

July 28, 2014

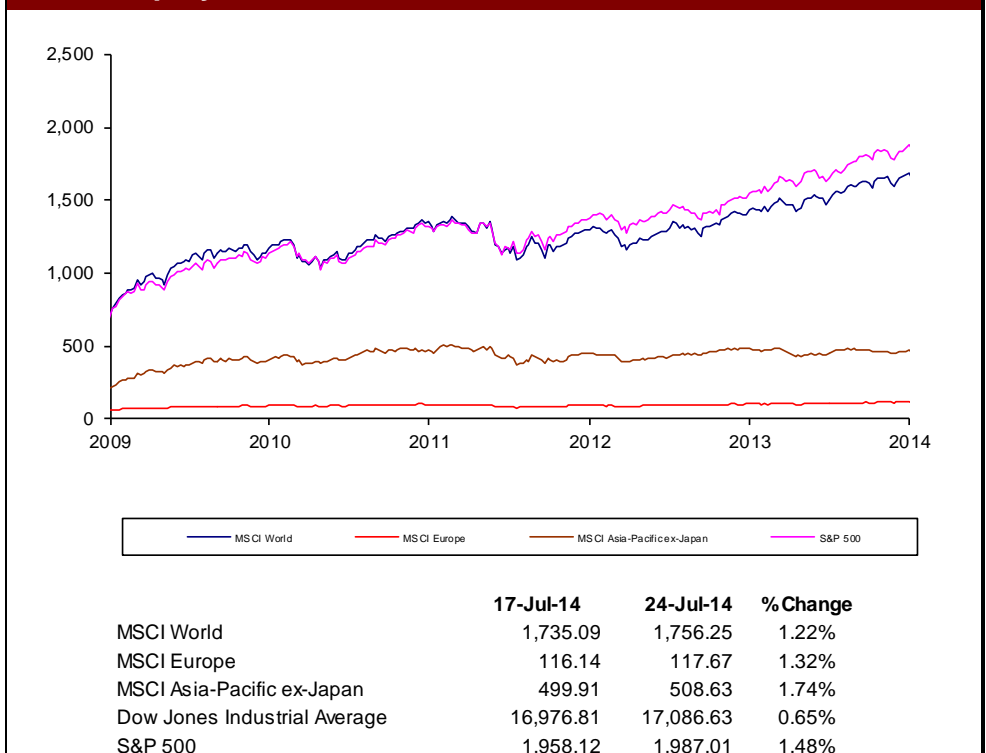
Global Financial Markets

Global equities continued to rally this week as investors shifted attention from geopolitics in favor of positive corporate earnings results and economic data releases. US Treasury prices fell as investors took profits in positions taken in light of tensions in Eastern Europe. Meanwhile, the US dollar continued to strengthen against the euro on the back of strong US corporate earnings and economic data.

Global Equities

Global equities continued to rally this week despite dealing with the aftermath of last week's geopolitical tensions, as mixed economic data releases and strong corporate earnings results buoyed the market. US share prices were driven mostly by second quarter earnings and data on inflation, home sales, and jobless claims. Investors were cautious during the earlier part of the week as the markets responded to the Malaysia Airlines plane crash over the Russia-Ukraine border and to tension in Gaza Strip. However, the specter of geopolitics disappeared as corporate earnings data took the limelight for the rest of the week. Despite the Fed Chairwoman's comments regarding stretched valuations of biotechnology shares, the sector rallied this week in response to stronger-than-expected earnings results and positive drug trial data. US stocks were held up by the lower-than-expected core inflation, suggesting that the US will not raise interest rates soon. Downward pressures were caused by slower than expected production growth.

Global Equity Performance



European equities also rallied, as the European market reflected movements in US equities and in light of corporate earnings expectations. Share prices in European stocks were initially affected by the rising geopolitical tension in Eastern Europe, which led to the crash of a civilian plane carrying approximately 300 passengers. As the week progressed, investors shifted focus from geopolitics to earnings, resulting to European equity gains week-on-week. Upward movements in European share prices were also brought about by economic data release in the US, along with better-than-expected manufacturing activity in the euro-zone. Slumps in the movement of European equities were caused by financial reporting issues faced by Deutsche Bank's US operations, a slump in Italian industrial sales, and weak consumer confidence in the euro-zone for a second consecutive month.

Meanwhile, in Asia, markets generally edged higher this week following a string of positive economic data releases in US and China and country-specific factors. Movements in Asian share prices paralleled US equities as market players dealt with a positive economic data releases such as growth on China's manufacturing activity as measured by the preliminary HSBC Manufacturing PMI. Upward swings in the Asian markets were also driven by lower-than-expected core inflation in the US. Selling pressures on Asian shares were led by the lack of strong economic data releases for Japan.

Week-on-week, the MSCI World index climbed 1.22% led by the world's largest economy, as both the Dow Jones Industrial Average and S&P 500 index climbed 0.65% and 1.48%, respectively. MSCI Europe and MSCI Asia Pacific ex- Japan also gained ground this week, as both advanced 1.32% and 1.74%, respectively.

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Economic data releases for the week were mixed, which indicates need for further evidence of growth.

- Data from the Chicago Federal Reserve Bank showed that US economic activity slowed down in June, brought about by weaker production compared to May. The National Activity Index dropped to +0.12 in June from +0.16 in May, with the three-month moving average falling to +0.13 from +0.28. The production category did not contribute to the index, declining from last month's +0.14. The consumption and housing subset improved to -0.14 from -0.16, while employment indicators climbed to +0.22 from +0.14. The sales category was stable at +0.4.
- Data from the US Labor Department showed that inflation slowed down in June, with core inflation figures lower than consensus. The US consumer price index climbed 0.3% from last month, in line with estimates and lower than the 0.4% rise in May. Excluding food and energy, core prices increased 0.1%, lower than the expected 0.2%. Gasoline prices accounted for a large part of the monthly increase, climbing 3.3%. Food prices rose 0.1% MoM, the lowest monthly increase for food for the year. YoY, the CPI increased 2.1%, in line with expectations. Core prices, on the other hand, climbed 1.9% YoY, lower than the 2.0% market estimate.
- Data from the US Labor Department showed that new applications for unemployment benefits fell last week, which is a fresh sign of an improving labor market. Initial claims for jobless benefits came in more positive than expected, as it fell 19,000 to a seasonally adjusted 284,000—beating market estimates of a seasonally adjusted 307,000. This was the lowest jobless claims figure since February 2006. The four-week moving average of claims also dipped 7,250 to 302,000—the lowest level in more than seven years.
- Reports from both the National Association of Realtors and the US Census Bureau showed mixed data for US home sales. While existing home sales increased for the third consecutive month in June and reached the highest level since October, new home sales dropped significantly from May to June. Sales of previously owned homes grew 2.6% in June, higher than the expected 1.9%, to a seasonally adjusted annual rate of 5.04 million. On the other hand, sales of new single-family homes fell 8.1%, lower than the expected 5.1% decline, to a seasonally adjusted annual rate of 406,000.

Global Bonds

US Treasury prices rose this week, as investors mostly took their positions based on geopolitical issues and unrest. Since a Malaysian airline was shot down over Ukraine airspace late last week, an incident that many speculate may have involved Russia, investors became concerned over the possibility of additional sanctions made against Russia. Moreover, escalating and continued violence in the Middle East, particularly around Gaza, also weighed on investors' minds. Geopolitical incidents aside, the US published a core June inflation that was lower than expected, pushing yields down further. Week-over-week, the 3-m 2-y, 5-y, 10-y, and 30-y yields fell by 1.05, 3.29, 9.01, and 10.37 basis points respectively, while the 6-m yields increased marginally by 0.51 basis points.

US Treasury Yield Curve			
Tenor	10-Jul	17-Jul	+/- bps
3m	0.015	0.010	-0.51
6m	0.046	0.051	0.51
2y	0.454	0.444	-1.05
5y	1.650	1.617	-3.29
10y	2.536	2.446	-9.01
30y	3.370	3.266	-10.37

Currencies

The euro depreciated further this week, amidst the lack of major, market-moving economic data. Geopolitical tensions in Ukraine and Gaza had little effect overall, though the start of the week saw investors' risk appetite rise during a lull in major news from those areas. As the week progressed, investors began to weigh in the possibility that Germany would publish weaker PMI than the month before. Week-over-week, the euro depreciated against the dollar, Swiss franc, and Japanese Yen by 0.63%, 0.01%, and 0.65% respectively.

Currencies			
	11-Jul	18-Jul	% Change
USD/PHP	43.560	43.500	0.14%
EUR/USD	1.3608	1.3522	-0.63%
GBP/USD	1.7116	1.7101	-0.09%
USD/JPY	101.30	101.32	-0.02%
AUD/USD	0.9392	0.9362	-0.32%
USD/CHF	0.8922	0.8978	-0.62%
EUR/CHF	1.21402	1.21394	0.01%
EUR/JPY	137.90	137.01	0.65%

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The week ahead (July 28 – August 4)

Market movements this week were driven by a mixed bag of global economic data releases, geopolitics in Eastern Europe, and corporate earnings expectations. Investors took positions ahead of positive expectations on corporate earnings results and key economic data releases. The market was also influenced by the tension between Ukraine and Russia and the subsequent increase in sanctions on Russia by the US following the Malaysia Airlines plane crash. For the coming week, we expect that earnings releases will continue to shore up global equities. Moreover, we expect investors to take their cues ahead and after a number of key events and economic data releases in the US. The FOMC meeting is scheduled to take place at the end of July, a day after the US publishes 2Q GDP data. Nonfarm payrolls will be published at the beginning of August. US Treasury prices are expected to fall, as economic data in the US come out stronger, and as investors become more complacent to the dragging conflict in Ukraine and Gaza. The euro will continue to remain under pressure as the pace of the EU's economic recovery continues to diverge from that of the US.

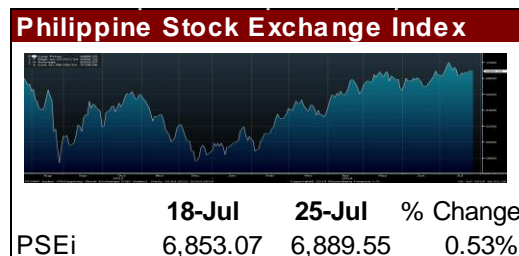
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Philippine Financial Markets

The local equities market rallied slightly ahead of corporate earnings results. On the local fixed income market, yields marginally increased on the country's strengthening external finances and heightened geopolitical risk in Eastern Europe. Meanwhile, the Philippine peso appreciated on the back of improving Philippine economic data releases.

Local Equities

The local equities market rebounded this week as investors priced in favourable earnings releases both in the domestic and global front. Earnings releases overshadowed geopolitical risks as the European Union prepares more sanctions to Russia. Within the region, better-than-expected manufacturing data in China contributed to the positive sentiment, supporting the index' rally. The PSEi climbed 36.48 points this week, or 0.53%, to end at 6,889.55. Foreign investors were net sellers at Php2.16 billion for the week.



Financials

- Lucio Co, the owner of Puregold, bought a 37.67 percent stake in Philippine Bank of Communications (PBCom) for Php5.98 billion. PBCom had accepted an offer from Co, through Union Equities Inc., to subscribe to 181.08 million common shares at Php33 per share. The share sale was made to expand the bank's market reach in the countryside and increase lending to the small and medium enterprises.
- Metropolitan Bank & Trust Co. (PSE Ticker: MBT) offered Tier 2 notes yesterday to raise as much as Php6.5 billion in additional capital. This is part of the bank's approved issuance of up to US\$500 million, or peso equivalent. The debt notes will have a tenor of 11 years, with a buyback option in six years, with a coupon rate of 5.25 percent per annum and interest payments scheduled every quarter. The notes will also have a loss-absorption feature, which means they can be written off or converted to equity if the bank experiences trouble.

Consumer

- Philippine Seven Corp (Philseven), local licensee of 7-Eleven, is investing heavily in an effort to ward off intensifying competition in the convenience store business. It plans to establish a footprint in Visayas as it seeks to improve its nationwide market share. The company is targeting a store expansion rate of 25 percent, doubling store count every three years, as it focuses on maximizing market share rather than profitability. Philseven ended 2013 with a total of 1,009 stores, up by 180 from a year ago.
- Universal Robina Corp (PSE Ticker: URC) announced that its wholly-owned unit URC International Co Ltd will acquire 100% interest in NZ Snack Food Holdings Ltd. Griffin Foods Ltd, which NZ Snack Food holds, is reportedly the number-one snack food firm in New Zealand in terms of sales. The acquisition cost is roughly NZ\$700 million.
- RFM Corp.'s first half net income climbed to Php427 million, a growth of 10 percent from the same period last year, on stronger sales revenues from higher margin products. Meanwhile, revenues climbed by five percent to Php4.99 billion. According to RFM's president and CEO Jose A. Concepcion III, the company could have posted stronger growth if not for the operational bottlenecks caused by the Manila truck ban and severe Manila port congestion. RFM was hit by the shortage of delivery trucks, adversely affecting the supply chain.

Construction

- According to the Cement Manufacturers Association of the Philippines (CeMAP), cement sales rose six percent in terms of volume in the first semester from a year ago due to stronger demand. Total cement sales for the first six months of the year reached 10.72 million metric tons (MT), up from 10.14 million MT a year ago. For the second quarter alone, cement sales climbed by 3.2 percent to 5.52 million MT from 5.349 million MT in the comparable period last year on higher demand from both the public and private sector.

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Philippine Bond Market

Yields of Philippine government securities increased during the week as investors adopted a flight-to-safety stance ahead of the Bangko Sentral ng Pilipinas Monetary Board meeting slated next week and amid heightened geopolitical risk as a result of the continued tension between Ukraine, Pro-Russian rebels, and Russia. Upswings in bond prices were caused by speculation on the Philippines' strengthening external finances. Meanwhile, upswings were countered by the continued risk-off sentiment as a result of the Eastern European tension and as investors moved ahead of the Monetary Board meeting slated next week. Week-on-week, yields on average increased by 1 basis point, led by an increase in the belly of the curve by 3 basis points.

Philippine Peso

The Philippine peso rallied this week following heightened expectations on the country's improving external finances. The peso initially appreciated at the start of the week due to investor sentiment on positive economic data releases before ending the week at an 8-month high on the eve of the release of imports data. The USD/PHP lost 23 centavos week-on-week to close at 43.250.

Peso Yield Curve (PDST-F Reference Rates)			
Tenor	18-Jul	25-Jul	Change
1m	1.43	1.40	-3
3m	1.35	1.39	4
6m	1.74	1.77	3
1y	1.96	1.97	1
2y	2.62	2.94	31
3y	3.19	3.17	-2
4y	3.22	3.16	-6
5y	4.07	4.03	-4
7y	4.12	4.10	-1
10y	4.23	4.24	0
20y	5.28	5.25	-3
25y	5.36	5.31	-5
Average			1

- Data from the Department of Finance showed that the government expects to incur a budget deficit of P42.9 billion in the third quarter this year as it steps up spending on infrastructure in order to boost economic growth. The expected budget shortfall for July to September is still 14% lower year-on-year.
- Bangko Sentral ng Pilipinas Governor Amando M. Tetangco Jr. announced that the new law allowing the full entry of foreign banks could strengthen domestic banks and ultimately increase investments. He stressed that the economic benefits from this development would be attained through additional financial resources by means of augmented foreign direct investments, enhancement of labor skills, and an overall transfer of technology that could increase productivity of the banking sector.
- According to the International Monetary Fund's (IMF) latest World Economic Outlook, economic growth forecast for the Association of Southeast Asian Nations – 5 (ASEAN-5) has been downgraded due to geopolitical risks and the impending rise in global interest rates. The ASEAN-5 (Indonesia, Malaysia, the Philippines, Thailand and Vietnam) is now seen growing slower-than-expected at 4.6% this year compared to the 4.9% forecast made in April. The IMF explained that downside risks remain a concern, as increased geopolitical risks could lead to sharply higher oil prices, while financial market risks include higher-than-expected US long-term rates and a reversal of recent risk spread and volatility compression.
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- The Bangko Sentral ng Pilipinas (BSP) Governor Amando M. Tetangco Jr. advised Philippine banks to strengthen their risk management efforts, put in place more good governance policies and focus on consumer protection in preparation for the upcoming regional economic integration in 2015. He added that domestic banks would need to step up amid expected increased competition following the Association of Southeast Asian Nations' banking integration framework and the imminent reforms local banks need to make under the Basel 3 accord.

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The week ahead (July 28– August 4)

We expect the local equities market to trade range-bound between 6,821 and 6,937 next week. Market will get its direction from the monetary board meeting this coming Thursday as surveyed economists are leaning towards another rate hike. Should there be another round of hike, the equities market may react negatively especially on the property sector as the increase in rates may dampen demand in real estate. In the global front, investors would watch out for the tone of the Federal Open Market Committee meeting.

For the week ahead, yields in the local fixed income market may trade sideways with an upward bias as investors anticipate the possibility of an interest rate hike in the upcoming Monetary Board meeting. Moreover, investors may adopt a further flight-to-safety stance as the continued conflict in Eastern Europe may drive commodity prices up. This would affect sentiment in emerging market assets, including Philippine bonds.

For the peso, we expect the currency to depreciate next week as investors may take the opportunity to book profits following the peso's week-long rally.