



Weekly Market Commentary

19 December 2011

Macro environment continues to improve. We normally cannot have our cake and eat it too but apparently this is the way things are evolving. Despite strong inflows from remittances and from the IT/BPO sector as well as increased lending from the banking system domestic liquidity has been easing.

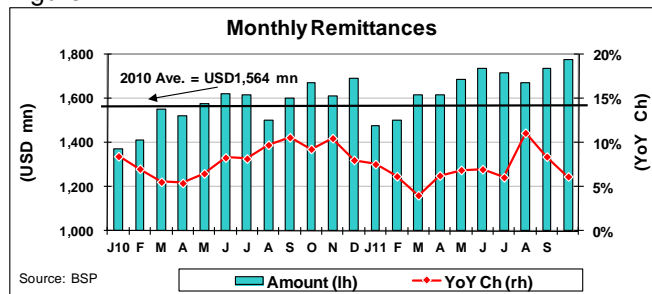
Foreign currency inflows, especially remittances and to a certain extent income coming from the IT/BPO sector, are mostly exchange for pesos which increases the amount of money in circulation as well as boost the savings of Filipinos. Furthermore, when banks lend money this process likewise expands the money in circulation.

So how come domestic liquidity is easing? Before we answer this question, let us first take a look at the major sources of liquidity.

- 1 Remittances. A major source especially since the money that comes in usually stays here.
- 2 Revenues from IT/BPO sector. A big portion stays here in the form of rentals, telecom expenses & salaries.
- 3 Loans made by banks. Once funds move out of the banks' vaults it become part of the money in circulation.

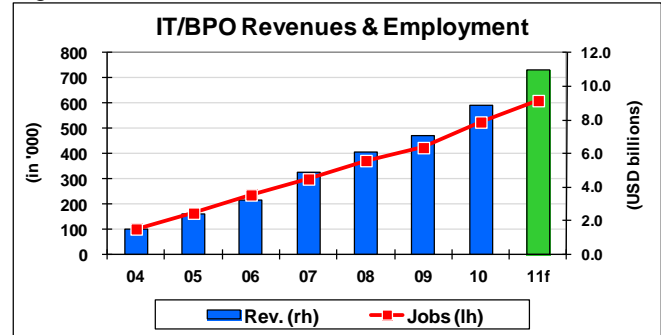
Remittances remains resilient. Latest data from the BSP shows that Oct. remittances grew by 6.2% to USD1.8 bn. This brings year-to-Oct. total to USD16.5 bn which is 7% higher compared to last year. Remittances this year has surprised on the upside given the problems in Europe, Middle East, the U.S. and Japan. In the last 10 months, monthly remittances were all above the 2010 average except for Jan. and Feb. (Fig. 1)

Figure 1



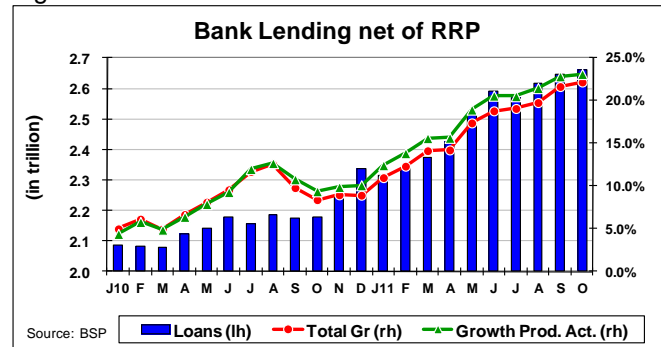
IT/BPO sector remains strong. The sector expects to generate USD11 bn in revenues this year

Figure 2



Bank lending growing. Outstanding loans of commercial banks (net of lending to the BSP) rose by 22% in Oct. More importantly, loans for productive activities (which account for 91% of total loans) continue to expand and have grown by 23% for the same period.

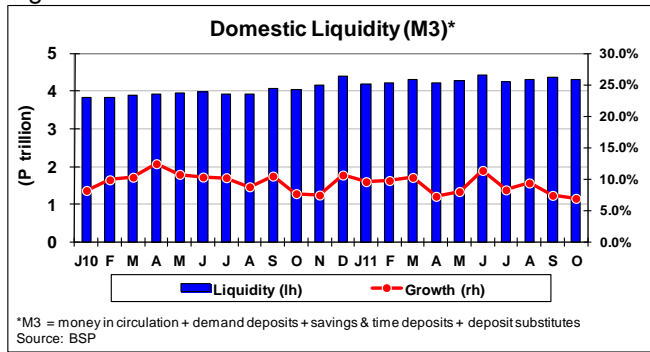
Figure 3



But domestic liquidity is decelerating. The above indicators show that there is more money in circulation yet domestic liquidity is easing. The red line in Figure 4 below shows that the trend is indeed decelerating. Domestic liquidity (M3) grew at an average of 8.8% for the first 10 months of this year versus 9.9% for the same period in 2010.

I would like to propose a toast to our readers:
For an inquiring mind, a boundless spirit, joyful memories and lasting friendships.
Happy holidays, everyone!

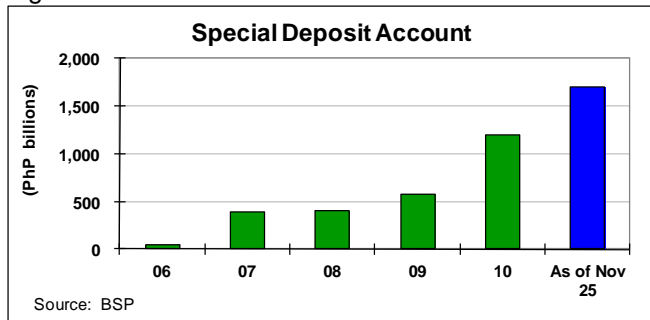
Figure 4



We can now go back to our earlier question on why liquidity is easing despite key indicators showing otherwise.

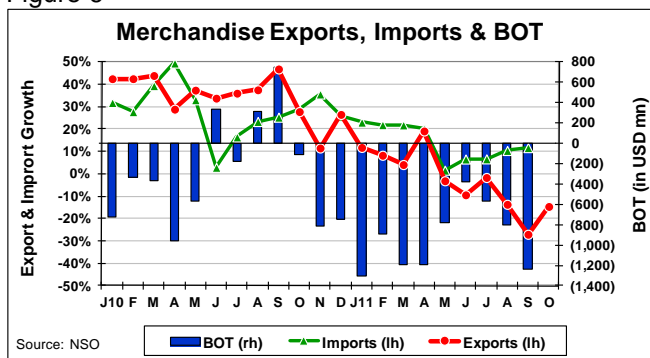
Excess cash being kept by the BSP. One of the reasons for this trend is that excess cash has been siphoned off by the BSP via its Special Deposit Account (SDA). This facility has steady grown and has now reached P1.7 trillion (Fig. 5). This is the main reason why domestic liquidity is being held at bay despite higher inflows and increased bank lending.

Figure 5



Exports continue to suffer from weak global demand. Merchandise exports for Oct. dropped by 14.6% to USD4.1 bn as overseas demand remains lackluster. The country's exports will continue to be under pressure on account of Europe's lingering debt crisis.

Figure 6



S&P raised its outlook on the country's BB credit rating to positive from stable citing strong external liquidity and signs of improving growth prospects. This move by Standard & Poor's has increased the possibility of an upward adjustment to the country's credit rating.

Impeachment case versus Chief Justice Corona, SWS survey & PPP projects. The Phil. Senate is now preparing to convene as an impeachment court after the House of Representatives voted to impeach Chief Justice Corona.

Social Weather Stations surveys. Despite heightened political noise, what gives some investors confidence is that public remains very satisfied with the performance of Pres. Aquino himself (Fig. 7) as well as his administration (Fig. 8).

Figure 7
NET SATISFACTION RATINGS* OF PRESIDENTS
PHILIPPINES, MAY 1986 TO SEP 2011

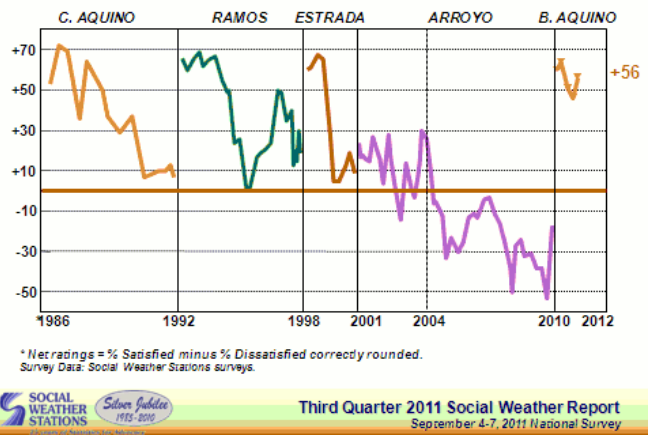
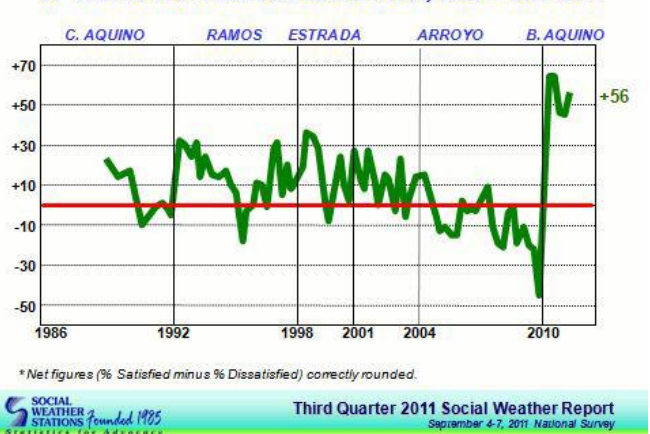


Figure 8
NET* SATISFACTION WITH GENERAL PERFORMANCE
OF THE NATIONAL ADMINISTRATION, 1989 - SEP 2011



Unfortunately, the same cannot be said about Chief Justice Corona whose rating has remained “neutral” (a reading of between +9 to -9) since Sept. 2010 (Fig. 9).

Figure 9

NET SATISFACTION RATINGS* OF CHIEF JUSTICES OF THE SUPREME COURT, OCT 1986 – SEP 2011



SOCIAL WEATHER STATIONS Founded 1985
 Third Quarter 2011 Social Weather Report
 September 4-7, 2011 National Survey

PPP starting to move (finally). Far from being distracted by recent developments, the administration has started to roll out its much delayed Public Private Partnership (PPP) program. It awarded to Ayala Corp. the right to construct and manage the 4 km. Daang Hari toll road for the next 30 years. AC’s winning bid of P902 mn is way ahead of the second best bid of P608 mn submitted by a consortium led by San Miguel Corp.

Aside from Daang Hari, five other projects will likely be bid out by DPWH next year. These are school buildings for the Dept. of Education, NLEX-SLEX connector road, the Cavite-Laguna expressway (Cavite side), the C5/FTI connection to the Skyway and the NAIA expressway (Table 1).

Table 1.

	Length (km)	Cost (mn)	Bidding
1 School Buildings	9,623 units	10,400	June 2012
2 NAIA Expressway	5.2	6,756	July 2012
3 NLEX-SLEX Connector	13.4	19,984	Oct. 2012
4 C5/FTI Skyway connector	6.8	5,640	2012
5 Cavite-Laguna Expressway	27.5	11,790	2012 - 2013

While the Daang Hari project is the first PPP ever bid out, we believe that more will be awarded early next year. Table 2 below lists the projects likely to be auctioned off in 2012.

Table 2. PPP Projects for 2012

	Proponent	Cost (P mn)
Dec. 2011		
1 Daang Hari-SLEX Link Road (4 km)	DPWH	1,956
2 Classroom Project (9,623 units)	DECS	10,400
1H 2012 Rollout		
3 Puerto Princesa Airport Dev.	DOTC	4,200
4 NLEX-SLEX Connector (13.4 km)	DPWH	20,181
5 Vaccine Self-Sufficiency Project	DOH	900
6 Laguindingan Airport (O&M)	DOTC	7,800
7 Mactan Passenger Terminal	DOTC	10,200
8 Fare collection system (MM light railways)	DOTC	
9 Hydroelectric plants O&M (Angat & Macau)	DOE	
2H 2012 Rollout		
10 CALA Expressway (Cavite side)	DPWH	11,790
11 New Bohol Airport Dev.	DOTC	8,000
12 LRT 2 Extension to Antipolo	DOTC	12,000
13 Dam & Water Treatment Plant for Metro Manila	MWSS	25,000
14 Cold Chain System	DA	1,500
15 Balara Water Hub	MWSS	20,000
16 Corn Bulk Handling Facility	DA	
17 Phil. Orthopedic Center Modernization	DOH	

Source: Presentation to the Financial Executives Institute of the Phil. (FINEX), by Cosette V. Canilao, PPP Center Executive Director, 23 Nov. 2011

Corporate News:

San Miguel Corp. (SMC) through its wholly owned subsidiary San Miguel Holdings Corp. has acquired a 46% stake in Atlantic Aurum, Inc. (AAI). AAI has a controlling interest in Citra Metro Manila Tollways Corp. (CMMTC), the concession holder and operator of the Skyway project. Under the agreement, SMC has the option to acquire up to 51% of AAI at a later date.

Higher public float. The Phil. Stock Exchange (PSE) has granted publicly listed firms up to the end of 2012 to comply with the 10% minimum float requirement. By Jan. 2013, a listed firm that does not comply with this rule will be suspended and its transactions subjected to capital gains tax. There are 41 listed firms whose public ownership levels fall below 10% as of September. This includes Ayala Corp’s IMI (9.7%), Petron (7.5%), Filinvest Dev. Corp. (3.7%), Republic Cement (3.7%), Tanduay Distillers (2.9%), Metro Pacific Tollways (0.2%), Purefoods (0.1%) and San Miguel Brewery (0.6%).

Meralco has signed power supply contracts with three parties namely, South Premiere Power Corp. (a unit of San Miguel Power Corp.), Masinloc Power Partners (a unit of AES Corp. of the US), and Sem-Calaca Power Corp. (a subsidiary of Semirara Mining Corp./DMCI Holdings). Conspicuously absent in the list was Aboitiz Power (AP). Without a long term contract with Meralco (the largest utility distributor in the country) AP will be forced to sell its power in the

spot market which could translate to volatile earnings for the company.

Alsons Group has increased its stake in Indophil, a publicly listed Australian company, via a USD99.4 million share placement. After the deal, the Alsons Group will own 20% of Indophil's expanded share capital. Indophil's main asset is its 37.5% interest in the Tampakan copper-gold project. The balance is controlled by Xstrata Copper, a unit of Xstrata PLC of Switzerland. According to [Xstrata Copper](#), Tampakan has a measured, indicated and inferred resource estimate of 2.4 billion tons at an average grade of 0.6% copper and 0.2 grams per ton gold. This translates to 13.5 million tons of copper and 15.8 million ounces of gold using a 0.3% copper cut-off grade. The project will have an average annual production of 375,000 tons of copper and 360,000 ounces of gold over an initial 17 year mine life.

If approved, the project will be the largest in the Philippines and among the largest copper mines in the world. The proposed mine site covers an area of approximately 10,000 hectares and is situated on the tri-boundary of South Cotabato, Sultan Kudarat and Davao Del Sur in southern Mindanao.

Phil. financial markets ended on a subdued note last week from a combination of lingering concerns in Europe (sadly this will be a recurring theme) as well as profit taking from some quarters.

Last week's trading in the local bourse was mostly concentrated in a number counters. Mining stocks were sold down following gold's recent retreat. The precious metal fell by 6.6% to USD1,599/troy oz. on the back of the rally of the US dollar.

Megaworld (MEG) was sold down heavily as its warrants are now convertible and very much in the money. The sell-off on MEG further weakened an already depressed property sector.

There were some winners though. Metro Pacific Investments (MPI) rallied after on news that the govt. has finally awarded its first PPP project. MPI did not participate in the bidding but it has positioned itself as a premier infrastructure company with interest in power, water distribution, tollways and healthcare.

Consumer play Puregold (PGOLD) was also a winner after it announced the opening of its 100th store.

Yields of local bonds moved slightly higher after a sharp rally in recent weeks. A benign inflation outlook

and the possibility of a BSP rate cut early next year have buoyed investor sentiment.

The peso has remained near the ₱44.00 level on continued US dollar strength. Interestingly, this level is favorable to exporters, overseas Filipinos sending money to the Philippines and BPO companies.

Table 3. PDSTF Rates

PDST-F	YIELD (%)		Change (bps)
	09-Dec-11	16-Dec-11	
1 Month	2.25	2.24	(0.89)
3 Months	1.71	1.81	9.81
6 Months	1.52	1.96	43.31
1 Year	1.71	1.66	(4.53)
2 Years	2.54	2.74	19.60
3 Years	3.16	3.47	30.75
4 Years	4.75	4.83	8.31
5 Years	5.01	5.11	10.25
7 Years	5.26	5.29	2.77
10 Years	5.71	5.70	(1.77)
20 Years	6.78	6.57	(20.58)
25 Years	6.72	6.71	(1.18)

Source: Bloomberg

Table 4. SDA Rates

Tenor	YIELD (%)		Change (bps)
	09-Dec-11	16-Dec-11	
1 Month	4.6875%	4.6875%	0.00
14 Days	4.6250%	4.6250%	0.00

Source: BSP

Table 5. Indicative ROP Prices

Series	Coupon	Maturity	Yrs to Maturity	PRICE	Yield to Maturity
				16-Dec-11	
ROP 13	9.000	15-Feb-13	1.2	108.27	1.8%
ROP 14	8.250	15-Jan-14	2.1	112.96	1.9%
ROP 15	8.875	17-Mar-15	3.2	121.56	2.0%
ROP 16 n	8.000	15-Jan-16	4.1	121.35	2.5%
ROP 16	8.750	07-Oct-16	4.8	126.89	2.7%
ROP 17	9.375	18-Jan-18	6.1	130.18	3.8%
ROP 19	9.875	15-Jan-19	7.1	138.98	3.6%
ROP 19 n	8.375	17-Jun-19	7.5	131.68	3.5%
ROP 20	6.500	20-Jan-20	8.1	119.24	3.7%
ROP 21 n	4.000	15-Jan-21	9.1	102.18	3.7%
ROP 21	4.950	15-Jan-21	9.1	99.50	5.0%
ROP 24 n	7.500	25-Sep-24	12.8	127.20	4.7%
ROP 24	9.500	21-Oct-24	12.8	144.14	4.8%
ROP 25	10.625	16-Mar-25	13.2	157.40	4.7%
ROP 26	5.500	30-Mar-26	14.3	111.52	4.4%
BSP 27	8.600	15-Jun-27	15.5	130.44	5.6%
ROP 30	9.500	02-Feb-30	18.1	153.67	5.0%
ROP 31	7.750	14-Jan-31	19.1	133.97	5.0%
ROP 32	6.375	15-Jan-32	20.1	118.32	4.9%
ROP 34	6.375	23-Oct-34	22.9	119.32	5.0%
ROP 36	6.250	14-Jan-36	24.1	99.00	6.3%

Source: Bloomberg

UITF Performance

Table 6. UITF Performance

UITF (PhP)	31-Dec-10	09-Dec-11	16-Dec-11	Change	
				Wk-on-Wk	Yr-to-Date
UCF	1.4839	1.5752	1.5787	0.22%	6.39%
U\$MMF	1.2462	1.2649	1.2648	-0.01%	1.49%
UCMF	1.1451	1.1750	1.1757	0.06%	2.67%
UBF	1.7428	1.9164	1.9088	-0.40%	9.52%
UEF	2.2666	2.5325	2.5134	-0.75%	10.89%
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 7. Market Indicators

Indicator		Level			Change			
		2010 Yr. End	09-Dec-11	16-Dec-11	Wk-on-Wk	% Ch	YTD	% YTD
Peso	1	43.80	43.59	43.88	0.29	0.66%	0.08	0.18%
Stocks	2	4,201	4,293	4,305	12.44	0.29%	103.80	2.47%
3-mo. PDSTF (ch in bps)	3	1.2917	1.7069	1.8050	0.10	9.81	0.51	51.33
Peso Bonds	4	307	334	335	1.41	0.42%	27.59	8.97%
3-mo. USD LIBOR (ch in bps)	5	0.3028	0.5418	0.5632	0.02	2.14	0.26	26.03
Rep. of the Phil. bonds (ROP)	6	178	195	196	0.24	0.12%	18.05	10.16%
Crude Oil (USD/bbl)	7	91.38	99.41	93.53	-5.88	-5.91%	2.15	2.35%
Gold (USD/troy oz)	8	1,420.78	1,712	1,599	-112.65	-6.58%	178.17	12.54%
DXY (USD Index)	9	79.03	79	80	1.62	2.07%	1.23	1.55%
ADX (Asian Currencies)	10	116.46	115	115	-0.52	-0.45%	-1.56	-1.34%
VIX	11	17.75	26	24	-2.09	-7.92%	6.54	36.85%
V2X	12	23.92	35	31	-3.76	-10.77%	7.23	30.21%

Sources:

1/ Phil. Dealing System	5/ Bloomberg; change in basis points	9/ DXY = USD spot index
2/ Phil Stock Exchange Index	6/ JPMorgan 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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