



Weekly Market Commentary

30 May 2011

Slower growth indeed. As we were finalizing this issue, the govt. announced that the economy expanded by 4.9% in the 1st quarter, well within the expectation of most observers.

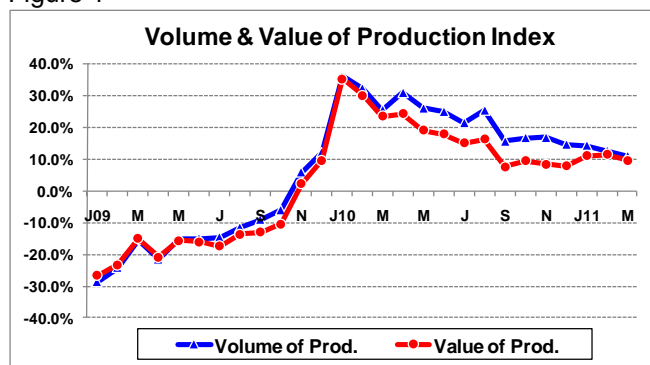
Economic Update:

Slower growth being flagged. NEDA Director General & Planning Sec. Cayetano Paderanga said that 1Q GDP growth would likely be within the range of 4.8% - 5.8%, way slower compared to the 7.8% growth during 1Q 2010. Similarly, BSP Gov. Amando Tetanco noted that the govt. will be hard pressed to achieve its 7.0% - 8.0% growth target this year given elevated commodity prices, crisis in the Middle East & North Africa (MENA) and the string of disasters that hit Japan recently.

We actually expected a slower growth this year since certain drivers like govt. pump priming activities, election related spending and a strong rebound in manufacturing activities will not anymore be present. We thus expect economic activities to normalize in 2011 before taking-off again in 2012 as PPP activities kick-in.

Industrial production easing. The prospect of a slower GDP growth is being supported by the deceleration of industrial production. Industrial production (IP) accelerated in late 2009 as retailers restocked their inventories but IP has since eased as final demand (i.e., demand coming from consumers) was not strong as earlier expected (see Fig. 1).

Figure 1



Improving fiscal position. The Dept. of Finance (DOF) reported that the National Govt. (NG) posted a P26.3 bn surplus for the month of April, the highest in 25 years. For the 1st 4 months of the year, revenues rose by 18.2% while expenditures contracted by 11.6% resulting to a marginal P61.0 mn surplus. If we net out interest payments, the govt. recorded a primary surplus of P102.2 bn reversing the primary deficit recorded last year.

While an improving fiscal situation is commendable, we also note that govt. expenditures have been contracting even though funds are available. It appears that the govt. keeping a tight rein on budget releases to avoid unnecessary and wasteful spending. The very difficult trick the NG. is attempting to do is to disburse govt. funds rationally while keeping graft and corruption at bay. Possible? Let's see.

Table 1. Fiscal Position

(In millions)	Jan-Apr Actual		1H11 Budget	Growth	
	2011	2010		4M 2011 vs 4M 2010	
Revenues					
BIR	302,942	265,054	460,300	37,888	14.3%
BOC	85,058	83,354	142,340	1,704	2.0%
BTr	44,505	18,971	47,152	25,534	134.6%
Others	28,908	22,913	36,627	5,995	26.2%
Total	461,413	390,292	686,419	71,121	18.2%
Expenditures					
Int. Payments	102,152	124,552	154,566	(22,400)	-18.0%
Others	359,200	397,320	683,981	(38,120)	-9.6%
Total	461,352	521,872	838,547	(60,520)	-11.6%
Surplus/(Deficit)	61	(131,580)	(150,000)	131,641	-100.0%
Primary Surplus/(Deficit)	102,213	(7,028)	2,438	109,241	-1554.4%

Source: DOF

Stocks:

MPI/PLDT strengthens hold over Meralco. Beacon Electric, a 50-50 joint venture between Metro Pacific Corp. (MPI) and PLDT (TEL), has increased its stake in Meralco (MER) by 4% to 45%. The additional acquisition – equivalent to 45.4 mn MER shares – shall be consummated in four tranches and partly funded via an P11.0 bn loan from local banks. On top of this stake, MPI/TEL group has an earlier agreement to purchase the remaining 6.6% MER stake owned by First Phil. Holdings (FPH). The stake of San Miguel Corp. (SMC), Meralco's second largest shareholder, remains at 27%.

Jollibee further expands its international business following the acquisition of a majority stake in Viet Thai International Joint Stock Co. (Viet Thai). Viet Thai owns and operates a chain of quick service restaurants in Vietnam, Hong Kong, Macau and Southern China. A total of 139 outlets will be acquired, 118 in Vietnam and 21 in 5 other territories.

Last week, JFC also announced that it has acquired all 20 Chowking stores in the US for USD16.0 mn. In 2010, EBITDA for the 20 stores reached USD1.9 mn on revenues of USD19.2 mn. The 20 stores, 18 of

which are in California, are being valued at 8.4x EBITDA and 0.8x revenues.

Bright prospects for Lepanto Consolidated. Gold Fields, Ltd., the South African company that plans to own 60% of Far Southeast (FSE), a mining area controlled by Lepanto and the family of Felipe Yap, reported that preliminary studies indicate that the FSE orebody may contain between 400 – 600 million tons at 2g gold and about 0.8% copper per metric ton. Nick Holland, the CEO of Gold Fields said that the orebody is *one of the largest and the highest grade copper gold projects that exists on the planet* (see attached Gold Fields presentation dated 11 May 2011).

Philex declares cash & property dividends. Philex Minign (PX) will distribute to its existing shareholders 36% of Philex Petroleum Corp. (PPC) or 1 PPC share for every 8 Philex shares held. PX has yet to seek approval from the Securities & Exchange Commission for registration of the shares and from the Philippine Stock Exchange for the listing of PPC shares by way of introduction.

The company also declared an interim cash dividend of P0.52 per share. The ex-date for both dividends is on 03 June 2011.

The competition is heating up. Singapore Airlines announced plans to operate budget flights to and from the Manila. The Manila-Singapore is a high traffic route for Cebu Pacific (CEB) and another budget airline may cut into CEB's market. Singapore Airlines will likely use Silkair for this purpose.

Fixed Income:

Yields of select tenors declined slightly (i.e., govt. bond prices rose) as investors believe that inflation will not be a serious threat this year. While upward pressure exists, the consensus view is that headline inflation will peak by the middle of this year and stabilize thereafter. Given this outlook, majority of investors believe that for the balance of the year, the BSP will only hike its policy rates by another 50 bps. This is the reason why bond yields haven't moved much either way (i.e., up or down) in recent weeks.

Table 2. PDSTF Rates

PDST-F	YIELD		Change (bps)
	20-May-11	27-May-11	
1 Month	2.36	2.48	12.33
3 Months	2.30	2.27	(3.65)
6 Months	2.58	2.66	7.93
1 Year	2.93	2.86	(7.46)
2 Years	4.49	4.53	3.46
3 Years	5.27	5.29	1.34
4 Years	5.50	5.44	(5.39)
5 Years	5.67	5.63	(3.85)
7 Years	6.07	6.06	(1.00)
10 Years	6.52	6.58	5.96
20 Years	8.10	8.11	0.69
25 Years	8.01	7.99	(1.89)
HSBC ALBI*	311	311	0.2%

*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.

We expect the current SDA rates to remain the same, at least, until the next meeting of the Monetary Board on June 16.

Table 3. SDA Rates

Tenor	YIELD		Change (bps)
	20-May-11	27-May-11	
1 Month	4.6875%	4.6875%	0.0000%
14 Days	4.6250%	4.6250%	0.0000%

ROPs were flat last week but prices of the longer end of the curve (i.e., ROP 31, 32 & 34) were slightly lower by around 100 bps. Where are ROPs headed? One prevailing view points to a moderate ROP appreciation in the near term should US Treasury yields continue to

fall. This is good news for ROPs since our bonds are benchmarked on US Treasuries and falling yields mean rising bond prices.

Table 4. Indicative ROP Prices

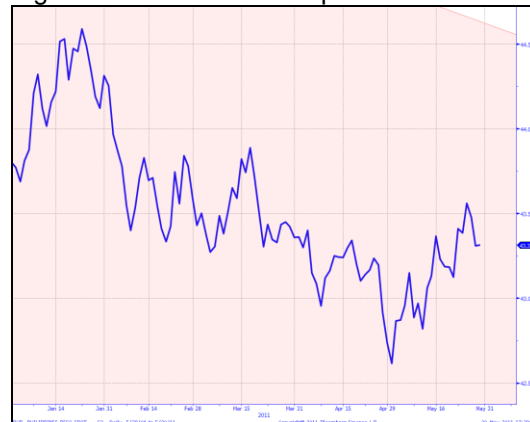
Series	Coupon	PRICE		Change (bps)
		20-May-11	27-May-11	
ROP 13	9.000	112.63	112.50	(12.50)
ROP 14	8.250	115.88	115.75	(12.50)
ROP 15	8.875	124.13	124.13	0.00
ROP 16 n	8.000	122.00	122.00	0.00
ROP 16	8.750	128.00	128.00	0.00
ROP 17	9.375	129.38	129.38	0.00
ROP 19	9.875	136.00	135.75	(25.00)
ROP 19 n	8.375	127.63	127.75	12.50
ROP 20	6.500	115.00	115.00	0.00
ROP 21	4.950	100.25	101.00	75.00
ROP 24 n	7.500	120.38	120.50	12.50
ROP 24	9.500	138.00	138.50	50.00
ROP 25	10.625	149.50	150.00	50.00
ROP 26	5.500	100.63	100.50	(12.50)
ROP 30	9.500	143.13	142.38	(75.00)
ROP 31	7.750	123.75	122.50	(125.00)
ROP 32	6.375	108.50	107.50	(100.00)
ROP 34	6.375	108.50	107.63	(87.50)
JACI Phil*		182	181	-0.2%

*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.

Peso:

The peso remained weak as investors fear that 1Q growth will be lower than 5.1% consensus estimate. Near term, there should be some support for the peso as remittances normally increase right before the opening of classes.

Figure 2. Peso Spot*



*Inverse chart, i.e., the lower the line, the stronger the peso

UITF Performance

Table 5. UITF Performance

UITF (PhP)	31-Dec-10	20-May-11	27-May-11	Change	
				Wk-on-Wk	Yr-to-Date
UCF	1.4839	1.4971	1.4994	0.15%	1.04%
U\$MMF	1.2462	1.2516	1.2517	0.01%	0.44%
UCMF	1.1451	1.1564	1.1571	0.06%	1.04%
UBF	1.7428	1.8747	1.8520	-1.21%	6.26%
UEF	2.2666	2.5232	2.4629	-2.39%	8.66%
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	20-May-11	27-May-11	Wk-on-Wk	% Ch	YTD	% YTD
Peso	1	43.80	43.12	43.38	0.26	0.61%	-0.42	-0.95%
Stocks	2	4,201	4,285	4,275	-10.65	-0.25%	73.37	1.75%
3-mo. PDSTF (ch in bps)	3	1.2917	2.3038	2.2673	-0.04	(3.65)	0.98	97.56
Peso Bonds	4	307	311	311	0.48	0.15%	3.72	1.21%
3-mo. USD LIBOR (ch in bps)	5	0.3028	0.2585	0.2540	0.00	(0.45)	-0.05	(4.88)
USD Bonds (ROPs)	6	178	182	181	-0.49	-0.27%	3.53	1.99%
Crude Oil (USD/bbl)	7	91.38	99.29	100.75	1.46	1.47%	9.37	10.25%
Gold (USD/troy oz)	8	1,420.78	1,503.75	1,524.90	21.15	1.41%	104.12	7.33%
DXY	9	79.03	75	75.07	0.08	0.10%	-3.95	-5.00%
ADXY	10	116.46	118	118	-0.19	-0.16%	1.76	1.51%
VIX	11	17.75	16	16	0.57	3.67%	-1.66	-9.35%
V2X	12	23.92	20	23	2.63	13.09%	-1.18	-4.91%

Sources:

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