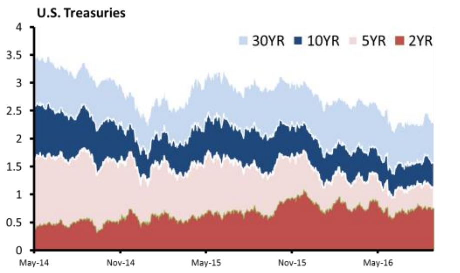
Investment Outlook

Global economy and markets

The third quarter saw a return to the 'risk-on' environment with markets and investors dismissing Brexit concerns and instead got encouraged by continued easy global monetary policy and decent economic data. Against this backdrop, equity returns were robust while fixed income lagged. With US economic growth rebounding last quarter, and global cyclical surveys have been steadily improving in recent months, market response following Donald Trump's surprise White House win seem to reflect a lagged rise in expectations for future inflation and growth. In a nutshell, after partly ignoring the steady economic improvements in the run-up to the election, the markets appear to have already largely adjusted their growth expectations to the new situation. Looking ahead, we expect market and policy uncertainty to prevail as a central theme for the remainder of the year. As such we favor shorter-term bonds whose returns are partly shielded from higher yields. We prefer value stocks that look relatively cheap on metrics such as book value and tend to perform well when bond yields rise. We also believe investors should be flexible and consider a tactical approach given the uncertain outlook.

Developed Market Bonds

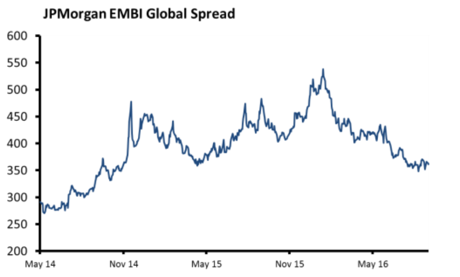
Bond market yields in developed nations were generally higher in the 3Q as improving macroeconomic data increased the chances of a 4Q US rate-hike and the yield on the 10-year US Treasury benchmark was up about 12 basis points (bps) for the period. Following Trump's victory however, the difference between the 30-year and two-year US government bond yield instantly surged. Market-based inflation expectations also jumped immediately. With current levels for interest rates still broadly the same as they were before the Fed's first rate hike in December 2015, we expect the upward pressure in US rates to continue through the end of the year.



Source: Bloomberg

Emerging Market Bonds

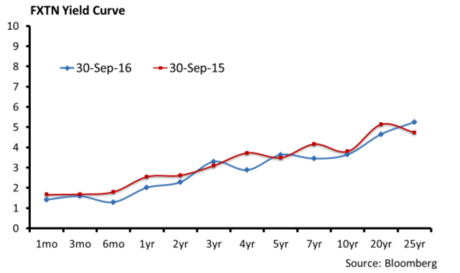
Emerging market (EM) assets have suffered in the wake of the Trump presidential victory and the Republican sweep of Congress. Since Nov. 8, EM USD sovereign bonds are down by more than -4.0%. EM currencies are also weaker by -4.0% on average versus the dollar for the same period. The negative market reaction is a result of fears that protectionist US policies could damage trade. Several EMs are far more resilient to potential increases in trade costs at the margin than markets have been indicating. As such, a select set of undervalued opportunities across local-currency emerging markets are preferable over many of the overvaluations and low yields across the developed markets.



Source: Bloomberg

Philippine Bonds

Although political 'headline' risks could contribute to short-term volatility, strong domestic fundamentals should be able to withstand these in the long term. BSP is unlikely to adjust its policy stance in the fourth quarter with inflation having just risen to the lower end of their 2-4% range. Liquidity continues to be adequate with the term deposit auction facility continually oversubscribed. External factors take center stage for the remainder of the year with the local bond market likely to take its cue from movements in global bond yields. We prefer to remain underweight interest rate risk but 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 3Q of 2016 when the exchange rate hit 48.50 pesos to the US dollar amid broad USD strengthening as markets repriced the probability of a US rate hike in 2016. A diminished current account (C/A) surplus due to a yawning trade deficit mainly on the non-oil import surge is also weighing on PHP market sentiment. Unless an economic crisis happens, further PHP deterioration from the ranges indicated are highly unlikely given upside inflation risks and strong domestic demand that evoke policy rate hike expectations and a steeper yield curve.

Source: Bloomberg

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Global economy and markets

Commodities

The commodity markets were fairly quiet during the quarter, although small declines in the prices of oil and gold, the two biggest components of the Bloomberg Commodity Index, resulted in a decline of 3.9% for the benchmark. The current dollar strength may dampen any further price increase in oil and gold for the remainder of the year. On the other side of the world, China's economy remains burdened by overcapacity and debt. Since demand in that country is a significant driver of global commodity prices which further supports the view that commodity inflation should remain subdued.

Developed Market Equities

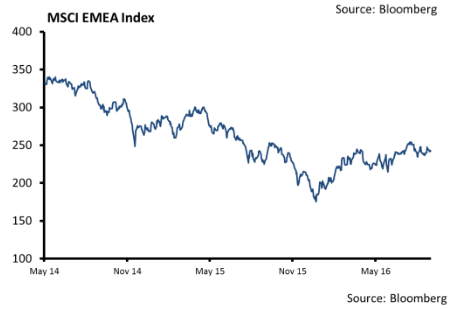
The Federal Reserve's decision to stand pat on interest rates, positive economic news and strong quarterly earnings reports from several companies buoyed the S&P500 Composite Index by 4% in the third quarter. Meanwhile, both European and Japanese equity markets rebounded from steep losses seen in the second quarter with the former led by economically sensitive stocks and the latter amid fresh stimulus measures from the Bank of Japan. With the moderate improvement in global growth momentum in recent months we expect the constructive tone for equity markets to continue.

Asia ex-Japan Equities

Asian stocks recovered strongly in the 3Q, helped by strong data coming out of China and strong earnings results of companies in the region. Gains in the technology sector helped lift major Asian markets as well. Looking ahead to the rest of the year, we expect EM Asia ex-Japan foreign exchange weakness to weigh on regional equity market performance given the risks of escalating trade tensions under Trump's regime and higher US rates. While markets attempt to price "*Trumponomics*", the unfolding growth and earnings momentum could act as the catalyst for new equity gains, especially as EM Asia ex-Japan valuations remain below their long-term averages.

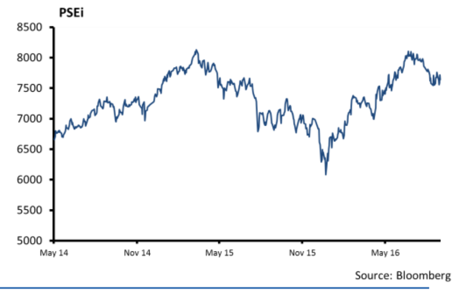
Emerging Market Equities

In the third quarter, EM earnings and earnings expectations cycles finally began to turn. Reported profits and margins rebounded off their cyclical lows and earnings estimates moved out of negative territory, diminishing a headwind that had weighed on performance from 2011 through 2015. A lot is still uncertain, thus volatility is likely to remain more elevated for EM assets compared to earlier this year; however, investors should be wary of overreacting before getting more clarity on U.S. policy over the next few weeks and months.



Philippine Equities

The Philippine Stock Exchange index (PSEi) slid 2.15% last quarter as investor sentiment soured. Foreign outflows started in August but gained traction in September as domestic political noise and international factors (e.g. major central bank policy changes, geopolitical bickering, and commodity prices) saturated the headlines. We believe in the administration's law and order and infrastructure development efforts, but we remain cautious of the government's execution of its policies (e.g. tax reforms, and the creation of new alliances). Infrastructure, financials and consumer sectors stand to benefit the most in the medium term.



Index/Currency	Price as of Sept 30	Percent Change		
		QoQ	YTD	YoY
MSCI World Index	1,725.7	4.4%	3.8%	9.1%
MSCI AC Asia ex Japan Index	550.93	9.4%	10.2%	14.0%
MSCI EMEA Index	241.39	4.6%	14.8%	4.9%
PSEi	7,629.7	-2.1%	9.7%	10.7%
USD / PHP	48.47	2.8%	3.3%	3.7%
USD / JPY	101.35	-1.8%	-15.7%	-15.5%
EUR / USD	1.1235	1.2%	3.4%	0.5%

Source: Bloomberg

Security	Yield as of Sept 30	Change in Yield (bps)		
		QoQ	YTD	YoY
US Treasuries 2YR	0.76	18	-29	13
US Treasuries 5YR	1.15	15	-61	-21
US Treasuries 10YR	1.59	12	-68	-44
US Treasuries 30YR	2.32	3	-70	-54
PHIL. FXTN 2YR	2.29	-10	-170	-33
PHIL. FXTN 5YR	3.63	73	-29	14
PHIL. FXTN 10YR	3.65	-57	-45	-15
PHIL. FXTN 20YR	4.65	41	-87	-49

Source: Bloomberg

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