2019 Market Outlook

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Equities

After seeing the Philippine Stock Exchange Index (PSEi) hit a new all-time high of 9,058.62 last January 29, 2018, the local stock market went on a downward trend due to macroeconomic concerns and events in the developed markets. The PSEi closed 2018 at 7,466.02 from 2017's 8,558.42, down by 1,092.40 points or -12.76%. Concerns on inflation, depreciating peso, rising interest rates, negative current account balance and the US-China trade war dampened the sentiment on Philippine stocks.

For 2019, we remain positive on the direction of the local market given that macroeconomic prospects are improving and that PHL inflation has peaked already. After hitting 6.7% in September and October, December Consumer Price Index (CPI) slowed down to 5.1% from 6% in November and moved below the consensus estimate of 5.6% as gains in food and transport prices eased. The continued decline in oil prices in the global market and government measures to ease food bottlenecks, particularly rice, helped reduce price pressures. This brought the 2018 average inflation rate to 5.2% in 2018. For 2019, the Bangko Sentral ng Pilipinas (BSP) expects inflation to return to the 2-4% target range and hit an average of 3.18%.

Given better inflation expectations, the BSP now has the elbow room to pause its tightening cycle. The Monetary Board, BSP's policy making body, has increased its borrowing rate by a total of 175 basis points in 2018. The BSP is also expected to reduce reserve requirements by 200 basis points this year. A 100 basis point cut in reserve requirement will add an estimated Php90B - Php100B into the system.

Equities

Recent dovish statements from the US Fed have also reinforced the view that the BSP may cut policy rates starting 2nd half of 2019. US Fed Chairman Jerome Powell said that the US central bank can be patient before adjusting interest rates as it awaits how global risks impact the US economy. Recent developments on the US-China trade war have also triggered risk on trades.

Earnings growth is expected to hit double digits this year. From an estimated growth of below 9% in 2018, it is expected to average around 11-12% in 2019.

The Gross Domestic Product (GDP) of the Philippines is expected to grow above the 6% level in the next few years as the Duterte administration continues to spend on improvements in infrastructure under the “Build, Build, Build” program. The World Bank expects the Philippine GDP to average 6.5% for 2018 and 6.7% in 2019.Election related spending could also provide a boost in the domestic economy.

These developments have made the PSEi the best performing market in the Asia Pacific during the first two weeks of trading in 2019. The recent debacle on the default of the local unit of Hanjin could provide an excuse for market players to take profit on Philippine stocks. On the other hand, weakness from this development could also be viewed as an opportunity to accumulate positions.

For 2019, we are looking at a PSEi target of 8,400 - 8,600 which is equivalent to a PE ratio 17.3x to 17.7x 2019 earnings. After selling down their position, foreign funds are starting to buy PHL stocks once again. For two weeks of trading (i.e. January 2 – 11), the PSEi posted a net foreign buying of Php5.7B.

Fixed Income

After its ascent in late second half of 2018, local bond rates are expected to drift lower and mirror the movement of consumer prices. With inflation peaking at 6.7% last September and October 2018, CPI has decelerated by 160 basis points with December inflation being reported at 5.1%.

With prices of crude oil in the global market going down and the stabilization of food prices, inflation expectations for 2019 remains very positive. Coupled with the dovish statements from the US Federal Reserve, a policy rate cut from the BSP in the 2nd half of 2019 is possible.

ROP yields are expected to mirror the movement of US Treasuries. After trading above 3.2%, the yield on the10-year US treasury benchmark has gone down to 2.7% on the back of statements from US Fed Chairman Jerome Powell that the US central bank can be patient in its rate increases.

Foreign Exchange

While the peso has appreciated versus the US dollar during the last quarter of 2018, we expect the peso to test the Php54 level again in 2019 as the country's twin deficits (i.e. trade deficit and current account deficit) will continue to put pressure on the exchange rate. If the net foreign buying we have seen in the local stock market during the first few trading days of 2019 can be sustained, this could provide some support for the peso.