Philequity Corner (May 21, 2018)
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Tightening the belt

The consumer is not swayed solely by minimizing costs and maximizing benefits. Other variables tweak the buying decision, like status-seeking, expert endorsement, or herd mentality. Is shopping affected by moods and emotions? Sure, sometimes, the mall is just there for the eats. Even window shopping can be too strenuous.

Even the savvy stock investor is not immune to mood swings.

Economists explain increases in consumer spending as one effect of a bull market. (Remember the mood when the stock index broke 9,000? How long ago was that?) This exuberance in spending is called the "wealth effect". When paper profits accumulate in one's stock portfolio, the high-spirited, though irrational, feeling of wealth sets in.

The investor spends cash he hasn't realized yet. Already, he feels richer from paper profits. The green numbers become his go signal to step on the accelerator of his spending motor. He feels there's a stash of cash he can still tap later.

This leads to discretionary spending and consumption of wine in a tapas bar, travel bookings, and splurges on art works. The feeling of being wealthy can drive consumption, fueled by credit card spending.

What if the stock market is volatile and on a downward trend as it has been since the exchange moved to its integrated location—is that a coincidence? This is accompanied by the depreciation of the peso driven by balance of payments deficit from imports for infra, along with higher inflation (4.5%) and rise in interest rates by 25 basis points.

Does the investor feel poorer and experience an opposite "poverty effect"? If the stock investor is trading on margin, the poverty may be even more real as his position is sold off at market with actual losses kicking in.

Poverty in the context of mood and emotions is different from real deprivation, a state of penury where there is no money to spend on rent and food. Still the poverty effect strikes both real and imagined reduction of disposable income.

Signs of the poverty effect are hard to miss.

There is little appreciation for statements on the drivers of growth remaining intact and unappreciated. (First quarter 2018 GDP growth rate is 6.8%. Our credit rating has been raised once more.) The gloom refuses to lift.

Days' receivables of supplier companies are stretching. Large corporations are hanging on to cash and postponing payments to suppliers. (I'm still looking for the signed cost estimates of two years back.) This postponement, if not deep discounting, of payment allows companies to hang on to cash from de facto suppliers' credit. The poverty effect applies to companies too.

Pre-booked Christmas holidays on the closed beach may have been refunded and struck off the consumption list. This small blip in tourist revenues contributes to the poverty effect. (Is the changing of the guard at the DOT going to lift the mood?) The island's closure is computed at a "mere" drop of less than 0.1% of GDP. But this does not reflect negative perceptions on the rest of the 7,099 islands as tourist destinations. There will be cancelled bookings in other locations too. Let's call this the "cesspool effect."

Preventing the poverty effect from taking root entails showing more than GDP numbers and the usual economic stats like inflation within the range, although in the upper levels. There is the emotional factor that an individual that felt wealthy before, with the index breaking 9,000, now feels uncomfortable, and worried about his financial health.

There's nothing wrong with feeling just a bit poorer. It may turn cash waiting in the sidelines into a viable portfolio component again. Still, it is consumption and optimism that drives the real economy.

Is the strategy of "averaging down" or buying the same stock as its price declines, sometimes abruptly, still a viable strategy? The "wait and see" advocates are probably getting more "likes" on their posts.

The poverty effect takes firm hold when it is time to cut losses and sell. Then a glimpse of real poverty may be like waking up from a nightmare and realizing you weren't even sleeping.

Still, it is good to remember you still have other assets left. Anyway, the stock market has a recurrent history of turning around…just when you are about to give up on it.