The Philippines, Emerging Markets and the World of Investment Opportunities

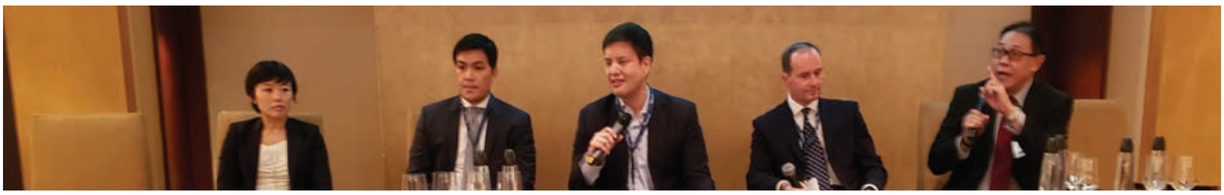
The range of investment opportunities at home is growing, although the pace of liberalisation could better emulate some of the ASEAN neighbours such as Thailand or Malaysia. The domestic economy is so compelling - remarkable demographics, high GDP and corporate profits growth, and fast-rising domestic demand - that the valuation gap between a country such as the Philippines compared to developed markets is too wide for value-investors to believe sustainable. Will the gap close? Asian investors believe so, as most appear happy to invest mostly in their region. And more foreign investors believe so, judging by inflows thus far in 2019.

These were the topics discussed:

- *Are we becoming more international in our investment thinking?*
- *Regulation and compliance - what developments?*
- *Impact of the new Tax Law on Investment Funds?*
- *Challenges and Opportunities for Unit linked insurance in the Philippines?*
- *How are you thinking about fund selection and portfolio construction?*
- *How has the Investment environment changed in Asia from 2017 to 2019?*
- *Managing and understanding risk – how do you estimate risk, and how does it impact your investment process?*
- *How do you think Asian equity market performance will be in 2019?*
- *Whats the outlook for emerging markets?*
- *What is interesting in the fixed income and credit universe today?*
- *Is the Philippines warming to index and ETF products?*

PANEL SPEAKERS

- **Adeline Tan,** Wealth Business Leader, Hong Kong, Mercer
- **Dr. Robert B. Ramos CFA, CAIA, CIPM,** Senior Vice President, Trust Officer and Chief Investment Officer, EastWest Bank
- **Roberto Vergara,** First Vice President & Head of Trust, Philippine Veterans Bank
- **Michael Gerard D. Enriquez,** Chief Investment Officer, Sun Life Financial
- **Rob Mumford,** Portfolio Manager, Emerging Markets



Link to Content Summary page
Link to Photos
Link to Event Homepage

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THE KEY TAKEAWAYS

More choice...
There is a growing array of choice for the wealth management market, as the authorities in the country gradually liberalise, with the advent of fund of funds, feeder funds, investors can invest more allocation in overseas assets, via local derivative structures. And qualified investors can now also invest overseas, or into instruments such as ETFs.

...but progress could be faster
However, the Philippines remains behind its major ASEAN peers such as Thailand, or Malaysia, as the regulators still tend to drag their feet.

Pressure being applied
The regulators are working increasingly with industry participants to review some of the somewhat archaic attitudes and regulations and to gradually modernise towards more international standards. An advance of moving slowly is that mistakes seen overseas will not be replicated in the country.

Some encouraging signs
The BSP - the central bank - is gradually changing its stance somewhat, towards greater emphasis on risk-based regulations, rather than blanket prevention. The fund management associations and other experts are meeting regularly with the central bankers, who are becoming increasingly proactive, indicating, for example, they will also loosen up on derivatives.

A wider doorway, leading to open architecture
As there is more choice, due to gradual liberalisation, the practice of open architecture is starting to become more popular, further accelerating the availability of funds, and hopefully offering clients class-leading opportunities.

Demographics and fundamentals combine
Both the country's demographics - a very young, fast-growing population that is consuming more and more at home - and the country's stable fiscal position - low debt levels and rapid savings accumulation - augur well for the wealth management market

But the EM discount gap persists
But despite these positives, the Philippines is emblematic of the broader problem for emerging markets, namely that their capital markets trade at deep discounts to the development, investment-grade markets, in the region of a forward PE multiple of 11 compared with 17 or more.

Domestic demand and rapid profits expansion might turn the tide
Faster profits growth seems to have had little impact on driving investors to reduce this gap, in fact, value-investors have been disappointed as momentum has continued to flow towards the DM arena for several years. However, there are those who believe the metrics are now so compelling and the risks in the developed world so profound that the markets will soon turn the corner soon. With a 6% GDP growth forecast for the Philippines, the country should be a major beneficiary.

Government paper calls
Within the wider EM universe, and certainly in the Philippines, sovereign debt appears to be a safe haven. However, while corporate debt is solid, spreads above the sovereign are today somewhat thin.

"IN THE PAST ROUGHLY FIVE YEARS OR MORE," began one expert, "with the advent of fund of funds, feeder funds, local institutions have been able to partake of funds that were created abroad but assembled locally to create the right structure. The SEC here then updated their regulations last year, allowing investors classified as knowledgeable investors to buy into ETFs or maybe even funds that were created abroad. That is a major change."

Playing catch-up

"The Philippines is some distance from what we see internationally in terms of the capital markets regulations," came another voice, "but I agree that the government and the institutions are really trying their best and we are excited, for example, to see REITs finally coming soon in the Philippines. I know we are about 10 years behind on short selling, derivatives and many of those things we do hope the regulations to evolve from what are somewhat antiquated rules. The regulators are starting to review some of these and hopefully modernise towards more international standards."

"Why are the regulators late in all this?" a guest asked. "The structure of the capital markets here is quite different," an expert replied. "But we can learn from the mistakes we have witnessed in the international markets, especially with regard to the more exotic products. We welcome these developments but at the same time we must take on board the learnings from overseas."

ROBERTO VERGARA
Philippine Veterans Bank

MICHAEL GERARD D. ENRIQUEZ
Sun Life Financial

Gradual enlightenment

"The BSP is changing its stance somewhat," advised another expert. "Today, they are more emphasising risk-based regulations, whereas before their rules have been preventive. Now they tell participants to understand and address the risks and proceed from there. Accordingly, this is permissive in a way that they are now allowing us to draw on risk management and other skills for international investments are concerned, and this includes allowing qualified clients to invest. There are fund management associations and other experts who meet regularly with the Central Bank and I have to say the latter are increasingly proactive. They have indicated they will also loosen up on derivatives."

ASEAN countries as the model

Another guest added that progress is certainly being made, but that to progress to levels seen in markets such as Malaysia, Thailand or even Singapore then more communication is required. "It is contingent upon us as practitioners that we talk to each other, work with organisations, discuss with the regulator and they will see the reason for allowing further liberalisation."

ADELINE TAN
Mercer

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A panellist noted that with a slowly growing set of funds in the cupboard, open architecture is starting to become popular and third-party funds will grow in numbers accordingly.

The numbers speak for themselves

A panellist referred to the immense opportunity the fast-growing and young demographics offer. "The country is also relatively stable now politically, so it is an exciting time. There is also a keen will to progress, as I see it. There is more onshore innovation taking place and more possible as the population here is quite well educated, with high levels of literacy as well. The excitement now for the Philippines is to see where that innovation can find a way to express itself, but the regulatory stance on many areas is somewhat vague, so I hope that the regulator can create fewer grey areas, and help provide a safe place for innovation and more risk-taking to happen."

The discussion moved to the continuing discount of emerging markets to developed markets, with a guest putting his perspectives forward. There has typically always been a premium for the more mature markets, he reported, but it has widened in recent years.

Mind the gap

"The global financial crisis and the ensuing QE has pushed people down the risk curve but only to fixed income or bond proxies, but at the same time a lot of the growth has come from emerging markets, causing the gap to widen further," he comments. "Moreover, the gap in terms of future growth forecasts has widened, so for example here in the Philippines, we forecast 6% GDP growth, inflation under control, the current account deficit under control, the equity market at reasonable valuations. In the fourth quarter last year, EM dramatically outperformed DM, as the valuation discount had become too wide, and the growth rate differential in favour of EM has become more pronounced."

Less risk at home

And as to trade war risks, he noted that the risks to countries such as Germany, with 50% of GDP in exports, is far higher than to a country such as the Philippines. "The DM arena is much more at risk , especially with their already very low growth, whereas at 6% growth per annum here there is a big buffer. And at a 10 times earnings valuation, a 10% earnings yield, and a 2% dividend, you can afford to lose some growth. And there are so many other forces driving markets like this forward, including urbanisation and other powerful forces for emerging markets."

"Collectively," he added, "the major EM economies all have the drivers I mentioned, such as high levels of domestic demand, young growing populations, low debt levels, and other appealing factors, so we are seeing the rotation of large domestic savings into investments, increasing domestic consumer activity that is insulated from external factors."

Staying local

Another expert noted that her firm had recently completed some asset allocation studies for Asian clients who are very comfortable investing in their domestic Asia region. "Remember," she remarked, "it also depends on where your liabilities are, which currencies they are in, and we need to consider inflation, which will be considerably higher than in the major economies. As to exactly where the Philippines sits, we have to look also at the other huge, rapidly growing economies and populations such as Indonesia, which has the largest population here in ASEAN, and countries such as Thailand. There are a lot of opportunities here."

"I believe it was Warren Buffett who said when the tide goes out you find out who has been swimming naked," remarked another panellist. "So is Asia a safe bet when the tide goes out, or do we need to look beyond Asia? Do we look at gold?"

DR. ROBERT B. RAMOS CFA, CAIA, CIPM
EastWest Bank

ROB MUMFORD
GAM

Swimming with the tide

"I believe this is a safe haven," came the reply. "Economies driven by domestic demand and that are self-sustainable, the right credit metrics across the government, fiscal balances, so we definitely include the ASEAN markets, and sovereign bonds within those markets are extremely attractive. If you do find Trump's latest tweets cause a mild recession, I think the carry you can get from Asian sovereign bonds is an attractive place to be. And as an inflation hedge, equities in these markets."

"Yes," added another, "even if the global market slows down, the Philippines will continue to prosper as demand is so domestic-focused. And there are the foreign worker remittances, which are robust, tourism is expanding fast, and there is better visibility of earnings in the corporate world here, especially because they are so domestic-centric, not really much affected by what is happening globally. We might get some volatility because of sentiment, but overall if you look at the fundamentals, things look good ahead. I therefore think the Philippines can be a safe haven for domestic equities, although on the fixed income side there is not a lot of spread over the sovereign paper for quality paper."

A negative is the shallowness of the equity market. "The outflow of foreign funds will definitely impact the market, but we can see that there has been a lot of foreign buying entering the market since the start of this year again."

Sovereign paper's appeals

"Sovereign debt is certainly a safe haven," said another expert. "I like long-dated paper and hope that as rates fall, prices will also rise. They are liquid and easy to see if I need cash. Corporate debt spreads are somewhat thin. And real estate appears to be stable, it is generating good cashflows."

The final portion of the discussion focused on alternatives. "Gold, perhaps a 10% allocation, as we heard earlier today, is a worthy consideration as a portfolio hedge that is non-correlated to mainstream markets," said one expert. "The right choice of hedge funds, especially on the conservative side, and also on an unconstrained type of credit strategy, although perhaps that is somewhat exotic and not for everybody, compared to holding physical gold. ■