Second Quarter 2016

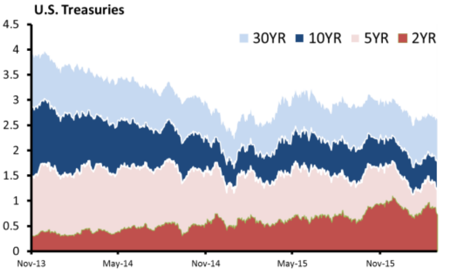
Investment Outlook

Global economy and markets

China-related concerns, the slide in oil prices, and the trajectory of the global economy weighed on sentiment at the start of 2016, causing panic selling in global risk assets during the first few weeks. By mid February, after crashing to lows not seen since 2013, risk assets bounced hard, finishing the quarter just shy of where it started. The flip in sentiment was largely due to the Federal Reserve (Fed) softening its rate-hiking stance, more closely resembling its highly accommodative global counterparts. As a result, global equity markets finished mixed for the quarter with U.S. equities closing in positive territory (S&p500 +1.4%) while developed non-U.S. equity markets declined modestly (MSCI EAFE Index -2.9%). Emerging market (EM) equities, a laggard for much of 2015, outperformed with 5.4% (MSCI EM Index) quarter-on-quarter returns. The Philippine Stock Exchange Index (PSEi) in turn was up 3.6%. Broad fixed income markets responded well to the sharp decline in interest rates and narrowing in credit spreads (JPM Global Aggregate Bond Index +5.7%; HSBC Philippine Local Currency Gov't Bond Index +3.3%). Brent Crude, which was down 25% at the height of the sell-off, ended the quarter 5.3% higher.

Developed Market Bonds

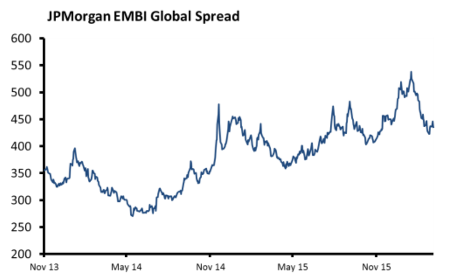
The Fed is now targeting two interest rate hikes for the remainder of 2016, down from an original expectation of four hikes following its December 2015 meeting. Negative interest rate policies in Europe and Japan continue to have massive implications for global sovereign debt. US Treasuries are likely to be range bound: while concerns about the potential to overshoot the Fed's 2% inflation target could push yields higher, investor appetite will likely continue to support perceived safe haven assets ahead of what may be another turbulent quarter, especially around Federal Open Market Committee (FOMC) meetings and crucial economic data releases.



Source: Bloomberg

Emerging Market Bonds

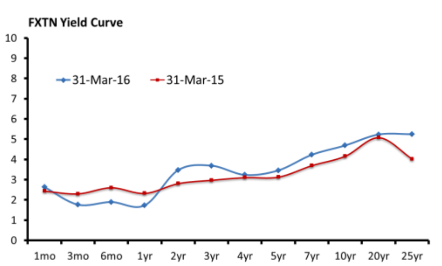
Fundamentals generally remain under pressure due to slow growth on weak domestic demand, exposure to the commodity downturn in many cases, and uncertainty about China's financial and structural reform efforts. Despite these issues, a weakening in the US dollar on a more dovish Fed and a search for yield has resulted in the recent narrowing in spreads. Valuations now appear stretched. We expect the spreads to consolidate with a widening bias, especially as the on-going risk rally tapers off. Expect volatility to pick up around central bank policy rate decision meetings.



Source: Bloomberg

Philippine Bonds

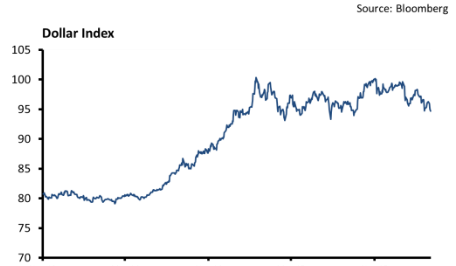
The local Philippine fixed income market will likely remain well-supported in the short term. Solid local fundamentals and the likelihood that the Bangko Sentral ng Pilipinas (BSP) will continue to hold policy rates steady should continue to keep yields anchored. External economic developments contributing to low global yields support this as well. The implementation of the upcoming term deposit auction facility (TDAF) 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.



Source: Bloomberg

Currencies

The Philippine Peso strengthened by almost 2% against the US dollar in the first quarter of 2016. During January's sell-off in risk assets, the Peso hit a low of 47.995, only to reverse in trajectory following the Fed's unexpectedly dovish statements during the March FOMC meeting. By the end of the quarter, the Peso closed 7 centavos shy of the 46 to a dollar level. The trend of a weaker USD against Asian currencies may persist in the short term but we believe the long-term theme of broad-based USD strength remains intact.



Source: Bloomberg

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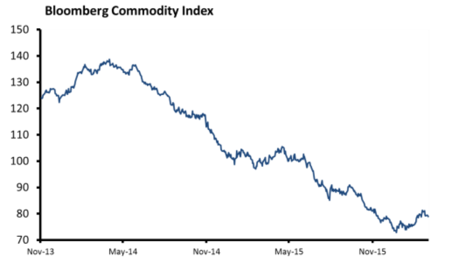
Global economy and markets

Commodities

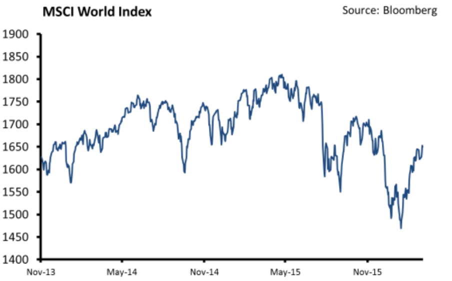
A shift in the US dollar's strengthening trajectory was key in reversing the bearish sentiment that weighed over the commodities complex since 2015. Optimism over the potential for easing oversupply dynamics given possible production restraints by major energy and metals producers helped sustain the mid-quarter turnaround. Expect commodity markets to remain choppy in 2Q16. Supply-side disruptions in oil production are also more likely than lower demand or higher supply in the near term, lending support to prices.



Source: Bloomberg

Developed Market Equities

In the U.S., peak margins and payout ratios may limit any upside to equity returns even if the consumer and housing sectors are strong, and growth appears to be stabilizing. Reasonable valuations in Europe and ECB policy are supportive, but weak growth and a challenged banking system are risks. Domestic U.K. equities look vulnerable to Brexit fears. Lastly, a significantly stronger Yen despite negative interest rates adopted by the BOJ in late January and mounting doubts over the progress of structural reforms should continue to weigh on Japanese equities.



Source: Bloomberg

Asia ex-Japan (AxJ) Equities

Asian equities (MSCI AxJ) gained 1.53% in 1Q, recouping all of its losses early in the year. Thai, Malaysian and Indonesian stocks where the biggest contributors to return with corresponding MSCI Country Indices up 16.42%, 13.62%, and 12.86%, respectively. This happened amid value investors going back to emerging markets as the view of a weaker dollar and lower rates for longer was confirmed in the March FOMC meeting. Asia ex-Japan equities are likely to consolidate before moving higher in 2Q driven by stronger emerging market currencies and as increased retail spending due to low oil prices kick in.

Source: Bloomberg

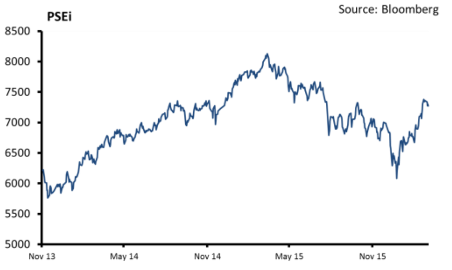
Emerging Market Equities

EM broadly outperformed last quarter, rising 5.4% (MSCI EM Index) , in a large part due to a rally in EM currencies. Oil exporting countries Brazil and Russia soared by 27.39% and 15.66% respectively, after oil prices bounced off lows not seen since 2003 (Brent oil at $27/bbl), hitting the $40/barrel mark at quarter close. While we have a more positive view in EM currently driven by a reduction in tail risk, a sustainable bull market requires EPS growth. Our enthusiasm in emerging markets is hampered by poor earnings dynamics, slowing Chinese growth and concerns over rising corporate leverage.

Source: Bloomberg

Philippine Equities

With the 1Q16 earnings season set to unfold, we observe leading indicators to be mostly positive. Consumer demand, credit growth, commodity prices and construction material costs all look favorable. Given current earnings expectations and the recent strong relative performance of the PSE Index (+3.6% Q/Q) however, we have a cautious view of the market in light of the presidential elections in May. Up to this point, the risks associated with uncertainties related to the conduct and outcome of the national polls are yet to be priced in. We also expect external factors to continue to dictate foreign fund flows and investor risk sentiment. The index may consolidate between 7,000 and 7,450 in 2Q.



Source: Bloomberg

Index/Currency	Price as of Mar 31	Percent Change		
		QoQ	YTD	YoY
MSCI World Index	1,648.1	-0.9%	-0.9%	-5.3%
MSCI AC Asia ex Japan Index	507.58	1.5%	1.5%	-14.0%
MSCI EMEA Index	235.64	12.1%	12.1%	-14.1%
PSEi	7,262.3	4.5%	4.5%	-8.5%
USD / PHP	45.97	-2.0%	-2.0%	2.8%
USD / JPY	112.57	-6.4%	-6.4%	-6.3%
EUR / USD	1.1380	4.8%	4.8%	6.0%

Source: Bloomberg

Security	Yield as of Mar 31	Change in Yield (bps)		
		QoQ	YTD	YoY
US Treasuries 2YR	0.72	-33	-33	17
US Treasuries 5YR	1.20	-56	-56	-17
US Treasuries 10YR	1.77	-50	-50	-15
US Treasuries 30YR	2.61	-40	-40	8
PHIL. FXTN 2YR	3.47	-51	-51	66
PHIL. FXTN 5YR	3.46	-47	-47	33
PHIL. FXTN 10YR	4.69	59	59	52
PHIL. FXTN 20YR	5.23	-29	-29	15

Source: Bloomberg

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