

## Weekly Market Commentary

07 January 2011

### Economic Update:

**Great news that went unnoticed.** Despite El Niño and the contraction of government spending during the 2<sup>nd</sup> semester, the economy still expanded by 7.3% in 2010 from 1.1% in the previous year. This is the fastest growth rate in 34 years (since 1976).

On the supply side, the growth was primarily driven by the industry sector which made a strong turn-around on the back of a rebound in manufacturing, construction and mining. The sector expanded by 12.1% compared to a contraction of 0.9% a year ago. Growth of the service sector remained firm as it increased by 2.5x faster compared to 2009 on the strong performance of trade and private services. Unfortunately, the agriculture sector was battered by El Niño last year which resulted to 3 consecutive quarters of contraction. It was only in the 4<sup>th</sup> quarter that the sector recovered due to better harvest & fewer typhoons. Nevertheless, the sector still declined by 0.5% for the entire year.

On the expenditure side, personal consumption continues to be the main growth driver with strong support from investments (capital formation) and external trade (exports & imports). Personal consumption, which grew by 5.3% in 2010 from 4.1% in 2009, is being sustained by robust remittances and the expanding operations of information technology/business process outsourcing (IT/BPO) sector.

Greater investments in durable equipment and in construction pushed overall investments by 17.0% in 2010 after falling by 5.7% in 2009. More importantly, investments-to-GDP is now at 18.5%, the highest in 6 years. Meanwhile, exports jumped by 25.6% last year from a decline of 13.4% in 2009 on increased demand for electronic products overseas. Imports likewise increased by 20.7% from a contraction of 1.9% in 2009 on higher demand for electronic components (for re-export) and elevated prices of petroleum products.

Overall, growth was impressive last year. The challenge going forward is how to sustain our above trend trajectory.

**The way forward.** Remittances and IT/BPO operations will continue to provide strong support to personal consumption. Strong foreign inflows also made possible increased savings amongst Filipinos, higher international reserves of the BSP and a stable peso. And yet, for the economy to continue to grow above trend, investments – particularly from the private sector -- should kick-in. Capital formation (investments), after remittances and IT/BPO revenues, is the second leg that will support our economic expansion.

Moreover, investments will only come if investors have confidence in the economy, in the regulatory environment and in the country's leadership. Do we have what it takes?

### 2009 & 2010 GDP By Industry & By Expenditure

	2010	4Q10	3Q10	2Q10	1Q10	2009	% of Economy	
<b>Table 1. GDP</b>								
GDP	7.3%	7.1%	6.3%	8.2%	7.8%	1.1%		2010 growth highest in 34 yrs.
NFIA*	6.0%	3.8%	3.9%	3.9%	14.1%	28.0%		Steady due to OF remittances
GNP	7.2%	6.7%	6.0%	7.6%	8.6%	4.0%		
*Net factor income from abroad								
<b>Table 2. GDP</b>								
<b>By Industry (supply side)</b>								
Agri	-0.5%	5.4%	-3.0%	-3.2%	-2.7%	0.0%	16.8%	Suffered due to El Niño
Industry	12.1%	8.3%	8.6%	16.1%	15.9%	-0.9%	33.6%	Rebound of manufacturing, construction & mining
Service	7.1%	6.9%	8.0%	6.7%	7.1%	2.8%	49.7%	Stronger as economy recovers
							100.0%	
<b>By Expenditure (demand side)</b>								
Personal Consumption	5.3%	7.0%	4.1%	4.6%	5.4%	4.1%		Stronger due to remittances & IT/BPO revenues
Govt. Consumption	2.7%	-7.6%	-7.9%	5.8%	20.0%	10.9%		Contracted post-elections spending
Capital Formation	17.0%	22.8%	12.4%	10.8%	21.9%	-5.7%		Increasing investor confidence?
Exports	25.6%	21.1%	28.3%	29.1%	22.4%	-13.4%		Renewed demand for electronics
Imports	20.7%	21.8%	18.5%	20.4%	22.4%	-1.9%		Higher demand on eco. recovery

**Stocks.** The PSEi fell sharply by 2.5% to end the week at 3,872. We believe that we are experiencing the tail end of foreign funds leaving our market. Certainly, the situation in Egypt did not help.

Amongst the index losers were **Lepanto A** (-9.4% to P0.44) and **Lepanto B** (-10.6% to P0.42) despite copper hitting record highs. **Aboitiz Power** (-7.2% to P27.20) and **Aboitiz Equity Ventures** (-7.8% to P34.35) are being weighed down by the issue on real estate taxes being levied by the Municipality of Pagbilao on TEAM Energy, the owners of the Pagbilao power plant. Aboitiz Power owns the energy that is produced by the plant. Banks like **Metrobank** (-4.7% to P63.45), **Banco de Oro** (-3.6% to P50.50), **BPI** (-2.6% to P52.80) and **Chinabank** (-0.2% to P429.00) on possible concern that higher interest rates could dampen loans growth.

**Metro Pacific Investments** (+0.3% to P3.68) is determined to pursue the NLEX-SLEX link project. The engineering design for the P17.0 bn project will be completed by August this year. This project is based on an unsolicited proposal of MPI and is thus subject to a Swiss challenge.

**SM Dev. Corp.** (-7.2% to P7.50) plans to raise P5.0 bn in equity via a private placement to help fund its China expansion and increase its free float to 30% from the current 16%. SMDC is looking at presale revenues of P25.0 bn – P30.0 bn this year from P22.0 bn in 2010 and net income of P4.0 bn from P3.0 bn last year. Based on Friday’s closing, this translates to an EPS of P0.55 and a PE 13.7x 2011.

**Airline competition heating up.** Air Asia Phil., the joint venture between Malaysia-based Air Asia Int’l. Ltd. and Filipino businessmen led by Antonio Cojuangco Jr., Michael Romero and Marianne Hontiveros, plans to mount flights to 5 Southeast Asian capitals (Singapore, Kuala Lumpur, Jakarta & Hongkong, Bangkok) and China by Sept. this year using Airbus A320. The local low cost carrier (LCC) is 40%-owned by Air Asia Int’l. Ltd. with the balance owned by its Filipino partners.

Meanwhile, the Dept. of Transportation said that Australia-based LCC Jetstar Airways is planning to enter the Phil. market by the end of 2011.

While the entry of new carriers is positive for the economy and to Filipino travelers, this means greater competition to local LCC Cebu Air (-1.0% to P98.00).

**Fixed Income.** Yields of local bonds edged higher last week on renewed inflation fears. January headline inflation rate inched higher to 3.5% from 3.0% in Dec. If we exclude select food and energy items, core inflation actually eased to 3.3% last month from 3.4% in Dec. 2010. The BSP expects inflation to average at 3.6% for this year.

While the January number should not surprise anyone, it still affirmed the outlook that inflationary pressures are on the rise.

Figure 1

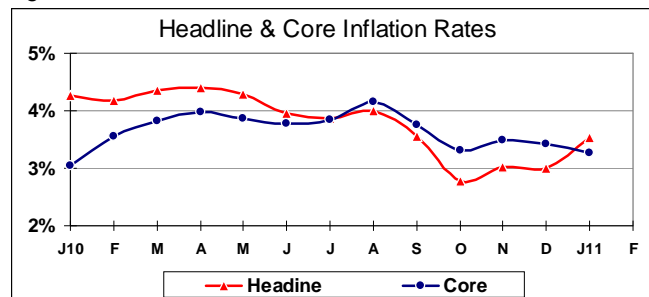


Table 1. PDSTF Rates

PDST-F	YIELD		Change (bps)
	28-Jan	4-Feb	
1 Month	3.31	3.53	21.54
3 Months	3.31	3.52	21.23
6 Months	3.39	3.78	39.48
1 Year	3.83	4.17	34.06
2 Years	4.92	4.82	(10.56)
3 Years	5.06	5.19	13.10
4 Years	5.65	5.68	2.81
5 Years	5.61	5.74	13.31
7 Years	6.73	6.74	1.56
10 Years	6.88	6.83	(5.71)
20 Years	8.49	8.53	3.27
25 Years	8.37	8.45	7.88
HSBC ALBI*	302	301	-0.1%

\*The HSBC Asia Local Bond Index (Phil.) tracks the price movement of Phil. sovereign bonds. A positive change means that bond prices moved higher & yields lower or vice versa.

Meanwhile, despite favorable economic fundamentals, ROPs soften as uncertainties rose over the leadership problem in Egypt. ROP prices fell around 25 – 100 basis points, on the average. We should see renewed strength this week as the situation in Egypt stabilizes.

Table 2. Indicative ROP Prices

Series	Coupon	PRICE		Change (bps)
		28-Jan	4-Feb	
ROP 11	8.375	100.24	100.25	0.50
ROP 13	9.000	114.00	113.75	(25.00)
ROP 14	8.250	117.00	116.75	(25.00)
ROP 15	8.875	124.13	124.00	(12.50)
ROP 16 n	8.000	124.22	124.00	(21.80)
ROP 16	8.750	131.00	130.50	(50.00)
ROP 17	9.375	130.50	130.50	0.00
ROP 19	9.875	136.75	136.25	(50.00)
ROP 19 n	8.375	127.74	127.25	(49.40)
ROP 20	6.500	114.49	114.00	(49.00)
ROP 21	4.950	100.50	100.00	(50.00)
ROP 24 n	7.500	122.78	122.00	(78.10)
ROP 24	9.500	142.75	141.75	(100.00)
ROP 25	10.625	153.75	152.75	(100.00)
ROP 30	9.500	142.33	141.75	(58.30)
ROP 31	7.750	122.45	121.75	(69.70)
ROP 32	6.375	106.01	105.25	(76.30)
ROP 34	6.375	105.88	105.25	(63.00)
JACI Phil*		178	177	-0.1%

\*JACI Phil. tracks the price movement of Phil. USD sovereign bonds with maturity of at least 1 year.

**Peso.** Strong domestic fundamentals continue to be supportive of the peso. It has appreciated by ₱0.34 last week and is headed toward our initial target of ₱43.30.

## UITF Performance

Table 3. UITF Performance

UITF (PhP)	31-Dec-10	28-Jan-11	04-Feb-11	Change	
				Wk-on-Wk	Yr-to-Date
UCF	1.4839	1.4866	1.4872	0.04%	0.22%
USMMF	1.2462	1.2484	1.2489	0.04%	0.21%
UCMF	1.1451	1.1473	1.1478	0.05%	0.23%
UBF	1.7428	1.7311	1.7136	-1.01%	-1.68%
UEF	2.2666	2.2358	2.2025	-1.49%	-2.83%
UCF	United Conservative Fund				
USMMF	United USD Money Market Fund				
UCMF	United Cash Management Fund				
UBF	United Balanced Fund				
UEF	United Equity Fund				

Table 4. Market Indicators

Indicator		Level			Change			
		2010 Yr. End	28-Jan-11	4-Feb-11	Wk-on-Wk	% Ch	YTD	% YTD
Peso	1	43.80	44.12	43.78	-0.34	-0.77%	-0.02	-0.05%
Stocks	2	4,201	3,970	3,872	-97.99	-2.47%	-328.79	-7.83%
3-month PDSTF (%)	3	1.2917	3.3096	3.5269	0.22	21.73	2.24	223.52
Peso Bonds	4	307	302	301	-0.41	-0.14%	-5.98	-1.94%
3-month USD LIBOR (%)	5	0.3028	0.3044	0.3115	0.01	0.71	0.01	0.87
USD Bonds (ROPs)	6	178	178	177	-0.19	-0.11%	-0.28	-0.16%
Crude Oil (USD/bbl)	7	91.38	89.34	89.03	-0.31	-0.35%	-2.35	-2.57%
Gold (USD/troy oz)	8	1,420.78	1,336.75	1,348.85	12.10	0.91%	-71.93	-5.06%
DXY	9	79.03	78.13	78.04	-0.10	-0.12%	-0.99	-1.25%
ADXY	10	116.46	115.82	116.42	0.60	0.52%	-0.04	-0.03%
VIX	11	17.75	20.04	15.93	-4.11	-20.51%	-1.82	-10.25%
V2X	12	23.92	22.13	20.90	-1.23	-5.58%	-3.02	-12.62%

## Sources:

1/ Phil. Dealing System

2/ Phil Stock Exchange Index

3/ Phil. Deal. &amp; 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/ DXDY = 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.*

-----  
**DISCLAIMER:**

The opinions and intentions expressed herein by the United Coconut Planters Bank – Trust Banking Group (UCPB-TBG) are held or have been reached after considering all relevant circumstances and based on reasonable assumptions, and that all reasonable inquiries have been made by UCPB-TBG to verify the accuracy of such information. However, please bear in mind that other external and/or internal factors, present, future or otherwise, such as, but not limited to, adverse or unanticipated market, financial or political developments or risk of default or settlement risk, may affect UCPB-TBG's opinion and analysis, and the recipient of this document should conduct his own independent analysis of the issues and the Issuers, and investment(s) therein should solely be the recipient's decision and risk.

In the event any investment decision shall be made, the recipient of this document must rely on his examination of the Issuer(s) and the terms of the issue(s), including the merits and risks involved. By receiving this document, the recipient acknowledges that (1) he is aware that he is expected to rely on his own independent investigation and evaluation of the Issuer and the terms of the Issue and consult his own professional adviser in passing upon the risks and merits thereof, (2) he has not solely relied on UCPB-TBG or any person affiliated with it, in connection with his investigation of the accuracy of any of the information contained herein or his consequent investment decision, and (3) no person has been authorized to give any information or to make any representation concerning the Issuer(s), other than what is contained in this document and, if given or made, such information or representation should not be relied upon as having been made or authorized by the Issuer(s) and UCPB-TBG.

No representation or warranty, express or implied, is made by UCPB-TBG as to the accuracy, completeness or adequacy of the information contained in this document. Neither the delivery of this document, under any circumstance, constitute a representation or create any implication that there has been no change, material or otherwise, in the condition, operations, or affairs of the Issuer(s) or that any information contained herein is correct as of any date subsequent to the date hereof.

Finally, this document does not constitute an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized, or to any person to whom it is unlawful to make any such offer or solicitation. In the event a decision shall be made to invest in any of the Issue(s), such potential investor must (1) comply with all applicable laws and regulations in force in the jurisdiction in which it invests or offers to invest in such security(ies) or issue(s), and (2) obtain the necessary consent, approval or permission for its funding, or offer to fund such investments under the laws and regulations in force in any jurisdiction in which it is subject or in which it makes such funding, and neither the Issuer(s) or UCPB-TBG shall have any responsibility thereof.

The information and data contained herein are confidential and may not be divulged to any person or entity, reproduced, disseminated or disclosed, in whole or in part, unless expressly allowed by the United Coconut Planters Bank -Trust Banking Group.