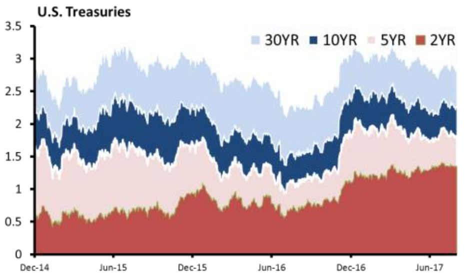
Investment Outlook

Global economy and markets

Global reflation amid geopolitical risk appeared to be the main theme in the second quarter of the year amid a number of European elections that threatened more potential exits from the EU and stable improvement in growth numbers. However, the French, and Dutch elections saw the decline of populist leaders, and markets turned risk-on once again. Meanwhile, inflation data reported softer in the second quarter. Despite this, the US Federal Reserve (Fed) as well as the European Central Bank (ECB) seem to be sticking to their hawkish stance with the Fed having already raised rates in June. The ECB has also been more vocal on improvements in the Eurozone economy and the possible implications this could have on policy now that major political risks in the region have abated. Overall, we expect the softness in inflation to persist throughout the year. Although growth has seen a slowdown in recent data, we still believe that the global economy has more room to expand. Globalization is also poised to make a comeback as we have been seeing steadily improving trade flows in Asia.

Developed Market Bonds

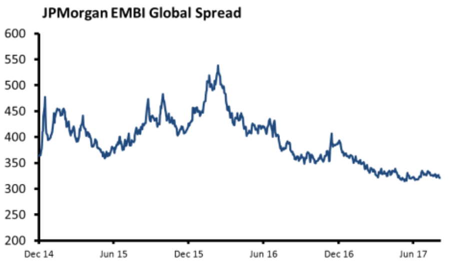
While the economic data coming out of the world's major economies has led to mixed sentiments in financial markets, what is clear is that the US Federal Reserve is intent on continuing with the rate normalization process. This sentiment is being reinforced by similar agendas from other major central banks including the European Central Bank (ECB) and the Bank of England (BOE). While softness in certain key data and myriad geopolitical risks are likely to provide persistent safe-haven demand, global bond yields appear poised to move steadily higher in the 2nd half of 2017. Announcements on reductions in the Fed's balance sheet and reduced bond-buying activity from the ECB are expected by September.



Source: Bloomberg

Emerging Market Bonds

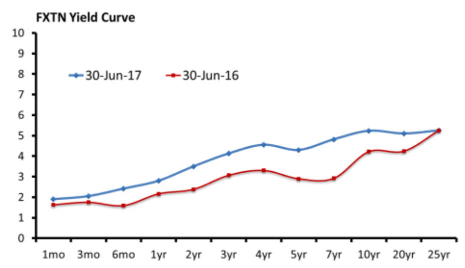
Emerging Market (EM) fixed income has had a stellar run during the 1st half of the year. The asset class has benefited greatly from the market repricing the US 'fiscal push' as doubts on the Trump administration's ability to execute meaningful reform has caused the US Dollar (USD) to steadily drop from the highs hit after the US election last November. While the USD is expected to regain some ground as the Fed begins its intended balance sheet reduction program, selective pockets of EM fixed income are expected to continue to benefit from inflows. Investors are likely to favor South East Asia with its sound macroeconomic fundamentals and reduce risk in Latin America and the Middle East where there has been an increase in political risk.



Source: Bloomberg

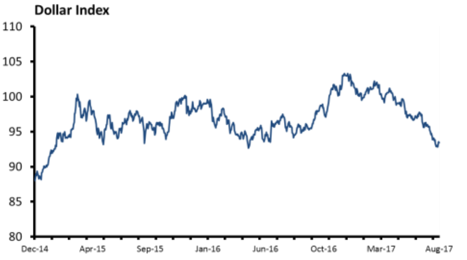
Philippine Bonds

Bangko Sentral ng Pilipinas (BSP) recently lowered their 2017 year-end inflation forecast to 3.1% from 3.4%. Incoming BSP Governor Nestor Espenilla has been vocal on continuity of recent Central Bank policy and not having to move In lock-step with the Fed. This has caused market participants to bring down their own expectations for a rate hike this year. Despite this, local yields have continued to move higher on the back of the recent trend in global bond yields. We expect global bond yields to remain the key driver behind local Government Securities (GS) in the short-term and expect yields to continue to move higher as we approach what we feel will be key policy meetings for the US Fed, ECB and BOE this September.



Currencies

The Philippine Peso (PHP) continues to underperform the region as the worst performing currency in Southeast Asia year-to-date. Despite the recent strengthening of the PHP on the back of optimism on the Tax Reform Package and broad USD weakness, we expect this weakness to persist moving forward as the government accelerates spending on their infrastructure program. The 'short-term pain' will be felt most keenly in the currency as the budget deficit increases and the current account deficit widens even further. The USD/PHP hit a year-high close of 50.53 this June and we expect the PHP to continue to weaken towards the 50.75 level as the USD regains some ground in the 3rd quarter.



Source: Bloomberg

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Global economy and markets

Commodities

Aluminum was the best performing base metal in 1H17 and is expected to rally further as China's government manages the country's oversupply. Nickel prices are expected to stabilize if more clarity is given over output from Indonesia and the Philippines. Moreover, increased geopolitical tensions suggest precious metals (gold) will rally further.

Source: Bloomberg

Developed Market Equities

Developed market (DM) equities exhibited some divergence in the second quarter with US equities rising steadily while European equities declined somewhat. Weakness in European equities was due to sectors affected adversely by the weakening in commodity prices and on a surge in the strength of the Euro as investors adjusted to the ECB's recent hawkish rhetoric. We also saw WTI crude oil hit a new low of $42.31 a barrel in June. The outlook for DM equities remains positive, and looking ahead, we expect some recovery in crude prices, which will buoy industrials and energy stocks. 2Q earnings results will also be a major catalyst for DM equities early in the quarter.

Source: Bloomberg

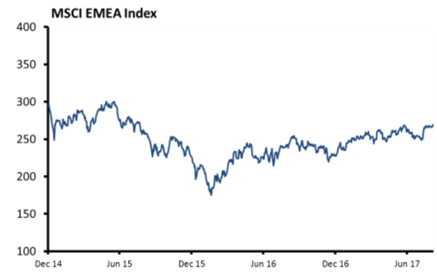
Asia ex-Japan (AxJ) Equities

The three major positive themes for Asia macro this year – softer-than-expected inflation, benign USD environment and stronger-than-anticipated export growth—which resulted to an excellent first half performance across the region will likely remain drivers in the third quarter albeit at much reduced importance. The respectable performance will act as a double-edged sword in the second half of the year as investors focus on the reasons why equities will go down, instead of the reasons for continuing the uptrend. Nevertheless, we anticipate growth to remain robust but investors will start to favor economies with stronger domestic growth as strong Asian currencies will likely pressure export growth moving forward. Accordingly, we remain positive on the region as it further benefits from relatively stronger economic growth and monetary policy that is less keen on raising rates than in developed markets.

Source: Bloomberg

Emerging Market Equities

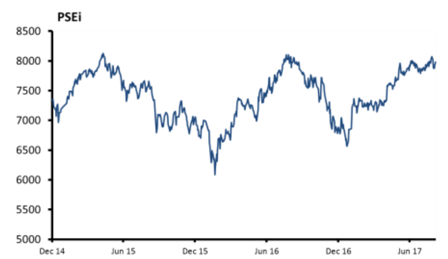
Similar to DM equities, Emerging market (EM) equities generated mixed performances during the second quarter of 2017. Emerging Asia was the clear standout and gained steadily throughout. Meanwhile, Europe, the Middle East and Africa consolidated lower. Equities in Latin America however, declined sharply due to a resurgence political risks in Brazil. Overall, we believe there continues to be room for growth in EM equities, especially with the sustained weakness in the USD. Although the US is seen to continue with its policy normalization, the pace appears to be more gradual than initially expected and this should mitigate the effect on EM currencies. The region is expected to continue to benefit from trade flows, particularly towards Asia.



Source: Bloomberg

Philippine Equities

The massive $757 million foreign inflow in the second quarter completely reversed the outflows seen in the first quarter and has pushed the index to relatively steeper valuation level versus regional peers. We anticipate the PSEi to trade between 7,700 and 8,100 in the third quarter given the lack of compelling catalysts. Furthermore, we expect the market to show some weakness in both price and value turnover this coming August if the last 6 years will be of any guide. (The PSEi was down 5 times during the month of August in the last 6 years.) Release of second quarter corporate earnings will take the spotlight as investors determine if earnings performance can justify the current PSEi level. As such, the third quarter will be the best time to position for the coming quarters.



Source: Bloomberg

Index/Currency	Price as of Jun. 30	Percent Change		
		QoQ	YTD	YoY
MSCI World Index	1916.4	3.4%	9.4%	15.9%
MSCI AC Asia ex Japan Index	625.37	7.5%	21.6%	24.2%
MSCI EMEA Index	252.80	1.2%	3.3%	9.6%
PSEi	7843.2	7.3%	14.7%	0.6%
USD / PHP	50.47	0.5%	1.8%	7.0%
USD / JPY	112.39	0.9%	-3.9%	8.9%
EUR / USD	1.1426	7.3%	8.6%	2.9%

Source: Bloomberg

Security	Yield as of Jun. 30	Change in Yield (bps)		
		QoQ	YTD	YoY
US Treasuries 2YR	1.38	13	19	80
US Treasuries 5YR	1.89	-3	-4	89
US Treasuries 10YR	2.30	-8	-14	83
US Treasuries 30YR	2.83	-17	-23	55
PHIL. FXTN 2YR	3.87	62	0	148
PHIL. FXTN 5YR	4.03	-22	-71	113
PHIL. FXTN 10YR	4.67	-39	4	45
PHIL. FXTN 20YR	5.08	5	-29	84

Source: Bloomberg

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