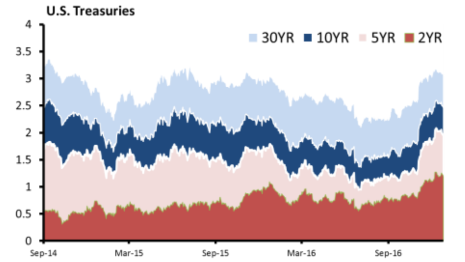
Investment Outlook

Global economy and markets

The global economic acceleration in the fourth quarter of 2016 provided a favorable backdrop for financial assets. U.S. wage gains are feeding higher inflation while solid consumer spending is supporting profits in the face of rising labor. At the same time, a resurgence of growth in China and a marked improvement global industrial activity point to the global economic expansion becoming more synchronized and thereby self-reinforcing. While this supports the view that the U.S.-led macroeconomic growth has further to run, such prospects also come with greater risks. The political uncertainties unleashed in 2016 will carry into 2017, as the Trump administration takes office in January, major European countries face key ballots, and formal talks kick off for the UK to leave the EU in March. Hence, the range of possible outcomes has also broadened in the year ahead. We are more constructive on the upside in a bull case scenario, fueled by the prospect of fiscal expansion, rising earnings and a return of true 'animal spirits'. That said, the downside risks have also grown.

Developed Market Bonds

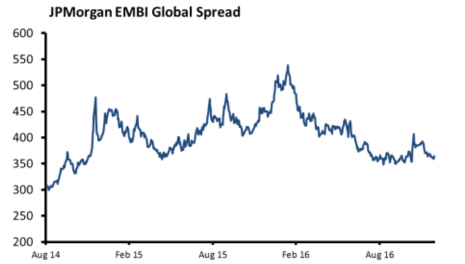
The leg up in benchmark government bond yields in the last quarter of 2016 was driven by the European Central Bank (ECB) tapering speculations in late September, a surprise-win for Trump in the US elections in November, and the highly anticipated US Fed hike in December. Expect continued recalibration in interest rates globally to reflect this "reflationary" dynamic in 2017, pushing yields upward, causing pain for holders of long-duration bonds. Steepening yield curves suggest investors should consider pivoting toward shorter-maturity bonds within their fixed income portfolios, preserving liquidity and otherwise preparing for increased bond market volatility.



Source: Bloomberg

Emerging Market Bonds

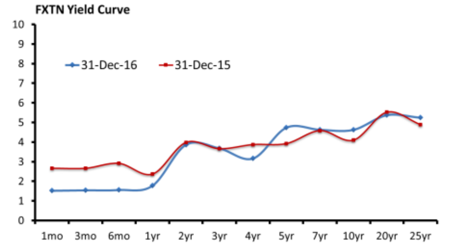
With spreads expected to contract by some 10–30 basis points, high yield US dollar debt should outperform. High beta, commodity-focused EM currencies versus the euro should also generate higher relative return returns. Losers in a US-driven growth recovery are likely to be any asset that is positively correlated to US Treasuries, which includes almost all investment grade US dollar debt. Local currency EM bonds linked to the euro, yen, or renminbi is likely to be pressured as further losses to the aforementioned currencies versus the US dollar is to be expected. These local currency debt include those of most of eastern Europe and emerging Asia.



Source: Bloomberg

Philippine Bonds

External factors and movements in global bond yields will continue to weigh on Philippine bonds before domestic factors begin to come back into focus. While there may be an injection of liquidity as Trusts and UITFs are displaced from the BSP's deposit facilities, rates are likely to continue trending higher with inflation seen to accelerate towards the middle of the BSP's 2-4% range and the PHP expected to depreciate further against the dollar. We prefer to remain underweight interest rate risk by keeping the duration of our fixed income portfolios short. We also see the most relative value in medium-tenor issues among Philippine Government Securities.



Source: Bloomberg

Currencies

The Philippine Peso continued to weaken against the US dollar in the 4Q of 2016 with the exchange rate testing the 50.0 level for the first time since 2008. While domestic fundamentals remain sound, broad USD strength is expected to persist. Markets continue to price in a more aggressive Fed rate normalization path due to the possibility of a revitalized fiscal policy agenda under a Trump administration. The Peso is likely to experience some volatility in the short term as investors react to additional information on US fiscal policy and the implications on the interest rate differential.

Source: Bloomberg

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Global economy and markets

Commodities

The world is positioning for a healthy period of global reflation in 2017, adding investor support from a demand perspective. A lack of new supply projects meanwhile is seeing the raw material end of value chains tighten in many cases. This is a very supportive environment for commodity prices. Factors that helped commodities over the past six months will continue to do so in early 2017. Global manufacturing continues to recover, while the Chinese government has repeated its desire for market stability. Moreover, while property sales are now trending negative, we feel there is enough momentum in Chinese construction activity to sustain positive demand conditions through mid-year.

Developed Market Equities

The United States is expensive and profit growth is likely to be at best in the mid-single digits. Margins are high and pressure from rising labor costs and the stronger dollar has room to grow. Fundamental support for U.S. equities looks mediocre, but there is the risk of an extended overbought period on euphoria over an anticipated Trump stimulus for the U.S. economy. Japan and Europe seem better placed for equity returns. Both have much better value than the U.S and central banks that are likely to continue with supportive policy settings. Political risk is an issue for Europe with elections in Germany, the Netherlands, France and potentially Italy in 2017. We remain cautious towards UK.

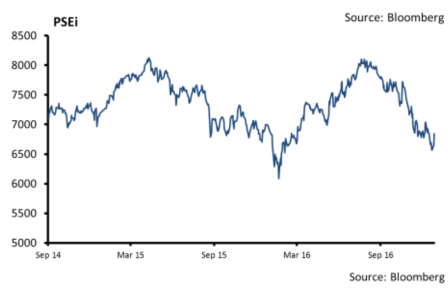
Asia ex-Japan (AxJ) Equities

While the outcome of the election presents some headwinds, particularly given the protectionist rhetoric during the campaign, the environment so far remains broadly positive for Asian equities. Potential upside surprises to global GDP growth in the coming months, should be positive for trade and sentiment. Recent developments such as a rebound in activity in China as further tailwinds to regional earnings growth. Favor countries with reform processes and improving earnings within emerging Asia ex-Japan.

Emerging Market (EM) Equities

By the end of 2016, EM equities were trading modestly above their long-term average, based on forward price to earnings, and are valued at about a 30% discount to developed markets. If fundamentals improve, valuations of certain companies should become even more compelling. There is also more upside given the positive outlook for oil and other commodities and should reform efforts start to bear more fruit. The earnings growth differential between the EM and DM should continue to widen barring any runaway strengthening of the US dollar.

Philippine Equities



We expect the Philippine Stock Exchange index (PSEi) to establish support around the 7,000 in the near term following the market's trend reversal in August 2016. The index has turned technically attractive relative to its historical valuations (5-year P/E mean at 16.4x)and versus regional peers (e.g. Thailand +20.2% and Indonesia +16.4%). The Philippines' economic fundamentals and sustainable growth prospects remain intact. However, we expect investors to be cautious given external factors and domestic political risks.

Index/Currency	Price as of Dec. 31	Percent Change		
		QoQ	YTD	YoY
MSCI World Index	1,751.2	1.5%	5.3%	5.3%
MSCI AC Asia ex Japan Index	514.34	-6.6%	2.9%	2.9%
MSCI EMEA Index	244.77	1.4%	16.4%	16.4%
PSEi	6,840.6	-10.3%	-1.6%	-1.6%
USD / PHP	49.60	2.3%	5.7%	5.7%
USD / JPY	116.96	15.4%	-2.7%	-2.7%
EUR / USD	1.0517	-6.4%	-3.2%	-3.2%

Source: Bloomberg

Security	Yield as of Dec. 31	Change in Yield (bps)		
		QoQ	YTD	YoY
US Treasuries 2YR	1.19	43	14	14
US Treasuries 5YR	1.93	78	17	17
US Treasuries 10YR	2.44	85	17	17
US Treasuries 30YR	3.07	75	5	5
PHIL. FXTN 2YR	3.87	158	-12	-12
PHIL. FXTN 5YR	4.74	111	82	82
PHIL. FXTN 10YR	4.63	98	53	53
PHIL. FXTN 20YR	5.38	73	-14	-14

Source: Bloomberg

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