Investment Outlook

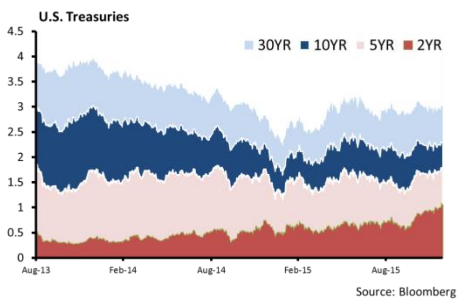
Global economy and markets

Global equities were up for the fourth quarter of 2015 notwithstanding a sell-off that followed the December European Central Bank (ECB) meeting. In fixed income, government bond market movements broadly reflected the diverging policy trajectories of the world's major central banks. After a long wait and as widely expected the US Federal Reserve capped off the year with its first policy rate hike rate since 2006, bringing the federal funds rate target to 0.25–0.50%. It was careful to note however that its stance remains "accommodative", despite messaging four additional hikes over the course of 2016.

After a year of poor performance for markets and forecasters, investors and money managers are understandably cautious. The sharp sell-off in risk markets at start 2016 however, has been much worse than anybody could have anticipated. We can only attempt to explain the recent market volatility as driven by several (not particularly new) developments: continued slowing economic growth in China, plummeting oil prices, disappointing corporate earnings growth, and a weak and slowing global economy. Looking forward, corporate earnings need to strengthen for equity markets to make any sustainable headway. And, while the deflationary global environment is anchoring bond yields, we remain wary of fixed income as an asset class, preferring the relative defensiveness of short duration strategic bond funds to largely negate concerns as to the timing and magnitude of the upturn in the interest rate cycle.

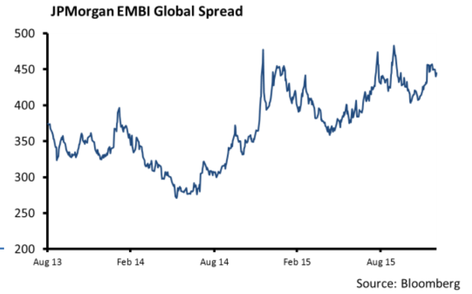
Developed Market Bonds

Volatility within developed fixed income markets are expected to remain elevated especially around Federal Open Market Committee (FOMC) meetings throughout the year. Markets seem to now be questioning the ability of the Fed to push through with its rate normalization cycle as planned, as reflected by falling forward interest rates and a depreciating US dollar. Long-end US Treasury yields will continue to be capped on relative value given the easing stance of the ECB, the Bank of Japan (BOJ), the People's Bank of China (PBoC). Prevailing negative global risk sentiment is also seen to support perceived safe-haven assets.



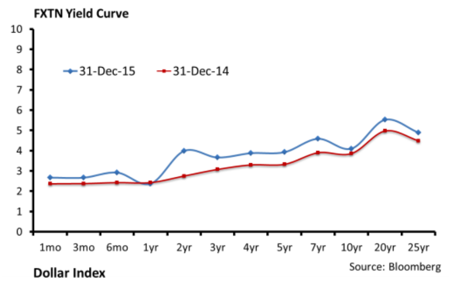
Emerging Market Bonds

The same factors that weighed on Emerging Markets (EM) in 2015, i.e. the end of the Zero Interest Rate Policy (ZIRP) regime in the US and the subsequent dollar strength, falling commodity prices, and global growth concerns, are expected linger in 2016. That said, strong case in favor of value has been developing in EM. There remains no evident catalyst for the asset class in the short-term however and 2016 is likely to be a year of stabilization. After the initial Fed hike, dispersion in EM is likely to increase and winners and losers can be identified based on relative economic fundamentals.



Philippine Bonds

Local Philippine fixed income investors are likely to have a tempered appetite for risk in the short term. While the Bangko Sentral ng Pilipinas (BSP) is widely expected to hold policy rates steady for the time being, the low trading volumes and elevated yield levels which characterized 4Q15 are likely to continue at the start of 2016. The shift to an interest rate corridor system which the BSP targets to do by this year, and an accompanying term deposit auction facility (TDF) to steer market rates toward the central bank's target or policy rate, targeted for 2Q16 is anticipated to affect prevailing market interest rates and demand for government securities.



Currencies

The US Dollar-Philippine Peso exchange rate ramped up prior to the well-telegraphed rate hike at the US FOMC meeting in December 2015. Although it recorded close of 47.39 for the year, it touched a high of 47.52 in intra-day. With the projected rate hikes in the US in 2016, we expect the 47.50 level to be re-tested and if broken convincingly will meet the next resistance level at 47.75 to 47.80. While pundits are divided and the pace and extent of the Fed's tightening cycle can be anyone's guess, the long-term theme of broad-based USD strengthening remains intact.

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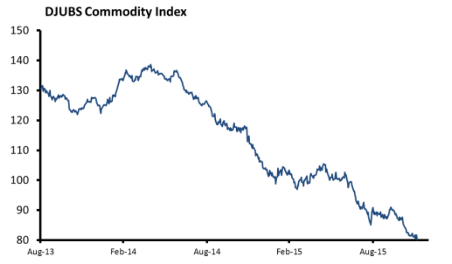
Global economy and markets

Commodities

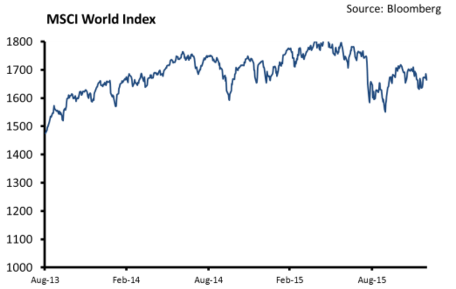
Almost every major commodity market saw prices trend lower on both an annual average and on an indexed basis in 2015. While supply side adjustments is expected to accelerate, a general lack of demand growth across many industrial commodities means fundamentals are likely to remain poor. The best hope for any wider commodity price recovery remains hinged on the prospects of oil prices heading higher and reversing threat of a deflationary cycle that currently prevails. This is unlikely to happen anytime soon.



Source: Bloomberg

Develop Market Equities

The recent market turmoil does not reflect a profound change in global economic growth prospects, yet. In developed markets, the United States continues to lead growth while Europe and Japan implement more stimulus. Low inflation and on-trend global growth remain in the cards for 2016 and it is expected for investors to favor fund flows to DM equities. A sensitivity to potential risks to the prevailing outlook however is warranted. We have a neutral view on U.S. equities, as gains may be harder to come by, and believe non-U.S. developed market equities appear more attractive, particularly in Europe.



Source: Bloomberg

Asia ex-Japan Equities

China is engaged in a self-engineered economic slowdown as it shifts its growth model from manufacturing to services. This has dampened demand throughout the world and is one of the many well-publicized challenges facing emerging markets. Despite recent market events, not that much has actually changed in China. While the current outlook for the Asian region may be poor, Asia ex-Japan stock markets are now back to the levels they fell to during the Eurozone crisis of 2011. Further falls in regional equity prices is an opportunity to invest in good quality businesses.

Source: Bloomberg

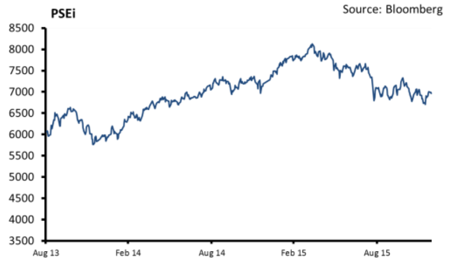
Emerging Market (non-Asian) Equities

Investor sentiment has been weak, largely due to top-down concerns at the asset class and country levels. While retail outflows were heavy in 2015, some institutional investors with a longer-term horizon and conviction in the asset class are beginning to add to their emerging markets allocations. While EM equities as a whole are currently trading at low relative valuations. Commodities price stabilization and corporate earnings growth improvements are two key factors capable of turning around broader sentiment. Longer term, select government and corporate reforms moving forward could have a broad positive effect on earnings growth.

Source: Bloomberg

Philippine Equities

We remain guarded in the current investment environment given the dearth of positive catalysts for Philippine equities in the near term. The local stock market remains dependent largely on foreign outflows, driven by negative EM investor sentiment and high relative valuation. Political uncertainty due to the presidential elections in May further weigh on investor sentiment.



Source: Bloomberg

Index/Currency	Price as of Dec 31	Percent Change		
		QoQ	YTD	YoY
MSCI World Index	1662.8	5.1%	-2.7%	-2.7%
MSCI AC Asia ex Japan Index	499.94	3.5%	-11.3%	-11.3%
MSCI EMEA Index	210.21	-8.6%	-22.4%	-22.4%
PSEi	6952.1	0.8%	-3.9%	-3.9%
USD / PHP	46.91	0.4%	4.9%	4.9%
USD / JPY	120.22	0.3%	0.4%	0.4%
EUR / USD	1.0862	-2.8%	-10.2%	-10.2%

Source: Bloomberg

Security	Yield as of Dec 31	Change in Yield (bps)		
		QoQ	YTD	YoY
US Treasuries 2YR	1.05	42	38	38
US Treasuries 5YR	1.76	40	11	11
US Treasuries 10YR	2.27	23	10	10
US Treasuries 30YR	3.02	16	26	26
PHIL. FXTN 2YR	3.98	137	123	123
PHIL. FXTN 5YR	3.93	43	60	60
PHIL. FXTN 10YR	4.10	30	24	24
PHIL. FXTN 20YR	5.52	39	55	55

Source: Bloomberg

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