Trust Banking Group

United Coconut Planters Bank

Weekly Market Commentary

13 June 2011

Will the NAVPU rise of fall tomorrow? This is a familiar question which we often encounter here at Trust Banking Group. The queries normally increase especially if the market is correcting. *Unfortunately however, we do not know the precise answer to this question*. More under the Section UITF Performance.

Economic Update:

Silver lining from an otherwise weak 1Q performance. First, last quarter's weak economic performance was actually due to the absence of key drivers which were present during the same period last year. There were three drivers: (a) election-related spending; (b) govt. pump priming activities; and (c) a strong recovery of exports. Look at the column under 1Q10 in Table 1. Except for Agriculture, the numbers were very good resulting to a GDP growth of 8.4%. This is way off our normal historic performance. The drivers I've mentioned made it all possible. Unfortunately, these drivers were not present last quarter. Again, check the column under 1Q11 in Table 1. Weak compared to 1Q10.

However weak the first quarter of this year was, I see some silver lining. Two of them actually. The first one is Govt. Consumption. It contracted by 17.2% not because the govt. has no money (we have a deficit but it is a manageable one) but because the new administration is trying to be careful that govt. funds, when released, will not be wasted or lost via corruption. The new govt. is reviewing control measures and we should see some boost in govt. spending as soon as the review is over.

The second positive aspect is Capital Formation or investments. It jumped by 37% due to expanded investments in durable goods, construction and intellectual property products. This only means that the private sector has the means and is willing to commit resources as long the right environment is present.

Figure 1 below shows that investments as a percentage of GDP have been rising since last year. Let's hope it continues.

Figure 1

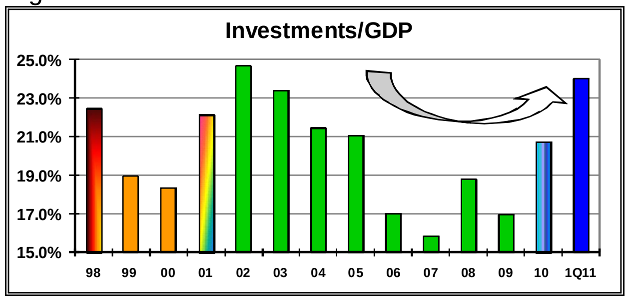


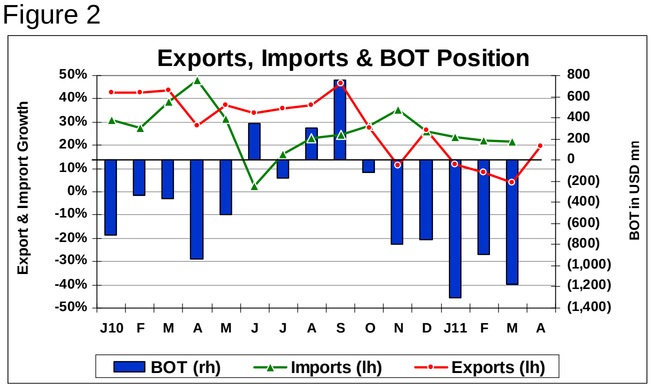
Table 1. 1Q 2011 GDP

At constant 2000 prices					
Table 1. GDP	**1Q10**	**2Q10**	**3Q10**	**4Q10**	**1Q11**
GDP	8.4%	8.9%	7.3%	6.1%	4.9%
NPI/1	21.2%	10.0%	5.7%	3.9%	0.0%
GNI/2	11.5%	9.2%	6.9%	5.6%	3.6%
Table 2. GDP	**1Q10**	**2Q10**	**3Q10**	**4Q10**	**1Q11**
By Industry (supply)					
Agri	-1.8%	-1.9%	-2.0%	4.1%	4.2%
Industry	15.4%	15.7%	9.8%	6.5%	7.2%
Service	7.2%	7.3%	7.8%	6.4%	3.7%
By Expenditure (demand)					
HH Consumption	4.0%	1.9%	2.4%	4.9%	4.9%
Govt. Consumption	21.4%	7.4%	-6.5%	-6.6%	-17.2%
Capital Formation	31.9%	38.0%	34.5%	25.7%	37.0%
Exports	18.8%	24.0%	23.1%	16.8%	3.3%
Imports	24.2%	22.1%	22.1%	21.9%	8.8%

1/ net primary income
2/ gross national income
Source: NSCB

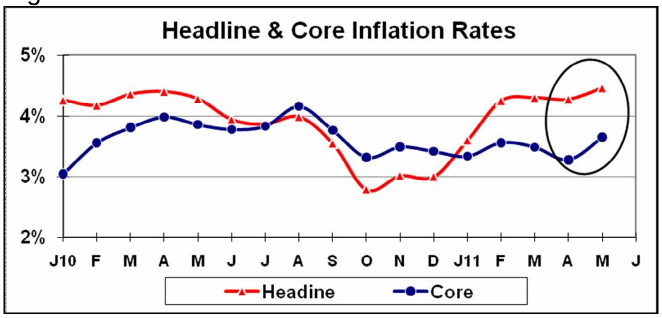
Exports jumped by 19.6% in April on the back of strong demand for metal and agriculture products. Export receipts for copper and gold as well as coconut oil and bananas rose strongly in April. However, demand for electronic products contracted (Fig. 2)

Figure 2



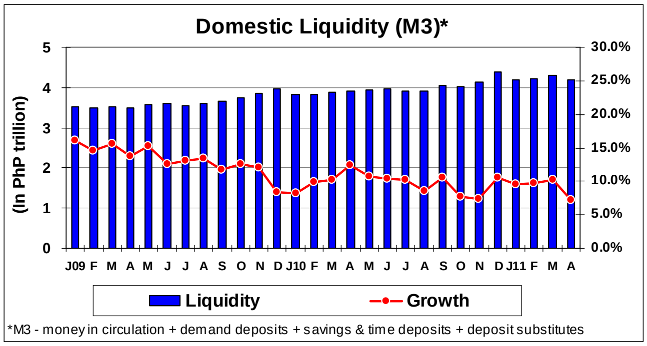
May headline inflation tame at 4.5% despite higher energy prices. Many observers were surprised at the actual result since the expectation was 5.1% from 4.3% in April. What needs to be watched though is core inflation which rose by 3.7% in May from 3.3% the month before. Apparently, the prolonged elevated prices of energy products are slowly working its way into the rest of the economy (Fig. 3).

Figure 3



Domestic liquidity (M3) decelerated by 7.3% in April after growing at around 10% for the last four months (Fig. 4). The BSP is comfortable with this level given the current expansion of the economy. M3 growth is being watched very closely by the BSP as too high a growth could fan inflation (i.e., demand-pull type). Conversely, a very slow growth could also restrain economic expansion. The BSP adjusts M3 growth via its various monetary tools.

Figure 4



Consumer confidence remains subdued based on the latest survey conducted by the BSP. The April reading was still at negative territory (-24.1) indicating that majority of those surveyed were still very uncertain about their near-term prospects (Fig. 5).

This latest reading on consumer expectation supports a similar survey conducted amongst business establishment which showed a less than robust outlook compared to previous months' readings (Fig. 6).

Figure 5

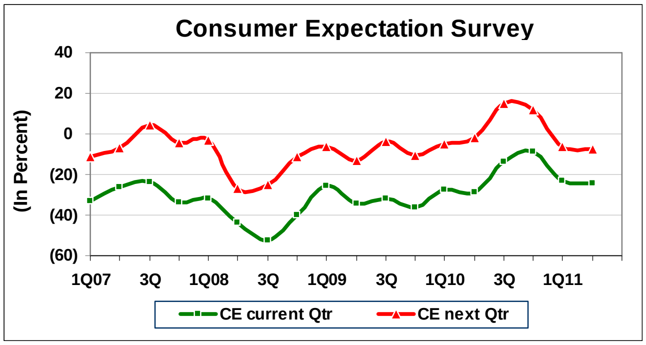
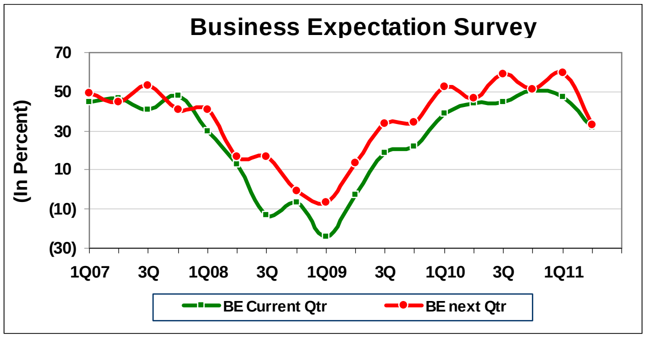


Figure 6



Stocks:

Good news for mid-size banks. The BSP announced that banks with less than 200 branches (like UCPB) may now set up branches in eight previously restricted areas in Metro Manila. Qualified banks are given until June 2014 to apply for and establish branches in said areas.

Metro Pacific Investments Corp. (MPI) is conducting feasibility study for a transaxial expressway in Cebu running from the Municipality of Daangbantayan in the North to the municipality of Santander in the South. The highway, if built, will connect 47 towns and 6 cities.

Meanwhile, MPI is finishing another feasibility study on Clark International Airport. The company plans to rehabilitate the airport and build a high-speed railway connecting Clark to Metro Manila.

TPLEX project funding signed. The Private Infrastructure Dev. Corp. (PIDC) signed an ₱11.5bn 10-year loan as part of the funding for the construction of the Tarlac-Pangasinan-La Union Expressway (TPLEX). This high impact project is expected to be completed by 2014. The PIDC is a consortium led by San Miguel (35%) and DMCI (32%).

Fixed Income:

The moderate rise of headline inflation in May provided some relief to investors who were generally expecting a higher inflation number (i.e., an expectation of 5.1%. vs. the actual 4.5%). This surprise development encouraged some to take additional position in government securities which resulted to a slight decline in yields (i.e., prices slightly rose).

At the moment, people are now uncertain on whether the BSP will hike rates this Thursday, June 16, during the regular Monetary Board meeting since (a) headline inflation has not spiked sharply as earlier expected; and (b) domestic liquidity growth have been very tame, so far (see item above on M3). Nevertheless, the BSP may still hike rates as a pre-emptive move against inflationary pressures.

Table 2. PDSTF Rates

PDST-F	**YIELD**		**Change**
	03-Jun-11	10-Jun-11	(bps)
1 Month	2.88	3.26	37.88
3 Months	2.58	2.85	27.23
6 Months	3.02	3.31	29.20
1 Year	3.26	3.44	18.19
2 Years	4.78	4.53	(25.65)
3 Years	5.36	5.12	(24.42)
4 Years	5.60	5.33	(27.69)
5 Years	5.83	5.43	(39.42)
7 Years	6.14	6.95	80.77
10 Years	6.65	6.48	(16.77)
20 Years	8.19	8.07	(11.53)
25 Years	8.12	8.05	(7.00)
HSBC ALBI*	310	312	0.7%

*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.

Still no change in the SDA rates.

Table 3. SDA Rates

Tenor	**YIELD**		**Change**
	03-Jun-11	10-Jun-11	(bps)
1 Month	4.6875%	4.6875%	0.0000%
14 Days	4.6250%	4.6250%	0.0000%

Table 4. Indicative ROP Prices

Series	**Coupon**	**PRICE**		**Change**
		03-Jun-11	10-Jun-11	(bps)
ROP 13	9.000	112.50	112.13	(37.50)
ROP 14	8.250	115.75	115.50	(25.00)
ROP 15	8.875	124.13	124.13	0.00
ROP 16 n	8.000	122.13	122.13	0.00
ROP 16	8.750	128.00	128.25	25.00
ROP 17	9.375	130.50	130.75	25.00
ROP 19	9.875	137.38	137.50	12.50
ROP 19 n	8.375	129.00	129.00	0.00
ROP 20	6.500	116.00	116.25	25.00
ROP 21	4.950	98.00	101.75	375.00
ROP 24 n	7.500	121.50	122.25	75.00
ROP 24	9.500	139.25	139.75	50.00
ROP 25	10.625	151.50	152.13	62.50
ROP 26	5.500	102.25	102.63	37.50
ROP 30	9.500	144.13	145.00	87.50
ROP 31	7.750	124.00	124.88	87.50
ROP 32	6.375	108.50	109.13	62.50
ROP 34	6.375	108.63	109.13	50.00
JACI Phil*		183	183	0.3%

*JACI Phil. tracks the price movement of Phil. USD sovereign bonds with maturity of at least 1 year. A positive change means bond prices moved higher or vice versa.

UITF Performance

Will the NAVPU rise or fall tomorrow? This is a familiar question which we often encounter here at Trust Banking Group. The queries normally increase especially if the market is correcting. *Unfortunately however, we do not know the precise answer to this question*.

Bear in mind that investing is not an exact science but somewhere between science and art. On the science side, we use certain tools of economics and finance to determine the *likely trajectory* of events. That is why we often talk about the GDP, inflation, money supply, external trade, debt levels, remittances, foreign exchange movements and a host of other indicators so as to provide us with a *glimpse of things to come*.

Moreover, we also employ the more subjective tools of our forecasting. We monitor investor behavior, the inclination of our legislators on certain matters of national interest and the general mood of the market, among others, to gauge how people feel.

We then combine the science and art parts to come up with a more or less holistic view of the future, whether on the economy or a particular asset.

Investors must be aware though that while we use various tools to forecast or estimate future events, our view is still based on guesses, however intelligent and informed they may be. Obviously, we cannot foresee or divine the future. *We can only have an intelligent estimate of it*.

For those who are concerned about the recent decline of your investments, my professional advice is for you to hang on as this should be a temporary thing. Our economic fundamentals remain strong, albeit a little stressed due to recent developments (e.g., a faltering US recovery, Europe's debt crisis, trouble in the MENA region and disasters in Japan). I believe though that once our govt. puts its act together (we heard very soon), things will move a little faster.

While we are confident about our prospects, we have also made some tactical moves to protect our funds (especially those with equity components like the UEF & UBF) from severe market fluctuations. In this regard, we have slowly reduced our equity exposure so as to lower portfolio volatility. As a consequence we have increased our cash position. Our higher cash level is merely temporary but should provide us with greater flexibility once market conditions improve.

Nonetheless, be aware that investing in the UITF has its risks. One must be aware of these *before* investing a single centavo (see Risk Disclosure below).

As your fund managers, we are very much concerned with the performance of the assets in our care. Actually, we have a professional as well as a personal stake in the success of the funds we manage.

Professionally, if our funds perform well, we make our clients happy, we could further attract new investors and generate more fees for the bank. On a personal level a good, or better yet, great performance could mean being ahead of our peers in the industry. It is not just the bragging rights that come with it but the inner satisfaction that one has done very well indeed.

UITF risk disclosure. The UITF is not a deposit account & not insured with the PDIC. Any loss of income or principal due to market fluctuation of the securities held by the UITF, even if invested in government securities, is for the account of the investor. The UITF is not capital protected & may not be suitable for clients seeking capital preservation. Historical performance, when presented, is purely for reference purposes & is not a guarantee for similar future return.

Table 5. UITF Performance

UITF				**Change**	
(PhP)	**31-Dec-10**	**03-Jun-11**	**10-Jun-11**	**Wk-on-Wk**	**Yr-to-Date**
UCF	1.4839	1.4991	1.5009	0.12%	1.15%
U$MMF	1.2462	1.2519	1.2519	0.01%	0.46%
UCMF	1.1451	1.1577	1.1582	0.04%	1.14%
UBF	1.7428	1.8613	1.8387	-1.22%	5.50%
UEF	2.2666	2.4846	2.4323	-2.10%	7.31%

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 6. Market Indicators

Indicator		Level			Change			
		2010 Yr. End	3-Jun-11	10-Jun-11	Wk-on-Wk	% Ch	YTD	% YTD
Peso	1	43.80	43.20	43.33	0.13	0.29%	-0.47	-1.08%
Stocks	2	4,201	4,298	4,172	-126.08	-2.93%	-29.60	-0.70%
3-mo. PDSTF (ch in bps)	3	1.2917	2.5801	2.8531	0.27	27.30	1.56	156.14
Peso Bonds	4	307	310	312	2.28	0.74%	4.74	1.54%
3-mo. USD LIBOR (ch in bps)	5	0.3028	0.2520	0.2485	0.00	(0.35)	-0.05	(5.43)
USD Bonds (ROPs)	6	178	183	183	0.59	0.32%	5.76	3.24%
Crude Oil (USD/bbl)	7	91.38	100.22	99.29	-0.93	-0.93%	7.91	8.66%
Gold (USD/troy oz)	8	1,420.78	1,541.95	1,531.65	-10.30	-0.67%	110.87	7.80%
DXY	9	79.03	74	74.80	1.01	1.37%	-4.23	-5.36%
ADXY	10	116.46	119	118	-0.45	-0.38%	1.82	1.56%
VIX	11	17.75	18	19	0.91	5.07%	1.11	6.25%
V2X	12	23.92	23	23	-0.04	-0.16%	-1.30	-5.43%

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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