

# Investment Outlook

## Global economy and markets

Volatility picked up during the second quarter of 2015 as uncertainties surrounding the impending US rate hike, event and contagion risk out of Greece, and a correction following the fast-paced rally of the Chinese equity market weighed on the performance of both the fixed income and equity asset classes. During the period, US Fed Chair Yellen reiterated that policy is data dependent and that the lift-off in interest rates is likely to happen sometime this year. In the Eurozone, negotiations between Greece and its creditors on the terms of a third bailout package dragged on, causing the former to miss a repayment to the IMF on June 30. In China, equity markets fell 22% by the quarter's end, less than a month after reaching its peak of 5,166 points equivalent to a 1 year return of 152% as of June 12, 2015.

Philippine fixed income outperformed as an asset class during the period with the HSBC Local Currency Bond Index (HSLI) up (+)87bps. Local equities meanwhile underperformed with the Philippine Stock Exchange Index (PSEi) down (-)4.7% quarter-on-quarter, as profit taking and foreign fund outflows weighed on the market. Global fixed income and equity asset classes likewise registered losses for the second quarter of the year. The JP Morgan Global Aggregate Bond (JGAGGUSD) Index lost (-)1.4% for the period as global bond yields rose. The global equity side saw a quarterly change of -0.3% for the MSCI All-Country World (MXWD) Index with both developed and emerging stock markets consolidating after a strong first quarter rally. Year-to-date as of the end of the second quarter, local assets still lead in terms of asset class performance with the PSEi and HSLI returning (+) 4.6% and (+)2.1% respectively. Meanwhile, global assets relatively underperformed in the same period with the MXWD Index up (+)1.1% and the JGAGGUSD down (-)2.1%.

### Developed market bonds

Rising rates and wider spreads caused most fixed-income categories to experience negative returns during the second quarter of the year, with long duration bonds having the largest decline. Lower-credit-quality fixed income assets outperformed during the same period since their higher coupons helped offset rising rates. Bond yields remain well below their historical averages. Credit spreads however, are now closer to their historical averages across most investment-grade and higher-yielding categories, providing more attractive valuations. Looking ahead we expect the market to price in at least one rate hike by the Fed before 2015 ends, and a path of rate hikes that is gradual, but slightly above current market pricing. The US yield curve should flatten as a lift off in interest rates is initiated, whether in September 2015 as the Fed "dots" (i.e. the prediction of the Fed Funds rate from each Fed Governor) suggest or sometime closer to the end of the year, as indicated by the federal funds futures market. While interest rates on short end of the yield curve will inevitable rise, the long-end should remain well-anchored. Demand from institutional investors, and, more importantly, loose monetary policy by central banks elsewhere around the world should continue to keep long-end yields low.

### Emerging market bonds

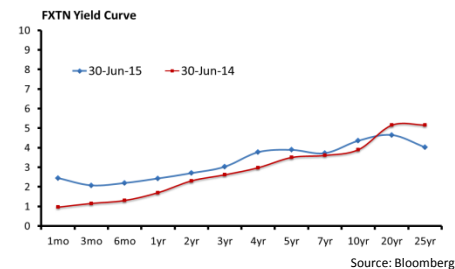
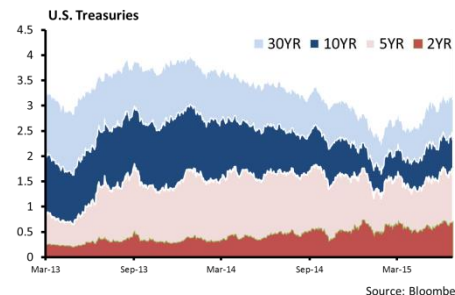
In June, emerging markets debt sold off for a second consecutive month, as a combination of global macro concerns and emerging markets-specific events roiled capital markets. The initial sell-off in May was centered on correcting stretched yields in local debt. A subsequent sell-off in June pushed US dollar-denominated emerging markets bond spreads and yields higher. With the recent market correction, returns are now negative for the broad asset class on a year-to-date basis, with its attractive carry having been erased. With many expecting the Fed to hike in the second half of the year, we expect US rates to become relatively attractive compared to other countries that have engaged in expansionary monetary policy. This may result in capital outflows in select EM countries, particularly those with commodity-oriented economies (CEEMEA) and fragile financial conditions. EM Asia in particular continues to benefit from comparatively low oil prices but suffer from a slowdown in exports. We expect EM local currency bonds to underperform despite compelling nominal yields due to the continuing USD strength versus EM local currency bonds and a potential risk-off move brought about by the inevitable rate hike. However, we believe that global risk appetite will continue to be headline driven and provide select buying opportunities.

### Philippine bonds

While analysts predict that oil prices may have finally bottomed out, inflation continues to print at the lower end of the BSP's 2-4% range and has prompted downward revisions in their inflation expectations to 2.1% from 2.3% and to 2.5% from 2.6% for 2015 and 2016 respectively. Having remained one of the few hold outs thus far, the BSP is unlikely to join the legion of central banks around the world easing monetary policy this 3rd quarter. Given that liquidity remains abundant and growth prospects continue to be robust, we expect the BSP to reiterate that the present policy stance is appropriate. At present levels, yields are flat against year-end 2013. While the anticipated Fed tightening could cause some volatility, we anticipate that government securities will be supported by local demand.

### Currencies

The Philippine Peso touched a year-high of 45.20 and a low of 44.195 in 2Q15. It has settled into a range of 45.05 – 45.20 to the US dollar for the moment as market participants continue to speculate on the timing of the US Federal Reserve's first rate hike in almost a decade. 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 continued strengthening of the US Dollar, the local currency peso is anticipated to approach the 45.50 level as we near US interest rate normalization later this year.



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# Global economy and markets

## Commodities

Commodities were subjected to heavy short-selling amidst macroeconomic headwinds and ever-declining Chinese demand outlook. Base metals have certainly been the underperformers relative to expectations. With supply growth slowing, copper, zinc, and nickel were supposed to be moving closer to raw material constraint. In actual fact all three are, but the weakening demand projections skews financial market positioning towards the short side. Gold, which typically benefits from market volatility, declined along with the base metals. Oil continued to be volatile amidst the delay in Iran nuclear deal. Overall, we expect the volatility to persist until the 3Q which will continue to weigh down on basic commodities.

## Developed market equities

US markets had a relatively quiet quarter with the S&P500 Index ranging from an intraday low of 2,048 to an intraday high of 2,135, and experiencing the narrowest range of trading since 2006. This was against an economy which recovered from a weak first quarter, where bad weather conditions affected economic growth in the east coast. The absence of a strong catalyst and concerns with Greece made it hard for the broad US index to trade at higher levels. Elsewhere, in Japan on the other hand, the Nikkei Index moved higher, gaining 5.36% in the same period. A weaker yen, corporate earnings which exceeded expectations, and commitment from the Bank of Japan to support the markets through continued Quantitative Easing, helped in the upward movement in the Japanese equities. Lastly, European stocks experienced a volatile quarter, amid the Greek Drama that went from optimism that a bailout deal can be made, to total tragedy when talks failed and Greek Prime Minister Alexis Tsipras called for a referendum on whether the Greek People should accept their creditor's bailout offer. Although we remain bullish on developed market equities, we expect to see some more volatility in the third quarter, as the risks from a Greek Exit remain.

## Asia Ex-Japan equities

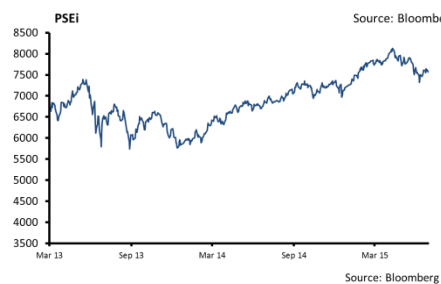
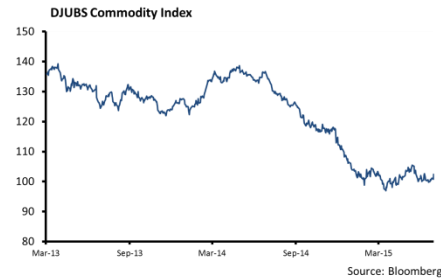
China reached a seven year high last June 12, closing at 5,166 points, (+)37.85% higher from the start of the quarter and a level last seen back in January 2008. In the weeks after reaching its recent high, the index floundered, falling by (-)17.40%. The selloff was caused by unwinding of margin positions by retail traders, which the government viewed as a big risk to its growth. The People's Bank of China acted in stemming the rout by cutting benchmark rates and its reserve ratio for agricultural banks, but this was not enough, pushing them to allow government pension funds to have stocks in their portfolios. We see continued selling from China, before reversing and moving up to test its major resistance. Elsewhere in Asia ex-Japan, South Korea's main index (Kospi) had a strong start in the second quarter, reaching a high of 2,173 before paring some of its gains and ending the quarter lower at 2,060. The Kospi was affected by the weak performance of Samsung Electronics, the index's biggest constituent with a weight of 14.8%, who saw earnings go down. The MERS outbreak has also depressed consumer sentiment in Korea (+2.8%), and led to negative forecast revisions. Asian economies should continue to benefit from the drop in oil prices which started in the July of 2014. Emerging Asia-ex-China/India is expected to grow 3.5% this year.

## Emerging market (non-Asian) equities

The MSCI Emerging Market (MXEF) Index finished the second quarter slightly lower, declining by (-)24 bps. Emerging markets (EM) equities erased almost all of its gains for the quarter amid negative sentiment on the group's vulnerability to a US Fed interest rate hike and strong US dollar. While the asset class currently sells at an estimated 12.5x 2015 earnings, and at a roughly 25% discount to the MSCI World Market Index, valuations that are within historic norms, the short term outlook for EM equities remain slightly bearish. The roughly 11% rally in emerging market equities from March 13th April 13, 2015 demonstrates, however, that sentiment can change rapidly.

## Philippine equities

Analysts are less upbeat about earnings growth prospects this year after companies disappointed on first quarter income. We expect 2Q earnings to continue to be lackluster as well, based on company forward guidance. Furthermore, macroeconomic data is losing some positive momentum with 1Q GDP coming in below forecasts on slower government spending. This trend is not expected to reverse anytime soon given the latest budget balance data. Adding to investors' cautious stance are developments in the political scene in anticipation for the residential elections next year. With all these considerations, and given that external factors are not supportive for the market, we approach 3Q with guarded optimism. The weaker oil prices could be supportive of consumption in the country.



Index/Currency	Price as of Jun 30	Percent Change		
		QoQ	YTD	YoY
MSCI World Index	1735.6	-0.3%	1.5%	-0.4%
MSCI AC Asia ex Japan Index	587.20	-0.5%	4.2%	1.3%
MSCI EMEA Index	277.05	1.0%	2.3%	-16.8%
PSEI	7564.5	-4.7%	4.6%	10.5%
USD / PHP	45.11	0.9%	0.9%	3.3%
USD / JPY	122.50	2.0%	2.3%	20.9%
EUR / USD	1.147	3.9%	-7.9%	-18.6%

Source: Bloomberg

Security	Yield as of Jun 30	Change in Yield (bps)		
		QoQ	YTD	YoY
US Treasuries 2YR	0.64	9	-2	19
US Treasuries 5YR	1.65	28	0	2
US Treasuries 10YR	2.35	43	18	-18
US Treasuries 30YR	3.12	59	37	-24
PHIL.FXTN 2YR	2.70	-11	-5	40
PHIL.FXTN 5YR	3.89	76	56	39
PHIL.FXTN 10YR	4.36	19	49	46
PHIL.FXTN 20YR	4.65	-43	-32	-50

Source: Bloomberg

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## Global Macro Outlook

The global economy seems to be gathering momentum as negative sentiment over Europe and the US dissipate. Global growth should pick up in the second half of the year, but will remain too low to counteract the persistent shortfall in demand facing most major economies. Data suggest that developed economies are certainly beginning to advance steadily but still not fast enough to generate price pressures so that inflation should remain relatively low. This is allowing Central Banks to maintain relatively accommodative monetary policy even though in the US, the Fed is about to embark on a tightening phase. However, it has been at pains to stress that the pace will be slow and the projected peak is significantly below historic norms. In Europe, finally a potential solution has emerged for Greece that may just allow the focus to switch towards a nascent economic recovery across the Eurozone. On the other hand, emerging markets that were the growth leaders provide some uncertainty, as China attempts to rebalance towards domestic growth whilst Brazil and Russia enter a contractionary phase.

Asset Class	Factors and Drivers	Current View	Prev. View
<b>Fixed Income</b>			
• US Treasuries	Yields to remain low short-term but risks skewed to the upside with the market pricing in a December hike.	=	=
• Asia	Asia to continue to outperform although slightly we are more cautious in anticipation of the Fed lift off.	-	=
• Emerging Markets	EM to experience slight rebound off of lows hit last year but general USD strength could weigh.	=	-
• Philippines	Government Securities expected to trade sideways for the time being. May see some momentum once more details in local initiatives emerge and market sees how they are implemented.	=	=
<b>Equity</b>			
• Global	Investors will remain in the sidelines waiting for the resolution of the Greek Crisis.	=	=
• Asia	A rebound in China, due to Government's moves to stop the index rout could support Asian equities, though continued volatility is expected.	+	=
• Emerging Markets	The rate hike by the US Fed is expected to affect earnings which will be a consideration for investors moving money into emerging markets.	=	=
• Philippines	Performance should track 2nd quarter earnings results which markets expect to be lackluster.	=	+
<b>Currencies</b>			
• USD	Theme of USD strength to persist throughout the year against other currencies and continue 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.	-	=
<b>Commodities</b>	Oversupply and sluggish demand to weigh on commodity prices.	-	-
<b>REITS</b>	Fed lift off amidst continuing concerns on global growth will give rise to caution in the property space.	=	=

### Legend :

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

### Percentage Gain/Loss in 2Q 2015 (Source: Bloomberg)

#### Top Performing Major Currencies

British Pounds	6.03
Swedish Krona	4.15
Danish Krone	4.03
Swiss Franc	3.98
Euro	3.88
Brazilian Real	3.02
Norwegian krone	2.64
Singapore Dollar	1.85
Canadian Dollar	1.54
Taiwanese Dollar	1.41

#### Top Performing Equity Indices

Venezuela Stock Market Index	152.46
DFM General Index	16.28
MSE Top 20 Index	15.66
JSE Market Index	15.31
Shanghai Se Composite	14.18
Karachi 100 Index	13.88
Ukrainian Equities Index	11.94
Malta Stock Exchange Index	11.66
Kazakhstan KASE Stock Ex	11.62
Botswana Gaborone Dom	11.26

#### Top Performing Country Bond Indices

United Kingdom GVT ALL>1YR TR	3.10
Norway GVT ALL>1YR TR	2.04
Switzerland GVT ALL>1YR TR	1.83
Czech GVT ALL>1YR TR	1.03
Sweden GVT ALL>1YR TR	0.84
Canada GVT ALL>1YR TR	0.71
South Africa GVT ALL>1YR TR	-0.13
Finland GVT ALL>1YR TR	-0.38
Germany GVT ALL>1YR TR	-0.87
Ireland GVT ALL>1YR TR	-0.91

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