Trust Banking Group

United Coconut Planters Bank

Weekly Market Commentary

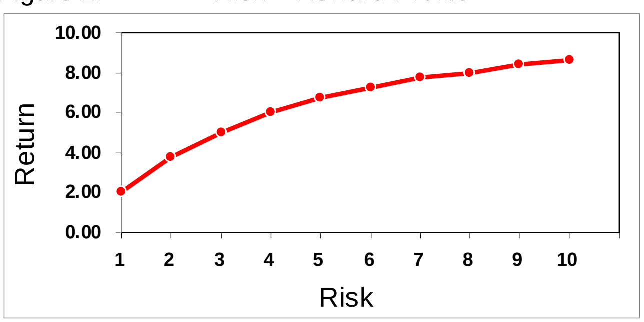
25 April 2011

Investment Process 101.

Happy Easter to everyone.

Normally, when we talk about investing the first thing that crosses our mind is the level of return to be achieved. Then almost as an afterthought we think about the risks involved. Some of you may say: "That's not true. I actually think about return and risks in the same breath." Then good for you and to everyone with this attitude as investing is indeed all about risk and reward. Investing is like a coin but instead of heads and tails we have risk and reward on either side. As illustrated in Figure 1, the level of desired return carries with it a corresponding amount of risk. The greater the potential return, the greater the attendant risks and vice versa.

Figure 1. Risk – Reward Profile



The key to investing is to achieve a balance between risk and return. This may sound trivial but balancing risk and return is tricky. Fortunately for us, there are proven processes that will make investing a successful and an even interesting endeavor.

The basics of investing are simple. While there may be complex investment ideas, the underlying principle is straightforward. What we will do here is to outline its basic principles.

1. **Know your investment objectives.** Whether you are an individual or a corporation, having a clear idea of what you want is the first step in the investment process. Are you investing for the education of your children, for your planned vacation, for your retirement or to meet a defined future obligation?
2. **Identify your present resources.** How much are you willing to commit to achieve your investment goals? Funds for investments are normally "excess" funds outside of an individual's basic requirements (e.g., food, clothing, housing, present educational expenses) or in the case of companies, expenses for its operating and other current obligations.
3. **Assess the investment climate.** What we want to know here is the external picture or the macroeconomic environment. Is it favorable or challenging? Are there external factors that will help us achieve our objectives? What are the potential investment risks out there? Answering these questions may be a bit taxing for some so the assistance of an investment professional is suggested.
4. **Craft your investment strategy.** After having a clear idea of your personal circumstances (i.e., internal factors) and the external investment environment (i.e., external factors) we are now ready to craft the investment strategy suited for your unique requirements. For an investment strategy to be meaningful, it should necessarily incorporate your risk tolerance. Meaning, you need to determine whether you are a conservative, a moderate or an aggressive investor.

What are the elements of a good investment strategy?

1. **Balancing internal & external factors.** This means a balance between what you want and what your resources are in the context of the current and foreseeable investment environment.

   Let us assume you want to prepare for the college education of your child in a premier institution. You have 10 years to prepare and ₱100,000 to start with. You are also inclined to keep your money in time deposit.

   The question here is: Is a time deposit strategy appropriate for your needs? Definitely not. Using the best time deposit rate at the moment (i.e., the Special Deposit Account of the BSP @ 4.4375%) your fund will only grow to ₱142,543 in 10 years net of the 20% withholding tax. Obviously you need a different strategy to achieve your ends or you may need to scale down your objectives to fit your investment style.

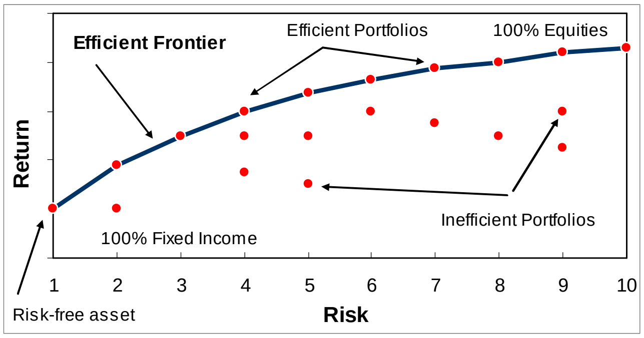
2. **Create a portfolio.** To achieve a reasonable degree of success for your educational fund, you need to build a portfolio of financial assets invested in various outlets instead of just relying on time deposit. There are two related things here: creating an efficient portfolio and achieving diversification within that portfolio.

   a. **It must be an efficient portfolio.** As an investor, you need to build a basket of assets that will, collectively, give you your desired return based on your risk tolerance. Going back to our educational fund, a portfolio that would have a reasonable degree of achieving your objective would probably have a mix of fixed income securities (e.g., govt. securities, corporate bonds & time deposit) and stocks.

      Furthermore, you will also need to choose assets the will provide you with the best return for the risk you are taking. A portfolio with an equity component should have a higher expected return than one without equities. Figure 2 illustrates this point. The blue line is a continuum of *best returns* based on different risk levels (i.e., efficient frontier). What you want is for your portfolio to lie within the blue line (i.e., an efficient portfolio) and not below the blue line (i.e., an inefficient portfolio). As Figure 2 suggests, an inefficient portfolio is one that that is not being rewarded for the risks it is taking.

      A rough measure whether your portfolio is efficient or not is to check whether the individual assets in your portfolio are the best in its class.

Figure 2. Efficient Frontier



   b. **The must be a diversified portfolio.** Our portfolio must not merely be a basket of assets but a *diversified* basket of assets. We oftentimes hear our folks admonish us *not to put all our eggs in one basket*. This is true as a general philosophy in life and equally true in investments.

      A well diversified portfolio will, most likely, contain government securities, corporate bonds, time deposit and equities. For more sophisticated investors, it may also contain investment in commodities and other currencies. Diversification also means avoiding having too much exposure on one issuer, industry, country or region. A portfolio that suffers from concentration risk is obviously not well diversified.

      Not only should your portfolio have different assets but these assets must have a low correlation to each other. This means that the different assets in your portfolio should not move in one direction. While highly correlated assets may be good in a bull market, you will likely find yourself in trouble if you have this type of portfolio during a bear market as the return of your assets will simultaneously decline in step with a weak market.

3. **Allow your portfolio to achieve its objectives.** Achieving your investment objectives needs time. The reason for this is embedded in how financial assets perform. Typically, an investor has two sources of investment income: coupon payments and capital appreciation. In both cases, you need to hold the assets for some time in order to enjoy their economic benefits.

   For example, if you own a 5-year bond that pays 7%, you need to hold that bond for, at least, a full year to enjoy the 7% coupon. Likewise capital appreciation does not occur overnight since it is based, among others, on corporate earnings -- a factor that can only be realized over time.

   In addition, the value of your portfolio may be depressed, however excellent its assets may be, due to unfavorable market conditions. An investor will have to be patient and wait for the market to recover.

   The message here is that you need to have a medium- to long-term investment horizon in order for your portfolio to deliver properly. Indeed, the market normally rewards the patient investor.

4. **Portfolio review & adjustments.** The last step is the periodic review of your investment strategy. Its main purpose is to check whether your portfolio is still track to achieve its goals. Depending on the size of the portfolio, the review may be conducted once a year or as often as once every quarter.

   In addition to portfolio performance, the review should also take into account the risk management measures put in place. Are these still appropriate or should adjustments be made?

   Finally, the results of the investment review are used as fresh inputs to further improve portfolio performance.

UITF Performance

Table 1. UITF Performance

UITF (PhP)	31-Dec-10	15-Apr-11	20-Apr-11	Change Wk-on-Wk	Change Yr-to-Date
UCF	1.4839	1.4939	1.4943	0.03%	0.70%
U$MMF	1.2462	1.2509	1.2510	0.01%	0.39%
UCMF	1.1451	1.1535	1.1539	0.04%	0.76%
UBF	1.7428	1.7984	1.8378	2.19%	5.45%
UEF	2.2666	2.3773	2.4548	3.26%	8.30%

UCF United Conservative Fund
U$MMF United USD Money Market Fund
UCMF United Cash Management Fund
UBF United Balanced Fund
UEF United Equity Fund

Table 2. Market Indicators

Indicator		Level: 2010 Yr. End	Level: 15-Apr-11	Level: 20-Apr-11	Change: Wk-on-Wk	Change: % Ch	Change: YTD	Change: % YTD
Peso	1	43.80	43.24	43.20	-0.04	-0.08%	-0.60	-1.36%
Stocks	2	4,201	4,252	4,275	23.13	0.54%	73.63	1.75%
3-mo. PDSTF (ch in bps)	3	1.2917	0.9865	0.9462	-0.04	(4.03)	-0.35	(34.55)
Peso Bonds	4	307	310	311	0.75	0.24%	3.09	1.01%
3-mo. USD LIBOR (ch in bps)	5	0.3028	0.2748	0.2738	0.00	(0.10)	-0.03	(2.91)
USD Bonds (ROPs)	6	178	176	177	1.06	0.60%	-0.53	-0.30%
Crude Oil (USD/bbl)	7	91.38	110.22	111.45	1.23	1.12%	20.07	21.96%
Gold (USD/troy oz)	8	1,420.78	1,486.70	1,502.55	15.85	1.07%	81.77	5.76%
DXY	9	79.03	75	74	-0.46	-0.62%	-4.66	-5.90%
ADXY	10	116.46	118	118	0.37	0.31%	1.90	1.63%
VIX	11	17.75	15	15	-0.25	-1.63%	-2.68	-15.10%
V2X	12	23.92	19	19	0.28	1.50%	-4.83	-20.20%

Sources:
1/ Phil. Dealing System
2/ Phil Stock Exchange Index
3/ Phil. Deal. & Exch. Corp.; change in basis points
4/ HSBC Local Bond Index
5/ Bloomberg; change in basis points
6/ JP Morgan Asia Credit Index
7/ West Texas Intermediate
8/ Bloomberg
9/ DXY = USD spot index
10/ ADXY = Asian currencies vs. USD index
11/ CBOE volatility index
12/ Eurozone volatility index

Annex A
Explanatory notes on our Market Indicators.

In general, market indicators are used to assess the pulse and health of our economy. It is very similar to how doctors check our heartbeat, the color of our eyes, our cholesterol level or the sugar content of our blood to initially assess how healthy (or unhealthy) we are.

Since we are generally concerned with investments, the appropriate measures to look at are economic and market indicators. As investors, we want to know where these indicators are headed so we can make the appropriate decisions. These indicators are as follows:

Peso. *This is our currency and its current level and direction normally indicate the general health of the economy.*

Stocks. *A strong or robust stock market reflects a strong and growing economy or vice versa. Our stock market cannot be strong if our economy is weak. And the opposite is equally true. After all, corporate earnings and prospects reflect the overall outlook of the economy. The index we are using is the Phil. Stock Exchange Index (PSEi).*

3-month PDSTF Rate. *This is the indicator we use for domestic interest rates. It used to be the 90-day Treasury Bill rate but this instrument has lost its appeal since it is not very liquid and may not truly reflect market levels. PDSTF rates are better indicators of where interest rates are since these are based on actual rates of highly liquid instruments.*

Peso Bonds. *The HSBC Local Bond Index (Phil.) tracks the average price movements of local bonds and is a good indicator of how expensive (or cheap) bonds are. The index should also provide an indication of where bond yields are headed since bond prices and bond yields move in the opposite direction.*

3-month USD LIBOR. *This is the US dollar counterpart of the 3-month PDSTF rate. LIBOR means London Interbank Offer Rate, the rate at which banks lend to each other and used as a benchmark for commercial lending.*

USD Bonds (ROPs). *This index tracks the price movements of Phil. bonds denominated in US dollars. The index we are using is the JPMorgan Asia Credit Index (Phil.).*

Since the indices we use for stocks, peso bonds and USD bonds (ROPs) are based on price movements, the higher the level of the index, the better it is for investors.

Crude Oil. *At least in our lifetime, oil will always be one of the most important economic indicators since it is a basic feedstock of economies worldwide. The benchmark that we are using is the West Texas Intermediate (WTI) as it is the most common and widely used crude oil index.*

Gold. *This is our proxy for uncertainty. The price of gold normally goes up during uncertain or difficult times. This is because gold is the ultimate store of value. Paper currencies could lose their value but gold will always retain its value whether as an ornament or as a unit of exchange.*

DXY. *It is a spot index of the USD based on a basket of five currencies, Euro (57.6%), Japanese Yen (13.6%), British Pound Sterling (11.9%), Canadian Dollar (9.1%), Swedish Krona (4.2%) and Swiss Franc (3.6%). The DXY does not reflect the trade position of the US in the global economy. It is being used for convenience as its value is updated on a daily basis.*

ADXY. *It is a spot index of emerging Asian currencies versus the USD. It is composed of ten currencies, Renminbi (33.9%), South Korean Won (14.2%), Hong Kong Dollar (11.4%), Singapore Dollar (10.3%), Taiwan Dollar (8.2%), Indian Rupee (6.3%), Malaysian Ringgit (5.2%), Thai Baht (4.9%), Indonesian Rupiah (3.3%) and Phil. Peso (2.3%). The index is constructed based on two considerations, trade performance (75%) and liquidity (25%).*

Finally, note that there will always be a speculative element in the movement of these indicators. But speculation is not their main driver. The most important driver that normally sustains the movement of an indicator over the long-run is its fundamentals. For example, the movement of the peso is dictated by the following fundamental factors: (a) the health of our economy; (b) the amount of US dollars remitted by Filipinos working and living abroad; (c) the level of our exports; and (d) the amount of foreign direct investments we receive.

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