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MONEY TALKS

RIGHT TIME, RIGHT OPPORTUNITIES

THE YEAR THAT WAS AND MOVING FORWARD

Philippines: Still shining through

By Jonathan L. Ravelas, BDO Chief Market Strategist

SIX years after the global financial crisis, we are now living in interesting times.

With various capital markets recovering due to artificial and accommodative measures and policies, global trade and activity are now growing at an unprecedented three-speed growth. With world Gross Domestic Product (GDP) improving at an average growth rate of 2.1 percent in the first half of the 2014 and climbing to a 2.8 percent growth in 2015, Emerging Markets (EMs) has led the pack – exhibiting growth north of five percent. Meanwhile, Developed Markets (DMs) have gradually risen from the rubble- growing albeit at a slower speed of one to three percent.

Amidst a backdrop of general recovery, DMs themselves are in a unique spot of variance. The United States' GDP rose at a 5.0 percent annualized rate in the third quarter of 2014. With unemployment rate, inflation rate and consumer confidence improving and generally on track with the Federal Reserve's (Fed) guidance, the Fed implemented its exit plan and ended its quantitative easing in October 2014. Given this, the market is now faced with the conundrum of when the Fed will implement the well anticipated hike in interest rates.

In contrast to the Fed's direction, the European Central Bank (ECB) and Bank of Japan (BOJ) have promulgated a more dovish view in terms of their monetary policies by providing the markets with ample liquidity to accelerate growth.

Overall, this has put global financial markets in a mood of cautious optimism as divergence and uncertainties in monetary policy makers' direction and timing, as well as the possibility of inflated risk asset classes like equities and real estate lurkin the shadows.

What it means for PH?

With the improved and renewed investor confidence in 2013, when the country officially received investment grade status from three credit rating agencies, the Philippines' Cinderella story continues, albeit with some possible road blocks ahead.

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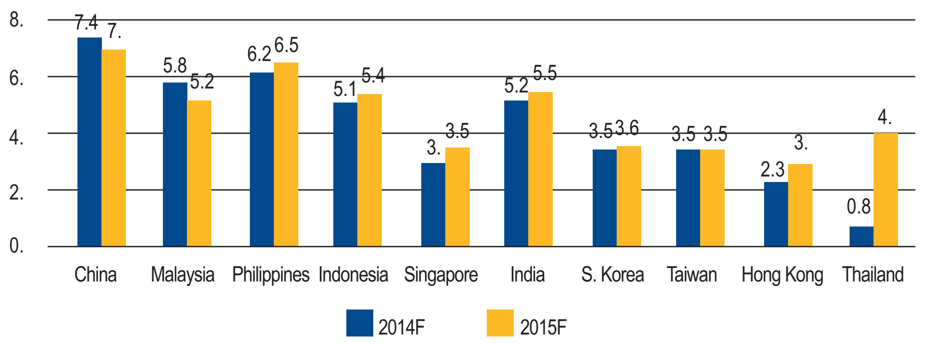
Even with uncertainties from both the local and foreign fronts, the Philippines is still expected to perform well given a confluence of affirmative factors:

- GDP growth for the first three quarters of 2014 stood at 5.8 percent, a sharp decline from last year's growth of 7.5 percent and falls below the government's 6.5%-7.5% target this year. BDO sees GDP growing by 6.2 percent by year-end, slower than the actual 7.3 percent posted in 2013. While the data may be quite disappointing, the Philippines is still among the fastest-growing economies in emerging Asia.

  For 2015, BDO sees the economy growing by a healthier 6.5 percent, to be driven by the robust performance of the private sector, and increased government spending.



Source: Bloomberg, BDO

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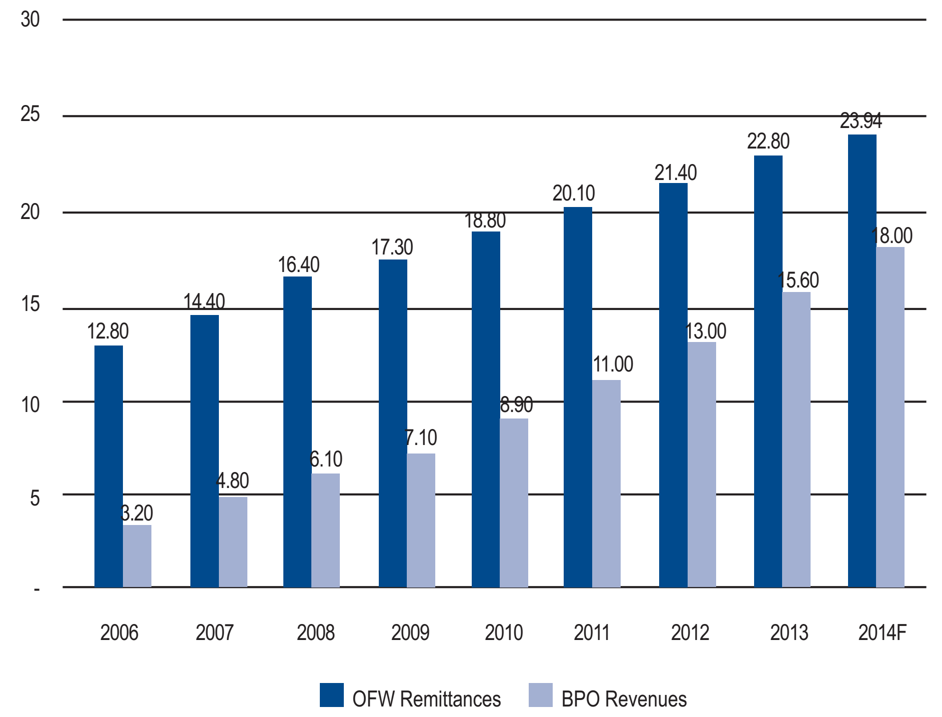
- The country has improved its fiscal position, with deficit in check and a current account surplus, a rare occurrence today in both EMs and DMs. Also, much needed government infrastructure spending is once again accelerating with big ticket Public-Private Partnership (PPP) projects slowly coming out of the pipeline. Eight projects have been awarded so far, with six being rolled out as the Aquino administration sees seven completed PPPs by the end of its term together with an additional seven signed PPP agreements and 50 projects said to being readied for bidding.

- Strong domestic private consumption has likewise not only insulated the country from external shocks and volatility but also has been the main driver of its economy. This has been supported by the two main pillars of our economy- Overseas Filipino Workers' (OFW) remittances and the Business Process Outsourcing (BPO) industry. Remittances are seen to grow at five percent this year and the soon-to-be US$20 billion BPO industry is estimated to have expanded by15 percent in 2014.

Having favorable demographics with a median age in the mid-20's and over 60 percent of the nearly 100 million Filipinos belonging to the economically active age bracket of 15 to 64 years old, the middle class is seen to incessantly grow and drive the demand side.

Dollar Flows (in Billion Dollars)



Source: Bloomberg, BDO

The country's current account, while still in surplus, will likely narrow with the massive capital equipment that need to be brought into the country as requirements for the PPP projects.

The manufacturing and tourism industries are likewise bright spots given their potential to continuously expand in the coming years.

Risks however, abound from both external and internal fronts. At the local front, interest rates are seen to increase gradually. The country's current account, while still in surplus, will likely narrow with the massive capital equipment that need to be brought into the country as requirements for the PPP projects. Political chatter has also started with the 2016 elections just around the corner and questions regarding the continuity of the political, economic and monetary reforms of the current administration come into play.

Geopolitical noise from regions like the Middle East and Easter Europe as well as expected rate adjustments from the Fed has likewise provided reason to keep investors cautious and vigilant.

PH financial markets

Interest rates: To increase gradually

For full year 2014, inflation averaged 4.1 percent, the midpoint of the BSP's three to five percent target for the year. Inflation advanced in mid-2014 driven mainly by the jump in prices of food and non-alcoholic beverages, and higher water, gas, and electricity rates. Inflation rate eased in the fourth quarter of the year due to the significant drop in oil prices.

In 2013, benign inflationary pressures have allowed the Monetary Board to keep policy rates at record lows. This year however, the BSP adjusted its monetary policies to stay within its inflation expectations as supply interruptions continue to put pressure on prices. The Monetary Board increased the reserve requirements of universal and commercial banks by two percentage points to 20 percent. It also hiked the rates on the special deposit accounts by 50 basis points to 2.50 percent. Lastly, the BSP raised key overnight borrowing and lending rates by a total of 50 basis points to 4.0 percent and 6.0 percent, respectively. These tweaks in the monetary policies were done to address financial stability risks associated with the strong domestic liquidity and credit growth.

For 2015, the bank estimates inflation to further slow to an average of 2.5% due to the collapse of crude oil price in the world market.

For 2015, the bank estimates inflation to further slow to an average of 2.5% due to the collapse of crude oil price in the world market. It also sees the BSP maintaining policy rates at 4.0% (compared to our previous forecast of an increase of 50 basis points to 4.50%). However, should the USD/PhP exchange rate weaken to the 46/47 levels, the BSP may raise rates to temper its impact on prices. BDO's forecast takes into account the moderate recovery of oil prices to close to $60 per barrel. Meanwhile, the BSP sees inflation rate ranging from 2%-4% for 2015.

Given the subdued increase in prices this year, local interest rates are expected to initially decline in the first half before stabilizing and slowly inching up in the second half. Nevertheless, interest rate levels would remain manageable compared to the historical double-digit levels in the 1990s as liquidity in the country remains ample.

Philippine Peso: 44-46 range seen in 2015

The USD/PhP exchange rate closed 2014 at 44.72, weaker than the previous year's close of 44.395 as the US economy showed some strength. The local currency reached a low of 45.50 in February 2014 but was able to recover driven by robust OFW remittances, strong BPO revenues and the hike in interest rates. Also the fact remains that interest rates in the US are still close to zero, driving investments in emerging markets.

For 2015, the Bank sees the local currency depreciating to 45.50 as the end of the Fed's quantitative easing and the imminent interest rate hike in the US could dampen demand for the Peso.

Stock market: Targeting 8,000-level in 2015

The local stock market rose by about 22 percent last year with the Philippine Stock Exchange Index closing at 7,231 on December 29. This was driven by favorable corporate earnings reports in the first and second quarters of the year. The market remained resilient inspite of weather disruptions in the country, the ending of the monetary stimulus in the US and a number of geopolitical issues abroad.

For 2015, BDO forecasts the local stock market index to range between 7500-8000 based on a price-to-earnings ratio of 18x and 20x as corporate earnings accelerate to at least 15% growth and close the year at 7800. Possible support lies at the 6250-6,500 levels (equivalent to a P/E of 15x to 16x). The first half of the year is seen to be a period of strength with the index likely to test the 8000 levels buoyed by stronger Q1 2015 GDP growth (*Note: We're looking at 7.5% to 8.0% growth*) and inflation further slowing to 3.1% in January.While higher interest rates do not bode well for the equities market as it would translate to higher financing cost and lower profits, BDO believes that this may have already been factored in by the market. The country's strong fundamentals and healthy corporate earnings will continue to support the local bourse and will catch up with its high valuations. Favored sectors include the following: **banking**, on the back of sustained loan growth and margin improvements; **power**, which will benefit from the expected power shortage; **construction**, which will benefit from the government's infrastructure spending and the continued growth of the real estate sector; and **food and beverage**, demand for which will be boosted by high OFW remittances and the robust BPO industry. Year 2015 will also be a good foreign exchange play, as the expected depreciation in Peso would benefit dollar-revenue generating companies such as those in the mining, electronics and oil sectors.

On target to sustain 6-7% growth

Moving forward, the Philippine economy is seen to post a sustainable and stable growth rate of 6 to 7 percent supported by investments in infrastructure, human capital and the continued pursuit of good governance. While geopolitical risks, elevated inflationary pressures and higher interest rates threaten the country's growth story, the Philippines' sound fundamentals should allow the country to weather these adversities.

Creating wealth through investment funds

> *Mutual funds or Unitized Investment Trust Funds (or popularly known as UITFs in the banking sector) are investment products that allow investors to invest their savings or money in different asset classes such as cash, fixed income and stocks to create wealth and fulfill specific goals or objectives (children's education, retirement, etc).*

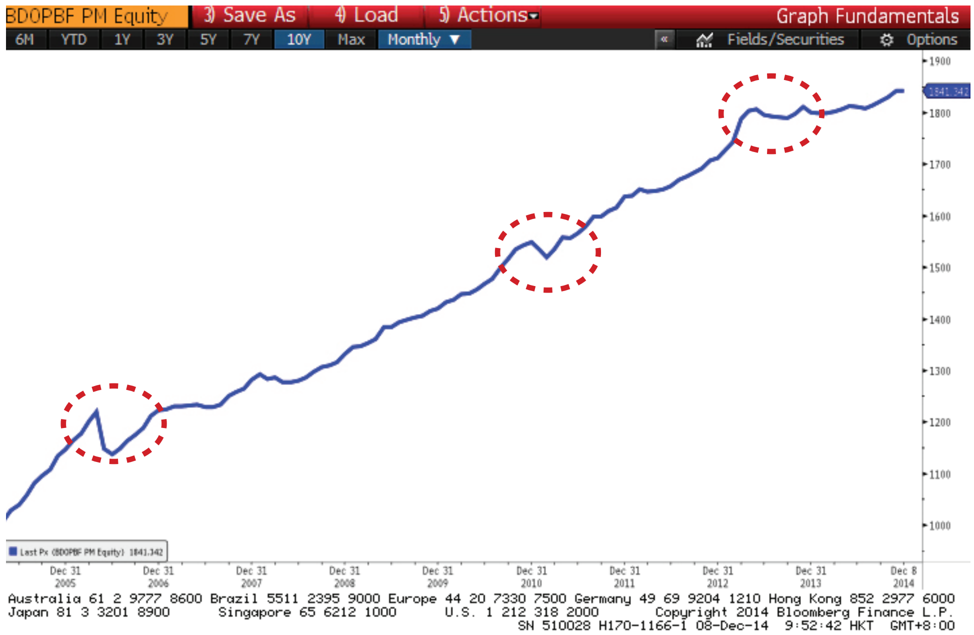
Aspiring to be wealthy or rich

Everyone aspires to become wealthy or rich (except probably those who have vows of poverty belonging to different religious congregations) to fulfill essential personal or family needs such as car for mobility, housing for shelter; good education for children, occasional vacations, and comfortable retirement during one's old age. The pursuit of these dreams vary from different walks of life. Some prefer to get rich through a heavy dose of luck by betting on lotteries or games of chance, while the gullible ones fall prey to pyramid scams. It's easy to predict that those who prefer these routes mostly end up disappointed because instead of creating wealth they usually lose their entire savings. On the other side of the fence are countless success stories of people who became wealthy through hard work, persistence, patience, commitment to their dreams or goals, ability to recover from setbacks or failures, and a bit of luck. The more important question is – can an entrepreneur or employee become wealthy even if they are not investment experts? The quick answer is – Yes – but only for those who have the patience and the persistence!

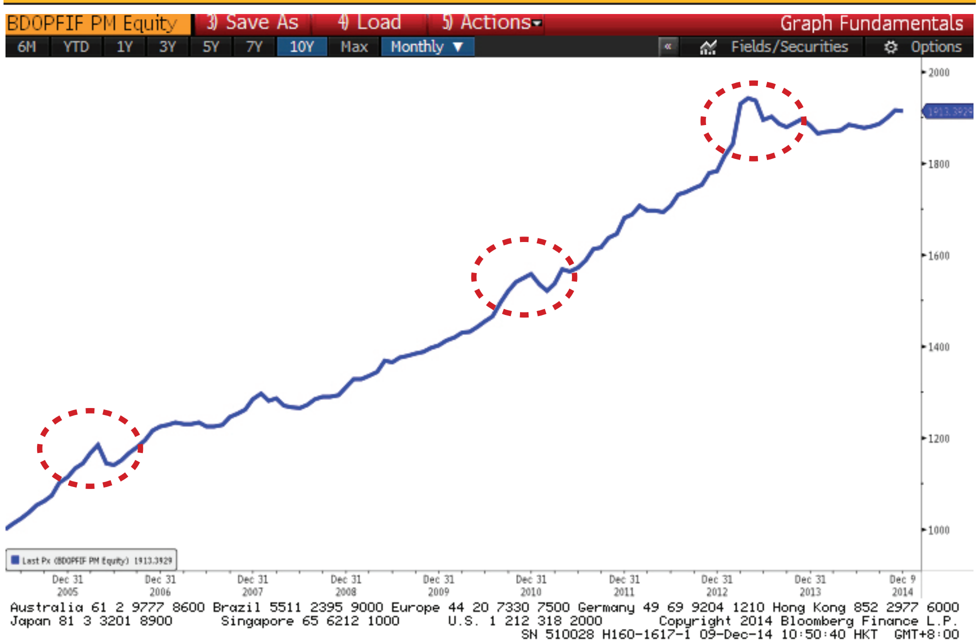
Through investment funds

The gradual evolution and development of investment products in the capital markets (both local and global) now allows an investor with modest savings to create and accumulate wealth over time. Mutual funds or Unitized Investment Trust Funds (or popularly known as UITFs in the banking sector) are investment products that allow investors to invest their savings or money in different asset classes such as cash, fixed income and stocks to create wealth and fulfill specific goals or objectives (children's education, retirement, etc). Basically, a mutual fund or a UITF is a pool of money from different individual investors and professionally managed by financial, banking or insurance institutions. There are many advantages in investing in mutual funds or UITFs. First, an investor can access these investment products even with smaller amounts of money. Second, investors are assured that their money is being managed by professional investment managers working for an established or reputable institution. Third, investors are assured that the choice or selection of investment outlets by fund managers in these funds is vetted by an investment committee limiting the investment universe to companies with solid track record in terms of profitability, depth of management, market leadership in the sectors that these companies operate. Fourth, mutual funds or UITFs are liquid in the sense that investors can easily redeem their money should they decide to encash after having met their goals or objectives. Fifth, mutual funds and UITFs are regulated by government agencies – Securities and Exchange Commission for mutual funds and the Bangko Sentral ng Pilipinas for UITFs. Sixth, investors can add to their investment in funds on a regular basis (monthly, quarterly, or annual). Seventh, investors can track or monitor their investments at any point in time. Eight, timing and rebalancing of the investment funds are done by professional investment managers therefore relieving investors of spotting opportunities, and investors enjoy the advantage of the compounding effect of the investments since funds are 100% invested in either cash, bonds or stocks. Sounds too good to be true.

BDO Peso Bond Fund (steadily rising but with minor bumps as it goes up)



BDO Peso Fixed Income Fund (steadily rising but with sideways movement)



But what are the drawbacks in investing in funds? Firstly, most of the funds (whether mutual funds or UITFs) in the Philippines don't give dividends directly to investors (this should not be concern because any dividends in an investment fund is directly re-invested and investors with a longer term horizon probably don't require immediate income from the funds). Second, while the redemption of stocks can be done at any time of the day as long as the exchanges are open, the value of the investments funds is only determined at the end of trading day or office hours through its net asset value unlike individual stocks or bonds that can provide moving price quotes at any time during trading hours. Third, investors have no say in the selection, universe or composition of the funds since this has been delegated to the professional investment manager. Fourth, mutual funds or UITFs are investments and not deposits. Therefore, investments in these funds are not guaranteed by the Philippine Deposit Insurance Corporation. Any losses are absorbed by the investor. Other than these drawbacks, the advantages in investing in funds outweigh those that investing on their own, particularly if one is not familiar in valuing specific bonds or individual stocks.

Since investments in stocks have no maturity, the returns are much higher than bond funds or money market funds but the risks are also much higher.

Types of investment funds

There are several types of investment funds. Each fund have specific attributes that may address the varying investment objectives of an investor.

- **Money Market Funds** – are funds which invest mostly in fixed income securities, debt instruments, deposits issued by either private or government institutions. Most of these investments have maturities of one year or less. These types of funds are appropriate for investors with low-risk preferences or those who can't tolerate losing money (conservative to defensive investors). Given the less risk in these funds, returns are also lower but are usually higher than rates offered by savings and time deposits.

- **Bond Funds** – are funds which invest in a mix of short-, medium- to long-term debt instruments, government bonds, corporate bonds. These funds generally have maturities of more than one year and are suitable for investors looking for higher returns (modest to moderate investor profile). Bond funds provide higher returns than money market funds (as investors are compensated for the longer maturity of bonds compared to cash or deposits) but are also more volatile since their market values correspondingly go up or down when interest rates either shifts lower or higher. (note: bond prices move inversely to that of interest rates; and prices of bond funds fall more sharply than money market funds when interest rates rise)

- **Stock or Equity Funds** – are funds that invest only in stocks or companies listed in the Philippine Stock Exchange. Since investments in stocks have no maturity, the returns are much higher than bond funds or money market funds but the risks are also much higher. These funds are appropriate for aggressive investors.

- **Balanced Funds** – are funds invested in both debt/fixed income securities and stocks. These funds generate returns higher than bond funds but lower than pure stock or equity funds in general. Risks in these funds are also in between that of bond funds and stock funds. These funds are appropriate for investors with balanced risk-return profile.

Basically, one invests in money market funds if constrained by a short-term investment duration. If an investor has a longer time period but has lower risk tolerance then a bond fund is probably appropriate. An investor who wants to higher return with a longer time horizon but has a higher risk tolerance would prefer to invest in a stock or equity fund.

How do I know which type of funds to invest into?

Knowing the different types of funds and their basic characteristics, how do I then know which of these funds are suitable or appropriate for me? Before investing in any of these types of funds, an investor usually goes through a client suitability assessment process together with his/her financial advisor/consultant. This process usually involves a question and answer survey or format about the client's investment experience of different products/services, time preference for investments (short/long), risk/return profile (preference for low/high returns; ability to withstand or absorb losses in any investments) depending on his goals/objectives. After the assessment, the investor is able to determine what specific types of funds are suitable from him/her. In addition, investors can invest in varying proportion or mix of asset classes depending on their risk/return profile.

BDO Peso GS Fund (steadily rising but with minor bumps along the way)

- These funds are invested only in government securities or government bonds

BDO Peso Equity Fund (more volatile than bonds)

Asset allocation, diversification benefits of having different funds in a portfolio

One misconception among investors is that an investor with a specific risk-return profile is subjected or confined only to invest in only one type of fund. This is not true. In fact, investors with different profiles can combine different type of funds in their portfolios without significantly increasing the risks of their portfolio, yet provide a combined return that could achieve one's objective or goals in the future. For instance, a conservative or defensive investor can have a mix of money market and bond funds in their portfolio. On the other hand, a moderate, modest to aggressive investor can combine money market, bond and stock funds in their portfolio to achieve a desired goal or objective. The act of dividing your investment portfolio among different types of funds – money market, bond, stock – is what investment experts call **"asset allocation"**. There is no hard and fast rule in mixing or constructing the different type of funds in one's portfolio since this is really based on one's unique personal circumstance depending on his or her time horizon and risk tolerance. Does this make sense? Haven't you observed those who run sari-sari stores? They sell different stuffs to get more customers and make more profit. If these sari-sari store owners sold only one product or service, this will limit the store's capability in attracting customers and making money. The same is true with asset allocation. Having different type of funds in a portfolio provides flexibility for an investor to generate income which may be needed in the short-; medium- and long-term. In addition, historical evidence shows that the returns of these funds don't move in tandem at the same time. Specific market events and conditions cause one type of fund to perform better or badly. If these funds move in different direction based on specific market conditions, then the fluctuations or volatility of the combined funds in a portfolio are smoothened out, tending to cushion or buffer each other's move.

On the other hand, a moderate, modest to aggressive investor can combine money market, bond and stock funds in their portfolio to achieve a desired goal or objective. The act of dividing your investment portfolio among different types of funds – money market, bond, stock – is what investment experts call "asset allocation".

BDO's unitized investment funds: Historical performance

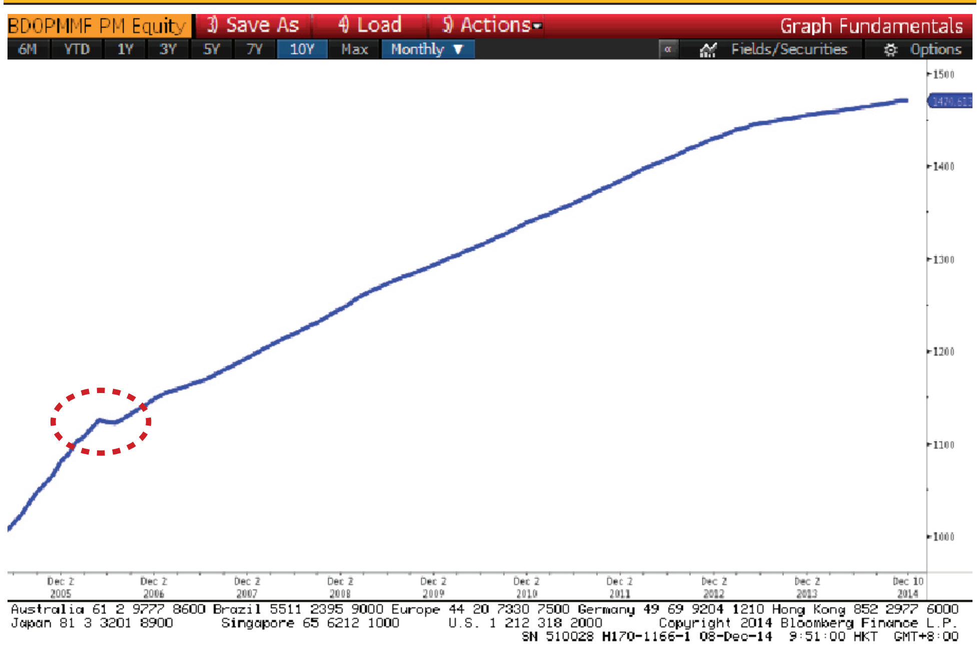
Historical analyses of BDO Unibank's different types of Unitized Investment Funds (UITFs) support the general characteristics of the different type of funds mentioned earlier. That, money market fund provides generally stable return but lower than that of a bond or stock fund. BDO's Peso Money Market Fund provided a compounded annual return of 4.0% over the past 9.75 years. On the other hand, BDO's 3 Peso bond funds returned from 6.4% to 6.9% annually during the same period. Note that there are few noticeable dips in the charts of all three bond funds compared to the money market fund. This means that investors could have lost money if forced to sell during these periods. BDO Equity Fund provided the highest annual return among all the funds at 16.7% over the same period. The highest return has also been marked by the sharpest decline in certain periods, proving the stock funds generate the highest returns among all types of funds but volatility is also sharpest.

BDO Equity Fund provided the highest annual return among all the funds at 16.7% over the same period.

BDO UITFs	Type of Fund	Apr-05	Dec-14	Annual Return
BDO Peso Money Market Fund	Money Market	1,005.24	1,470.56	4.0%
BDO Peso Bond Fund	Bond Fund	1,008.32	1,839.27	6.4%
BDO Peso Fixed Income Fund	Bond Fund	1,000.00	1,911.34	6.9%
BDO Peso GS Fund	Bond Fund	101.94	185.90	6.4%
BDO Equity Fund	Stock/Equity Fund	99.00	445.94	16.7%

Source: Bloomberg, BDO Private Bank Research

BDO Peso Money Market Fund (minimal volatility or fluctuation, steadily rising)



What would be the performance of combination of funds in a portfolio?

As mentioned earlier, an entrepreneur or employee could generate wealth even with modest amount of savings every year by investing in a variety of funds. Second, a combination of funds in a portfolio could improve the overall return of the portfolio without significantly increasing risks. An entrepreneur or an employee who earns Php 20,000 per month (gross) or a total of Php 240,000 and saves 12.5% of Php 240,000 would have saved Php 30,000 every year (or Php 84.24 per day). If this entrepreneur or employee keeps his savings in his house or under his bed, he would have saved Php 300,000 in about 10 years. What if the entrepreneur or employee saved and invested the money annually in a combination of funds in his/her portfolio, how much would this portfolio be worth in 10 years? For this illustration, we assumed four different types of investor profile: 1) the conservative investor who invested his savings purely in a BDO Peso Money Market Fund(100%); 2) the defensive investor invested his savings in a combination of money market (30%) for liquidity, bond fund (50%) for income and some capital appreciation, and stock fund (20%) for capital appreciation only; 3) the moderate to balanced investor invested his savings in the following: money market fund (10%); bond fund (30%), and stock or equity fund (60%) and lastly, the aggressive investor who wished only to seek capital gains over the long-term invested all of his savings in an equity or stock fund (100% - stocks). How would these four investors' performance compare to someone (ultra-conservative investor) who just kept his savings in his house (literally under the bed) or in a safety deposit box. BDO Private Bank simulation of the various mix of funds for the 4 portfolios representing different investors' profile showed that the balanced and the aggressive investors would have generated the greatest wealth in absolute terms during the 10-year period. The balanced investor's investments would have seen his investments grow to Php 556,000 from a total savings of Php 300,000 while the aggressive investor more than doubled his savings of Php 300,000 to Php 682,000. Note that even the defensive investor with a small allocation in equities (20%) generated time-weighted compounded annual rate of return of 11.2% more than enough to compensate for inflation running at an average of 4% during the same period. Even without the benefit of timing one's investments, all investors' profiles generated and created wealth (with the exception of the ultra-conservative investor) during adverse and benign macro-economic conditions from 2005 to 2014. So, the asset allocation mix is not fixed but really depends on the specific circumstance of the investor based on his risk-return profile.

Comparative Returns for Different Fund Mix of Different Investors' Profile

Type of Investor	Portfolio Mix Money Market- Bond- Stock	Savings Php 30,000/yr Year 1	Total Saved in 10 Years Php	Total Investments Years 10	Weighted Annual Return* (%)
Ultra-conservative	safekept	30,000	300,000	300,000	0.0%
Conservative	80-20-0	30,000	300,000	333,663	2.2%
Defensive	30-50-20	30,000	300,000	426,004	11.4%
Balanced	10-30-60	30,000	300,000	556,371	10.2%
Aggressive	0-0-100	30,000	300,000	682,211	13.3%

*Source: BDO Private Bank Research, Bloomberg – closing prices of BDO Unibank Funds, * - returns are calculated using time-weighted rate of return concept.*

Let the professionals manage and create wealth for you

Our illustration shows that one can pursue his career or business and still create wealth by letting investment professionals manage the savings and invest the funds on your behalf. By letting professional investors manage your investments, you are freed from the tedious task of monitoring and timing your investments. Second, investment professionals select their investment universe of stocks and bonds based on the fundamental strengths of the balance sheet, profitability and expansion of each and every company. Having a diverse selection of companies in a fund protects the overall fund from significant losses compared to an investment in one or few companies that may experience financial difficulties, go bankrupt or default on their debt obligations.

Tips on wealth creation

Let me now give you my simple and personal guide to wealth creation.

1) Make an accounting of your wealth (anything of value, e.g. financial assets, cars, real estate, jewelry, painting, etc.)
2) Save at least 30% (not just 12.5%) of your gross income
3) Define your financial objectives – retirement, children' education, house, car, vacation, healthcare, etc
4) Evaluate your investment profile. Identify your risk/return profile, define your time horizon, determine your appropriate asset allocation that meets your long-term financial objectives
5) Execute or implement your portfolio plan by investing in funds
6) Evaluate and monitor your portfolio's performance once or twice a year
7) Don't procrastinate, save and invest now
8) Live a simple, healthy lifestyle and enjoy your wealth.

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