



## Weekly Market Commentary

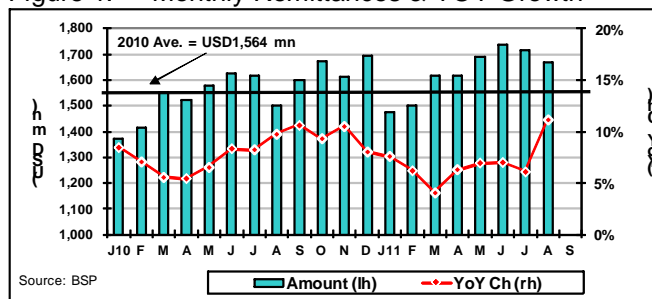
24 October 2011

**What happens when the govt. makes a mistake?** Like ordinary mortals, the govt. does commit mistakes. But what happens when an individual or firm acts on the basis of a govt. ruling that would later be deemed as not consistent with law and therefore null and void ab initio?

This is the situation that is obtaining in the recently matured Poverty Eradication & Alleviation Certificates (PEACE) bonds. The case is now with the Supreme Court. See details below under *Corporate News* section.

**Remittances continue to be resilient** despite slower growth in the U.S., Europe and social unrest in the Middle East & North Africa (MENA). Remittances for Aug. reached USD1.67 bn or 11.1% better year-on-year. This brings the 8-month total to USD13.0 bn or 6.9% higher compared to the same period last year. Interestingly, the monthly remittances this year were above the 2010 average in 6 out of the 8 months.

Figure 1. Monthly Remittances & YOY Growth



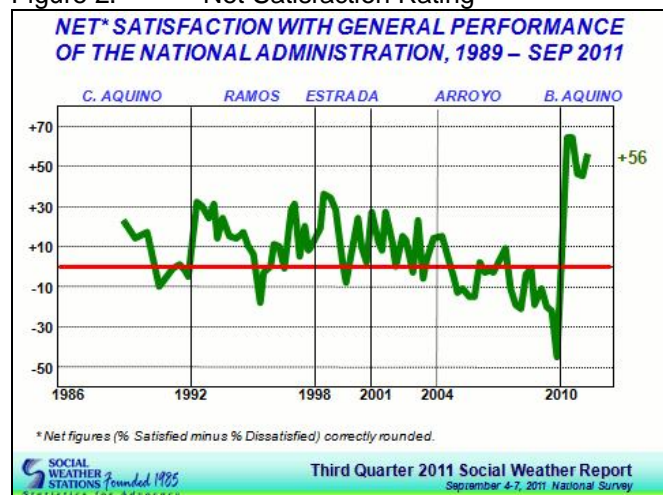
**Govt. successfully raised P110 bn from Retail Treasury Bond (RTB) sale.** The govt., through the Bureau of the Treasury (BTr), issued 10- and 15-year retail bonds with coupon of 5.75% and 6.25%, respectively. Coupon payment for the RTB is made quarterly.

**Aquino III admin ratings remain high.** The Third Quarter 2011 Social Weather Survey (conducted in Sept. 4-7, 2011) showed a *very good* net satisfaction rating of +56. The new administration's net rating is 11 points above the June 2011 rating of +45 (*good*) and way above those of previous administrations.

Geographically, the net satisfaction rating of the new administration stayed *good* in Metro Manila; rose from *good* to *very good* for the rest of Luzon & Visayas; and stayed *very good* in Mindanao.

Finally, the administration's net satisfaction rating moved from *good* to *very good* for all income classes.

Figure 2. Net Satisfaction Rating



### Corporate News:

**The Supreme Court issued a Temporary Restraining Order (TRO) against the immediate imposition of a 20% withholding tax on the Poverty Eradication & Alleviation Certificates (PEACE bonds) which matured Oct. 18 this year.** The TRO was the result of a petition from eight banks (BDO, Metrobank, Bank of Commerce, China Banking Corp., Phil. Bank of Communications, PNB, Philippine Veterans Bank and Planters Development Bank.). RCBC also filed a case with the Court of Tax Appeals questioning the validity of the 20% final withholding tax on the bonds.

The 10-year, zero coupon bonds were issued by the govt. in order to establish a fund that will finance the anti-poverty projects of non-government organizations. The bonds were issued at a discount through the usual govt. auction process. RCBC submitted the lowest bid of 12.75% and paid approximately P10.7 bn for a total face value of P35.0 bn. This earned the bank a

discount of ₱24.3 bn. RCBC later sold the bonds to the Caucus of Development NGO Networks (CODE-NGO) which subsequently sold the bonds to RCBC Capital for ₱12.1 bn thus realizing a gain of ₱1.4 bn.

At that time, the discount on the bonds were deemed as tax exempt based on three BIR rulings in 2001. However, subsequent BIR rulings in 2004 and 2005 found the earlier rulings as erroneous.

Cognizant that the PEACE bonds were about to mature, the DOF sought the opinion of the BIR on the proper tax treatment of the bonds.

The BIR, in its letter to DOF Sec. Cesar Purisima, reiterated its 2004 and 2005 opinion and likewise ruled that *the ₱24.3 bn discount on the issuance of PEACE bond should be subject to a 20% final tax on interest income on deposit substitute.*

It further ruled that *the BTr shall withhold the final tax due on interest income derive from the PEACEe bonds prior to its payment on the date of maturity.*

It is a mystery to me why the banks did not make any representation when the BIR overturned its earlier rulings in 2004 and 2005.

Over and above the PEACE bonds, a broader issue at stake is the consistency of govt. policies. Assuming the Supreme Court upholds the ruling of the BIR, what will be the impact of this decision on govt's. efforts to attract private capital?

At any rate, the Supreme Court ordered the Bureau of the Treasury (BTr) to place the ₱24.3 bn in escrow pending its final decision.

[For those interested, I have attached the relevant BIR rulings on the PEACE bonds.]

**Robust gaming sector.** The recent 9 months earnings report of state owned Phil. Amusement & Gaming Corp. (PAGCOR) has mildly surprised us in two ways. First, revenues from PAGCOR's own casinos rose by 9.3% year-on-year despite its modest facilities and growing competition from privately owned casinos. Second, revenue contribution from private casinos (majority would come from Resorts World Manila) jumped by 25.1% for the same period.

It appears that private casinos are attracting serious players – both locally and overseas. This would be the reason why Belle Corp., Bloombury Investments and Universal Entertainment are working double time to finish their respective casino complexes. We understand that the casino of Belle and Bloombury will

open by 1Q 2013 but a soft-open in late 2012 is a possibility.

However, until the new casinos are completed, Travellers Int'l., a joint venture between Alliance Global and Genting of Malaysia, will remain to be the only game in town in terms of a privately-run, large scale casino operations.

Table 1. PAGCOR Revenues

Revenues (in billions)	9M11	9M10	% Ch
PAGCOR Gaming Operations	18.0	16.5	9.3%
Others*	8.7	7.0	25.1%
Total	26.8	23.5	14.0%

\*Mainly franchise fees from licensed casinos  
Source: PAGCOR

**Phil. financial markets ended mixed last week** despite stronger remittance growth for Aug., successful issuance of the Retail Treasury Bonds and improved satisfaction rating of the Aquino administration. The PSEi (index for local stocks) remained flat ending the week at 4,158. Stocks may have taken a breather after staging an impressive rebound in recent weeks.

Yields of govt. bonds were slightly lower last week (i.e., prices higher) as investor sentiments remained positive. The yield of the 10-year govt. bond dropped to 5.98% last Friday from 6.01% a week ago.

ROPs retreated on mild profit taking. Prices of benchmark bonds (ROP 4% due Jan. 2021 & ROP 6.375% due Oct. 2034) dropped between 50 to 75 basis points.

The peso marginally retreated ending the week at ₱43.45 or ₱0.10 lower compared to a week ago.

Table 2. PDSTF Rates

PDST-F	YIELD		Change (bps)
	14-Oct-11	21-Oct-11	
1 Month	3.57	2.67	(90.00)
3 Months	2.80	1.73	(106.93)
6 Months	2.68	1.88	(80.19)
1 Year	2.72	1.94	(78.08)
2 Years	2.90	2.82	(7.89)
3 Years	4.01	3.93	(8.85)
4 Years	5.07	4.90	(16.92)
5 Years	5.29	5.22	(7.02)
7 Years	5.35	5.29	(6.00)
10 Years	6.01	5.98	(2.46)
20 Years	7.48	7.31	(16.92)
25 Years	7.57	7.51	(5.64)

Source: Bloomberg

Table 3. SDA Rates

Tenor	YIELD		Change (bps)
	14-Oct-11	21-Oct-11	
1 Month	4.6875%	4.6875%	0.00
14 Days	4.6250%	4.6250%	0.00

Source: BSP

Table 4. Indicative ROP Prices

Series	Coupon	Maturity	Yrs to Maturity	PRICE	Yield to
				21-Oct-11	Maturity
ROP 13	9.000	15-Feb-13	1.3	109.09	2.0%
ROP 14	8.250	15-Jan-14	2.2	113.02	2.2%
ROP 15	8.875	17-Mar-15	3.4	120.98	2.4%
ROP 16 n	8.000	15-Jan-16	4.2	120.56	2.8%
ROP 16	8.750	07-Oct-16	5.0	126.02	3.1%
ROP 17	9.375	18-Jan-18	6.2	128.68	4.1%
ROP 19	9.875	15-Jan-19	7.2	136.02	4.1%
ROP 19 n	8.375	17-Jun-19	7.7	129.08	3.9%
ROP 20	6.500	20-Jan-20	8.2	117.64	4.0%
ROP 21 n	4.000	15-Jan-21	9.2	100.72	3.9%
ROP 21	4.950	15-Jan-21	9.2	95.50	5.6%
ROP 24 n	7.500	25-Sep-24	12.9	124.19	4.9%
ROP 24	9.500	21-Oct-24	13.0	142.09	5.0%
ROP 25	10.625	16-Mar-25	13.4	153.82	5.0%
ROP 26	5.500	30-Mar-26	14.4	107.60	4.8%
BSP 27	8.600	15-Jun-27	15.6	127.19	5.9%
ROP 30	9.500	02-Feb-30	18.3	149.31	5.3%
ROP 31	7.750	14-Jan-31	19.2	131.34	5.2%
ROP 32	6.375	15-Jan-32	20.2	115.61	5.1%
ROP 34	6.375	23-Oct-34	23.0	117.50	5.1%
ROP 36	6.250	14-Jan-36	24.2	95.50	6.6%

Source: Bloomberg

## UITF Performance

Our United Equity Fund (UEF) was marginally higher by 0.18% last week, bringing YTD return to 6.4%.

Our United Conservative Fund (UCF) and the fixed income portion of the United Balanced Fund (UBF) are now fully invested in govt. securities. We continue to be positive on the local bond market given improving fundamentals.

Table 5. UITF Performance

UITF (Php)	31-Dec-10	14-Oct-11	21-Oct-11	Change	
				Wk-on-Wk	Yr-to-Date
UCF	1.4839	1.5356	1.5440	0.55%	4.05%
USMMF	1.2462	1.2564	1.2570	0.05%	0.87%
UCMF	1.1451	1.1701	1.1707	0.05%	2.23%
UBF	1.7428	1.8389	1.8455	0.36%	5.89%
UEF	2.2666	2.4074	2.4117	0.18%	6.40%
UCF	United Conservative Fund				
USMMF	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	14-Oct-11	21-Oct-11	Wk-on-Wk	% Ch	YTD	% YTD
Peso	1	43.80	43.35	43.45	0.10	0.23%	-0.35	-0.80%
Stocks	2	4,201	4,153	4,158	4.93	0.12%	-42.81	-1.02%
3-mo. PDSTF (ch in bps)	3	1.2917	2.7962	1.7269	-1.07	(106.93)	0.44	43.52
Peso Bonds	4	307	330	330	-0.06	-0.02%	22.16	7.21%
3-mo. USD LIBOR (ch in bps)	5	0.3028	0.4047	0.4183	0.01	1.36	0.12	11.55
Rep. of the Phil. bonds (ROP)	6	178	190	190	-0.10	-0.05%	11.87	6.68%
Crude Oil (USD/bbl)	7	91.38	87.00	87.40	0.40	0.46%	-3.98	-4.36%
Gold (USD/troy oz)	8	1,420.78	1,681	1,642	-38.35	-2.28%	221.60	15.60%
DXY (USD Index)	9	79.03	77	76	-0.23	-0.30%	-2.63	-3.33%
ADXY (Asian Currencies)	10	116.46	116	116	-0.34	-0.29%	-0.66	-0.57%
VIX	11	17.75	28	31	3.08	10.91%	13.57	76.45%
V2X	12	23.92	35	41	5.80	16.60%	16.82	70.34%

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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