JULY 10, 2023

VANTAGE POINT

A WEEKLY PUBLICATION FROM THE FUND MANAGERS AND ANALYSTS OF PHILEQUITY MANAGEMENT, INC.

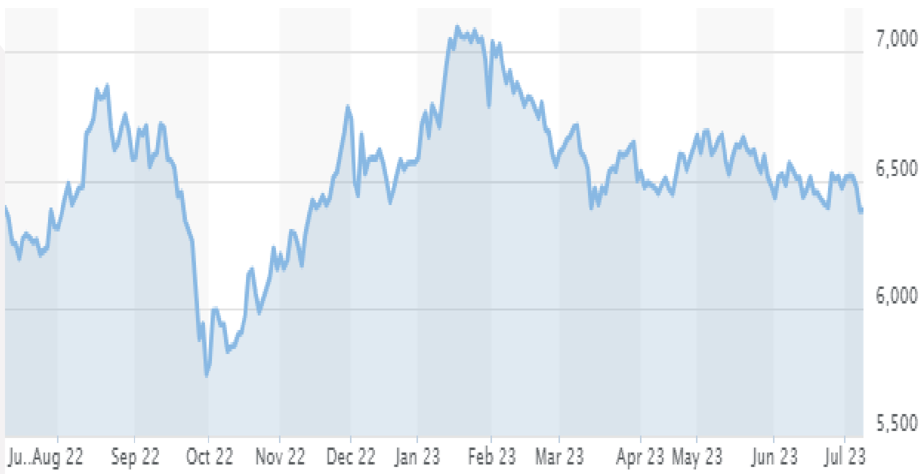
EQUITY OUTLOOK

MARKET OUTLOOK: NEUTRAL
SECTOR PICKS: CONSUMER, FINANCIAL NAMES, STOCKS WHICH BEAT EARNINGS FORECASTS, COMPANIES WHICH DERIVE A LARGE PORTION OF THEIR INCOME FROM FOREIGN SOURCES.
TECHNICALS: SUPPORT AT 6200 FOLLOWED BY 6000, RESISTANCE AT 6500 FOLLOWED BY 6800

Two main issues are confronting markets recently. First is the escalation of the tech war between the China and the US. The US is not only withholding tech exports to China, but it is also encouraging its allies to do so as well. This has angered China, which retaliated with a soft export ban on germanium and gallium. These are critical raw materials for special alloys and semiconductors. While this seems to only be a warning shot on China, a complete ban is on the table if the West does not soften its position.

Second is the sudden spike in bond yields and interest rate expectations. This was triggered by a blowout ADP employment report which showed that 497,000 additional jobs were created in June, versus as forecast of 220,000. Combined with the Fed's dot plot which indicated an additional 50 bps of hikes this year instead of a pause, interest rate expectations shot up higher.

Philippine Stock Exchange Index (PSEi) 1-year chart



The recent rally in equity prices was driven by bullishness in the emerging AI sector as well as expectations of interest rates peaking. With the AI hype fading, a tech war and interest rate expectations going up, markets naturally weakened. While it is hard to predict how deep or lasting this correction will be, investors with an abundance of cash and low equity exposure may use this as an opportunity to buy. Otherwise, prudence may be the better part of valor.

TRADING STRATEGY

With US 2-year bond yields hitting a 16-year high, equities retreated. Until such point that it is clear that interest rates are on the way down, we may continue to see weakness and volatility for Philippine stocks.

BOND OUTLOOK

MARKET OUTLOOK: **DEFENSIVE**

TRADING STRATEGY

Market has indeed sold off in the local bond space with the 1069 now given up to 6.7, following the move higher in USTs, with the 10y UST reaching 4.05. We look to remain defensive given that market seems to be quite heavy still, with sellers still overpowering opportunistic buyers. However with yields already at the highs for the year, this level is attractive, especially as local inflation seems to be trending lower.

Fed minutes showed that the June pause was hotly contested, and with jobs data coming out higher than expected, with the ADP jobs report adding double the jobs than expected, 10y UST shoots up to 4.05. The NFP jobs data report though shows a slower rate of growth, but market has decidedly become quite bearish as it is all but given that the Fed will now raise rates in its July meeting, with a chance to raise even higher than 25bp.

Here in the Philippines, inflation seems to be cooling already, and we may see inflation come back to target as early as 1Q of 2024.

However since the Fed will be raising rates, the chance is slim for the BSP to cut rates. It is more likely that they may follow suit and raise rates slightly higher just to keep the interest rate differential close with the US to protect the FX rate.

PHP BVAL Reference Rates – Benchmark Tenors

Tenor	BVAL Rate as of July 10, 2023
1M	6.0217
3M	6.1088
6M	6.1939
1Y	6.2834
2Y	6.3871
3Y	6.3918
4Y	6.4106
5Y	6.4436
7Y	6.536
10Y	6.6878
20Y	6.7353
25Y	6.7348