not caused our stock market to correct sharply, the recent peso weakness has served as a deterrent for the PSEi's breakout attempts. Last Friday, the peso touched 51 due to rising geopolitical tensions.
7. **Geopolitical tensions between the US and North Korea.** North Korea's missile launch, Trump's response of retaliating with "fire and fury", and North Korea's threats of launching a missile attack in Guam caused global stock markets to drop last week.
8. **Seasonally weak performance in August and ghost month.** In our book *Opportunity of a Lifetime* (see Chapter 10, page 191), we explained that August is a seasonally weak month for stocks. August has the lowest monthly average return and the lowest batting rate of netting positive returns. This year's ghost month will start on August 22 and end on September 19. This may cause some investors to postpone their stock purchases during the ghost month.

Reasons supporting the eventual breakout past 8,000

Despite the headwinds that our stock market is facing, we believe that there are reasons that may drive the PSEi's decisive breakout past 8,000. We enumerate these below.

1. **Passage of tax reform.** The tax reform package is positively viewed by most economists, credit rating agencies, research analysts, businessmen, bankers, fund managers and stock brokers. Unlike the imposition of the eVAT in 2005, the proposed tax reform package enjoys wider support from most sectors of society and is viewed as a major catalyst for the stock market and the economy.
2. **A recovery of the peso.** The passage of the tax reform package, as proposed by the Finance department, may trigger a recovery of the peso. A potential recovery of the peso will make our stock market more attractive to foreign investors and will cause the PSEi to strengthen.
3. **Global bull run.** Most global indices are moving up, with major markets making new highs. Though global markets have corrected recently due to geopolitical tensions, a recovery in global stocks may propel the PSEi to a new all-time high.
4. **Synchronized global growth.** With major economies growing at the same time, it is clear that we are witnessing synchronized global economic growth (*Synchronized global growth*, June 13, 2017). This gives credence to the global bull run in stocks that is currently unfolding.
5. **Historically low interest rates.** As global growth picks up, rates are rising at a slow pace as inflation remains benign. Despite recent rate hikes, interest rates are still historically low. Further, the Fed has telegraphed that interest rates will normalize at much lower levels.
6. **Rising corporate earnings.** 1st half earnings have started to come out and we have so far seen positive results for Ayala Land, SM Investments, BDO and PLDT. Considering this, we expect the index heavyweights to carry the PSEi higher as it tries to break past the 8,000 barrier.
7. **Strong net foreign buying.** With net foreign buying amounting to P23.6b year-to-date, it is apparent that selling from local funds and retail investors were absorbed by foreign funds. Thus, strong foreign buying should be an important catalyst for the PSEi's eventual breakout.

8. **Seasonality in the stock market.** After seasonal weakness during the ghost month, the PSEi may stage a recovery later this year. In our book, we discussed that Halloween to Valentine's is a favorable period for stocks, as it captures the seasonally strong months of December and January.
9. **EDC tender offer.** Up to \$1.27b is expected to come in as funds headed by Macquarie Infrastructure and Real Assets (MIRA) and Arran Investment purchase up to 8.9b common shares of Energy Dev't Corp (EDC). The influx of dollars should be positive for the peso and may counter some of the recent weakness that we have seen. Moreover, up to P50b in buying power may be freed up as investors tender their shares and redeploy their funds to other stocks. The EDC tender offer may have the effect of a reverse placement (*An avalanche of overnight secondary placements*, July 23, 2012), as it will result in additional liquidity in the stock market.

Philequity Investor Briefing on Saturday, August 19

Will the PSEi stage a decisive breakout past 8,000 on its 3rd major attempt? Or will it succumb to another sharp correction due to rising geopolitical tensions? Will the market fall because of seasonal weakness during the ghost month? Will the peso continue to be weak and eventually reverse our stock market's strength? These questions will be answered in greater detail during our investor briefing this Saturday, August 19, 9am at the Meralco Theater. Investors of Philequity and readers of this corner are requested to register for the event as seats are being filled-up quickly.

Guest speaker is Finance USec Karl Kendrick Chua

Finance USec Karl Kendrick Chua will be the guest speaker in our investor briefing. He will explain the tax reform package and how it will be beneficial to the stock market, the economy and the general public. After the presentations, we will hold a Q&A forum which will be moderated by Shawn Yao of Bloomberg Philippines.

Breaking up is hard to do

In light of the PSEi's difficulty in breaking past 8,000, we would like to leave you with an excerpt from the lyrics of the popular song, "Breaking up is hard to do." The song was recorded and released by Neil Sedaka twice. The first version, released in 1962, was in an up tempo beat. The second recording in 1975 came with a different and slower arrangement.

*Don't take your love away from me
Don't you leave my heart in misery
If you go then I'll be blue
Cause breaking up is hard to do*

*Remember when you held me tight
And you kissed me all through the night
Think of all that we've been through
And breaking up is hard to do*

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