Investment Outlook

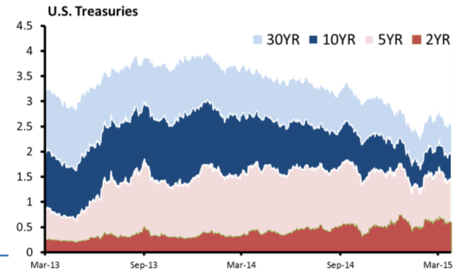
Global economy and markets

Monetary divergence continues to be the global theme this year, with the easing of many banks driving markets. Intervention and monetary accommodations from the Bank of Japan (BoJ), European Central Bank (ECB), and People's Bank of China (PBoC), along with over 20 other central banks that have so far eased their policies, have steered government bond yields lower and caused equity markets to rally considerably. While the US remains the driver of global growth, positive surprise came from Europe where economic data have beaten low expectations, helped by the weakening Euro. In contrast, outside of the labor market, US economic momentum has slowed sharply from last year. This, together with a strengthening US dollar, has pushed back expectations for the timing of when the US Federal Reserve Committee will raise interest rates away from zero.

On the local front, strong fundamentals and a long term growth story continue to be the key themes for the Philippines. Net foreign inflows of USD1.1 billion flooded the exchange and helped the PSEi Index to breach the 8,000 level at the close of the first quarter. Meanwhile, as widely expected, benchmark interest rates were kept unchanged at the last Monetary Board meeting. The Bangko Sentral ng Pilipinas (BSP) anticipates acceleration in economic growth to as much as 8% in 2015 with a lower inflation forecast to 2.2% this year, which reduces any likelihood of easing.

Developed market bonds

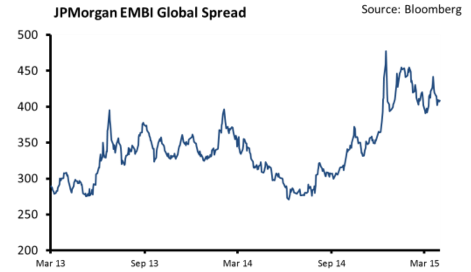
The long-anticipated expanded QE from Europe, which could amount to as much as a trillion euros, have pushed more than half of the outstanding core government bonds in the region to negative territory. Even with rate hikes expected from the Fed within the year, the search for yield and income remains as big a challenge as ever and US Treasuries continue to attract investors on a relative value basis. While sentiment appears to be pricing in rate normalization by the 3rd or 4th quarter of 2015, we do not underestimate the possibility of an earlier start in June. All eyes will be on the US economic data moving forward and we expect markets to provide sufficient volatility for tactical trading opportunities in the short term.



Source: Bloomberg

Emerging market bonds

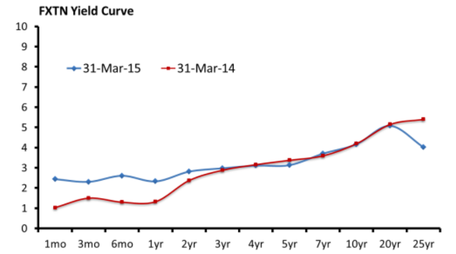
Expect EM local currency bonds generally to underperform as sustainably strong USD remains to be a key theme for 2015. Latin American (LATAM) economies and countries in Central and Eastern Europe, Middle East, and Africa (CEEMEA) are still being dragged down by the drop in commodity prices, an array of political problems and various conflicts. EM Asia remains to be a bright spot as large corporates start to deleverage and domestic funding conditions improve given the strong fundamentals and growth story in the region. Asian credit, both investment grade (IG) and high yield, offer significant yield pick-up over comparable European and US exposures. While we have seen some volatility in high yield, default rates in the Asian space is expected to be lower than broader Emerging Markets.



Source: Bloomberg

Philippine bonds

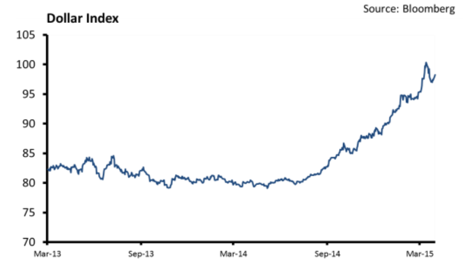
The yields of Philippine government securities (GS) continued to track those of US Treasuries in the first quarter of 2015. BSP remains as one of the few hold outs this year amid more than two dozen central banks around the world that have joined the rate cut band wagon. While the lower-than-assumed daily minimum wage hike in Metro Manila prompted the central bank to further cut its inflation forecast for this year, it is likely to settle within the lower half of the target range of 2-4% for 2015 and 2016. The growth outlook remains robust given the additional support from increased public spending. However, we are cautious in the short term given the effect the anticipated Fed tightening may have on the local fixed income market. At present levels, yields are flat against year-end 2013 after February's sell-off retraced the rally in January.



Source: Bloomberg

Currencies

The Philippine Peso touched a high of 45.068 and a low of 44.060 in the 1Q2015. It settled around 44.70 to the US dollar on the back of an expected broad strengthening of the greenback. The peso outperformed most of its regional neighbors against the USD early on as the Philippines has held off on cutting policy rates thus far. As we expect a sustainable strengthening of the US Dollar, the local currency peso is anticipated to break the 45.00 level as we approach US interest rate normalization later this year.



Source: Bloomberg

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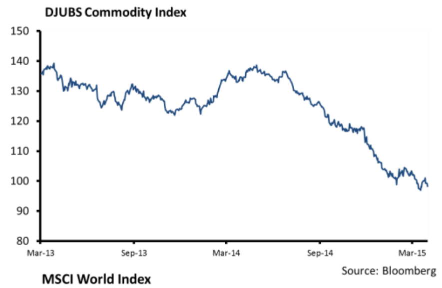
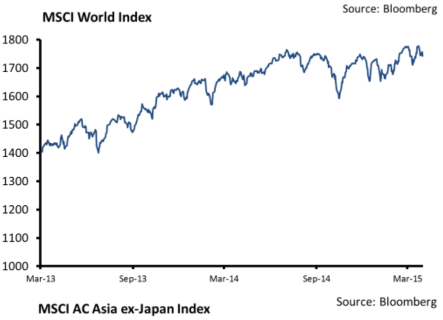
Global economy and markets



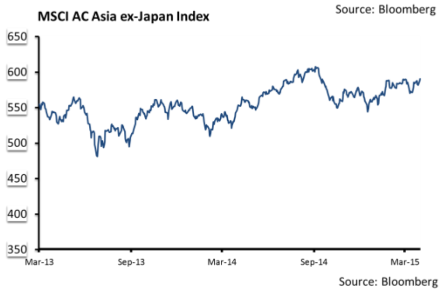
Commodities

Commodities continued to tumble with oil remaining at below $50/bbl. Spot gold market activity remained volatile, influenced by the rising US dollar and reduced "safe haven" demand after a four-month extension to the current Greek bailout program was secured. Copper futures remained negative as slowing global growth curbed the demand for the base metal. Also, China growth concerns continue to affect demand and supply gluts cause further price declines. Oil is expected to remain volatile amid all the political noise in the region and the strong ongoing supply of shale oil out of the US.



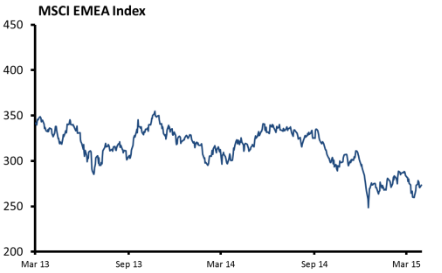
Developed market equities

European and Japanese equities had a strong 1Q, outperforming their US and EM counterparts. The round of global easing and flush liquidity in the system has pushed European equity market to rally by 18.6% (Stoxx Europe 600 Stock index) and Japanese equities (Topix) by 9.6%. European equities are no longer cheap. Corporate earnings growth is again coming into focus, which will be needed to justify the ongoing rally. Japanese equities remain attractively valued on a relative basis. The direction of foreign exchange remains key and argues for the ongoing use of a currency hedged approach. Despite being the most likely driver of global growth this year, US equities are less compelling given full valuations. A selective approach is more appropriate: favor cyclicals such as financials and technology versus richly valued bond proxies such as utilities.



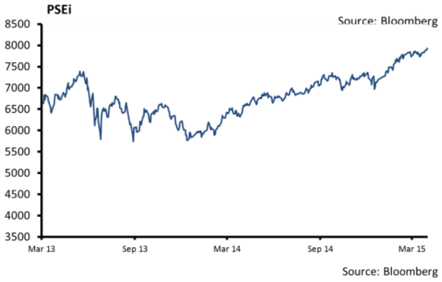
Asia Ex-Japan equities

Asia ex-Japan equities should continue to benefit significantly from all the excess liquidity in the system. Relative valuations show that the region is reasonably inexpensive at 13xPE 2015 as compared to developed markets which now trades at the high teens. On a country level, India and China have been boosted by monetary easing sentiment, and Korea and Taiwan equity markets have been gaining momentum. For India, a well-balanced budget, reform expectations and central bank accommodation should continue to drive equity markets after a healthy consolidation. In China, momentum for Chinese A shares can continue, as the authorities keep up the easing rhetoric and domestic stock market participation stays high.



Emerging market (non-Asian) equities

With valuations stretched in many developed markets, EM looks to offer attractive value alternatives and under-owned markets. However, EM remains a divergent world – challenged by the impact of oil and the pressure from the Fed and resultant stronger dollar. Recent Fed dovishness could provide a respite for EM equities in Q2 but idiosyncratic risks abound, ie for Brazil and Russia. EM equities should eventually benefit from any improvement in the global growth outlook.



Philippine equities

Positive sentiment reigned over the Philippine equity market with the index soaring at an all-time high above the 8000 level. Banks' NPLs are kept low at 1.98% while overall loan portfolio of universal and commercial banks grew by 17%. Foreign direct investments (FDI) to the Philippines surged to an all-time high last year, reaching $6.201 billion, up 65.9% from $3.737 billion in 2013 on strong investor confidence. Meanwhile, any consolidation in the market should be seen as a buying opportunity. We are neutral on the Philippines as valuations looks stretched with the PSEi now trading at 21xPE 2015 at current levels of 8,000. The stellar performance of the market is driven mostly by passive ETF flows. Philippine equities are ripe for a healthy correction.

Index/Currency	Price as of Mar. 31	Percent Change		
		QoQ	YTD	YoY
MSCI World Index	1740.8	1.8%	1.8%	4.0%
MSCI AC Asia ex Japan Index	589.92	4.6%	4.6%	8.1%
MSCI EMEA Index	274.21	1.3%	1.3%	-14.7%
PSEi	7940.5	9.8%	9.8%	23.5%
USD / PHP	44.70	0.0%	0.0%	-0.3%
USD / JPY	120.13	0.3%	0.3%	16.4%
EUR / USD	1.0731	-11.3%	-11.3%	-22.1%

Source: Bloomberg

Security	Yield as of Mar. 31	Change in Yield (bps)		
		QoQ	YTD	YoY
US Treasuries 2YR	0.56	-11	-11	14
US Treasuries 5YR	1.37	-28	-28	-35
US Treasuries 10YR	1.92	-25	-25	-79
US Treasuries 30YR	2.54	-22	-22	-102
PHIL. FXTN 2YR	2.81	6	6	44
PHIL. FXTN 5YR	3.13	-19	-19	-24
PHIL. FXTN 10YR	4.17	30	30	-3
PHIL. FXTN 20YR	5.08	10	10	-7

Source: Bloomberg

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Global Macro Outlook

The global markets will still be watching movements in oil prices, impending US rate hike, as well as additional easing liquidity injections from major economies such as ECB and BoJ. Global liquidity will help drive the equities market.

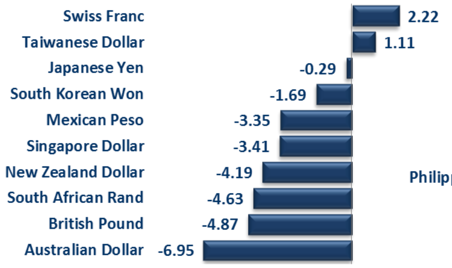
Asset Class	Factors and Drivers	Current View	Prev. View
Fixed Income			
• US Treasuries	Yields to remain low short-term but risks skewed to the upside; market bias on a September hike	=	=
• Asia	Asia to continue to outperform although slightly more cautious on Fed liftoff	=	=
• Emerging Markets	EM to experience slight rebound off of lows hit last year.	-	-
• Philippines	Sideways for the time being. May see some momentum once more details on local initiatives emerge and market sees how they are implemented.	=	=
Equity			
• Global	Global QE will still be positive for equities. Effects of EU QE program yet to be seen although there are signs of economic recovery. Possible rate hike by the US by 2H still imminent.	=	=
• Asia	Stock Connect program of China remains positive for HK equities. Valuations are still relatively inexpensive in Asia. Expect China to trade sideways and markets to stay data dependent. Economic transition from investment driven to a more consumption led may still cause volatility.	=	=
• Emerging Markets	Oil price recovery will provide support to EM growth. Low commodity prices, stronger USD, looming Fed rate hikes and structural concerns are headwinds.	=	=
• Philippines	Fundamental macro remains strong. Expect release of 1Q earnings to drive market. We expect a consolidation as valuations look stretched.	=	+
Currencies			
• USD	Theme of USD strength to persist throughout the year against other currencies and really take off once the US Fed finally hikes rates.	+	=
• PHP	PHP to underperform USD but viewed to be resilient relative to other Asian currencies. OFW remittances should continue to anchor USD reserves and the local growth story should see the PHP outperform regional neighbors	-	=
Commodities	Uncertainty on global demand growth will continue to weigh down on basic commodities but supportive growth policies worldwide will limit further downside.	=	=
REITS	Theme of preferring recurring income property portfolios to developers will continue.	+	=

Legend :

— —	Underweight	—	Slightly underweight	=	Neutral	+	Slightly overweight	++	Overweight

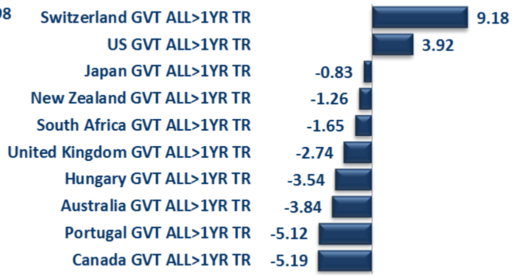
Percentage Gain/Loss in 1Q 2015 (Source: Bloomberg)

Top Performing Major Currencies



Top Performing Equity Indices

Top Performing Country Bond Indices



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