

**ASIA PACIFIC ASSOCIATION FOR FIDUCIARY STUDIES**

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**6<sup>th</sup> Annual Pacific Region  
Investment Conference**

**Shangri-la Makati, Philippines**

**November 9, 2006**

**ASIA PACIFIC ASSOCIATION FOR FIDUCIARY STUDIES**

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**The Philippine  
Mutual Fund Industry**

*presented by:*

**Fernando J. Sison III**

# OUTLINE

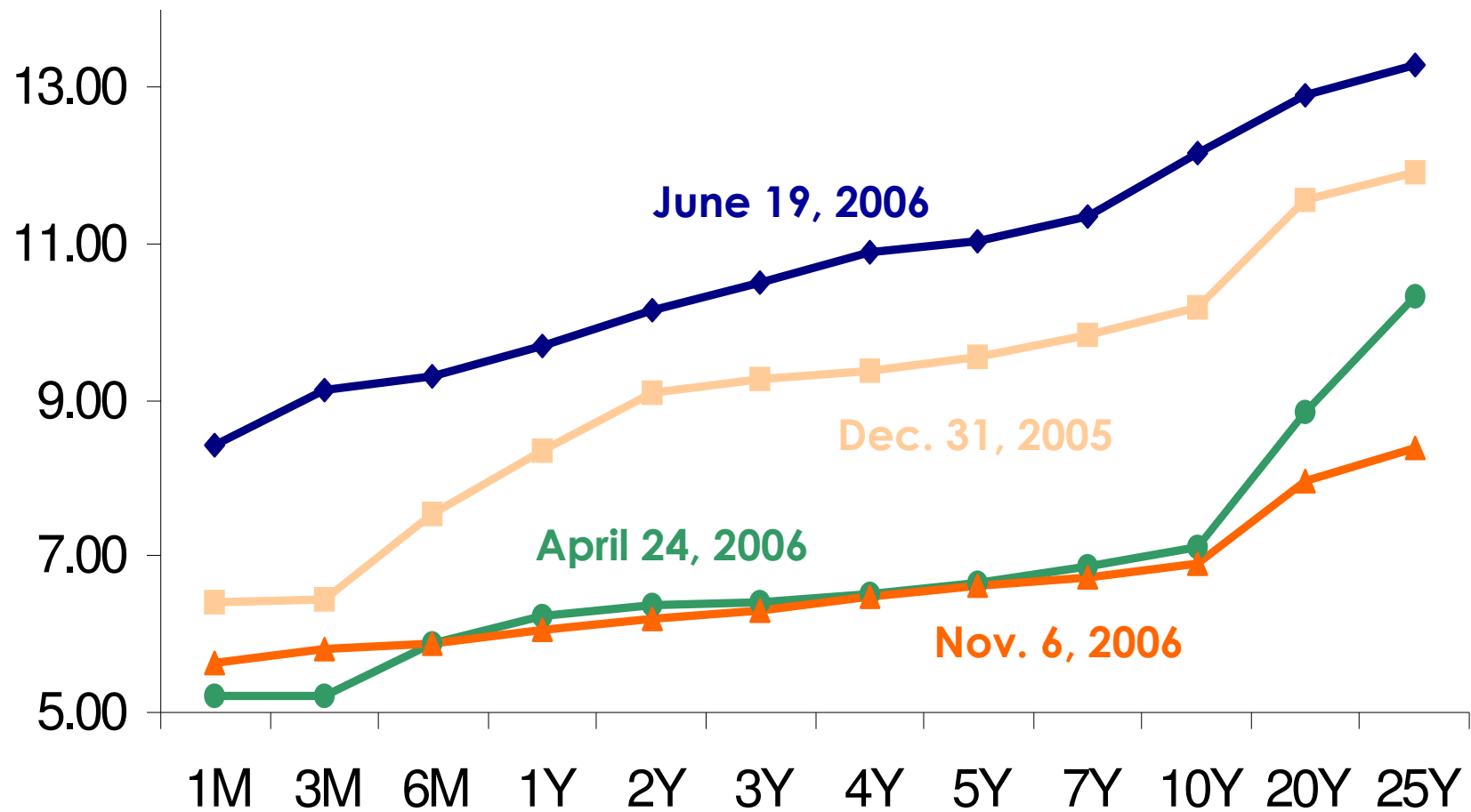
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**I. Economic Situationer**

**II. The Mutual Fund Industry**

**III. Outlook**

# Peso Bonds Yield Curve



# Change in MART1 Bids

Tenor	Dec-05	Apr-06	Oct-06	Change	
				April vs Oct	Y-T-D
O/N	7.50%	7.50%	7.50%	0	0
1 mo	6.40%	5.47%	6.09%	62	-31
3 mos	6.43%	5.48%	6.12%	64	-31
6 mos	7.53%	5.90%	6.70%	80	-83
1 yr	8.36%	6.24%	6.89%	65	-147
2 yrs	9.09%	6.48%	7.03%	55	-206
3 yrs	9.26%	6.60%	7.09%	49	-218
4 yrs	9.39%	6.70%	7.12%	42	-227
5 yrs	9.57%	6.88%	7.19%	31	-238
7 yrs	9.85%	7.15%	7.52%	38	-233
10 yrs	10.19%	7.44%	7.68%	23	-252
20 yrs	11.57%	8.77%	8.70%	-7	-287

# In retrospect . . .

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- ❑ Flattening of the yield curve
- ❑ General positive outlook on global economic growth & global financial markets
- ❑ Global investors sought higher-yielding assets, particularly in Emerging Markets (EM)
- ❑ Better-than-expected collections from EVAT
- ❑ Credit ratings outlook upgrade by Fitch, S&P, & Moody's
- ❑ Record-high OFW inward remittances

# In retrospect . . .

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- Sustained fiscal improvement and favorable economic fundamentals
- Market liquidity: foreign funds inflows
- Continued decline in interest rates after reaching highs in June 2006
- Effective cut in BSP policy rates
- Strong demand for government bonds with the more active participation of the unit investment trust funds and insurance company funds

# Reversal in interest rates . . .

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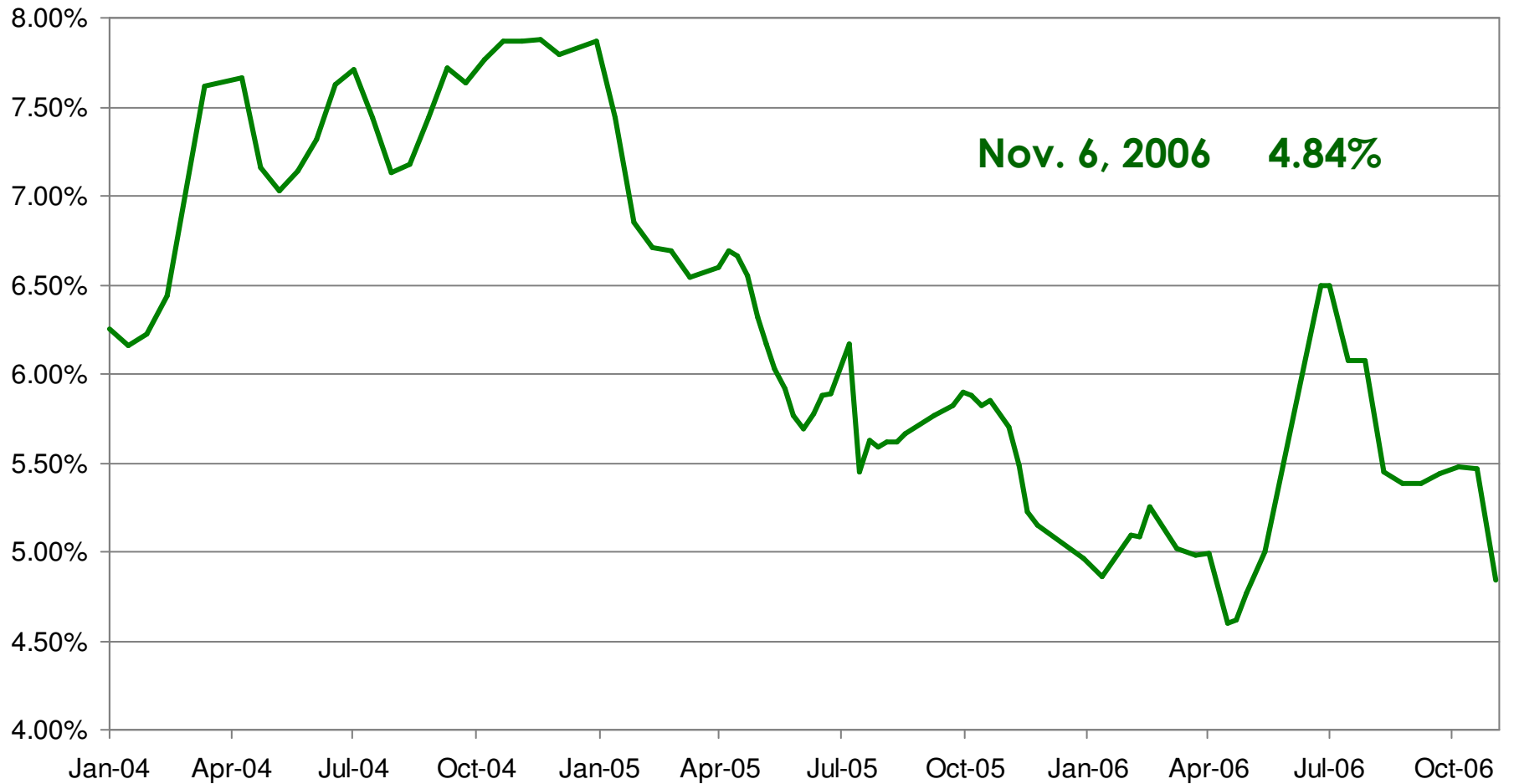
- **Reversal** of interest rates beginning June 2006
  - Anticipation that the U.S. Federal Reserve will cut the Fed funds rate by early 2007.
  - Buyback of Emerging Market (EM) bonds after sell-off in May due to previous concerns on rising global interest rates
  - Sharply lower oil prices, hence, inflation expectations, due to declining U.S. economic growth and thaw in Middle East geopolitical concerns.
  - U.S. Fed rate hikes may have been overdone as reflected in slower U.S. 3Q economic growth and softer U.S. housing market.

# Reversal in interest rates . . .

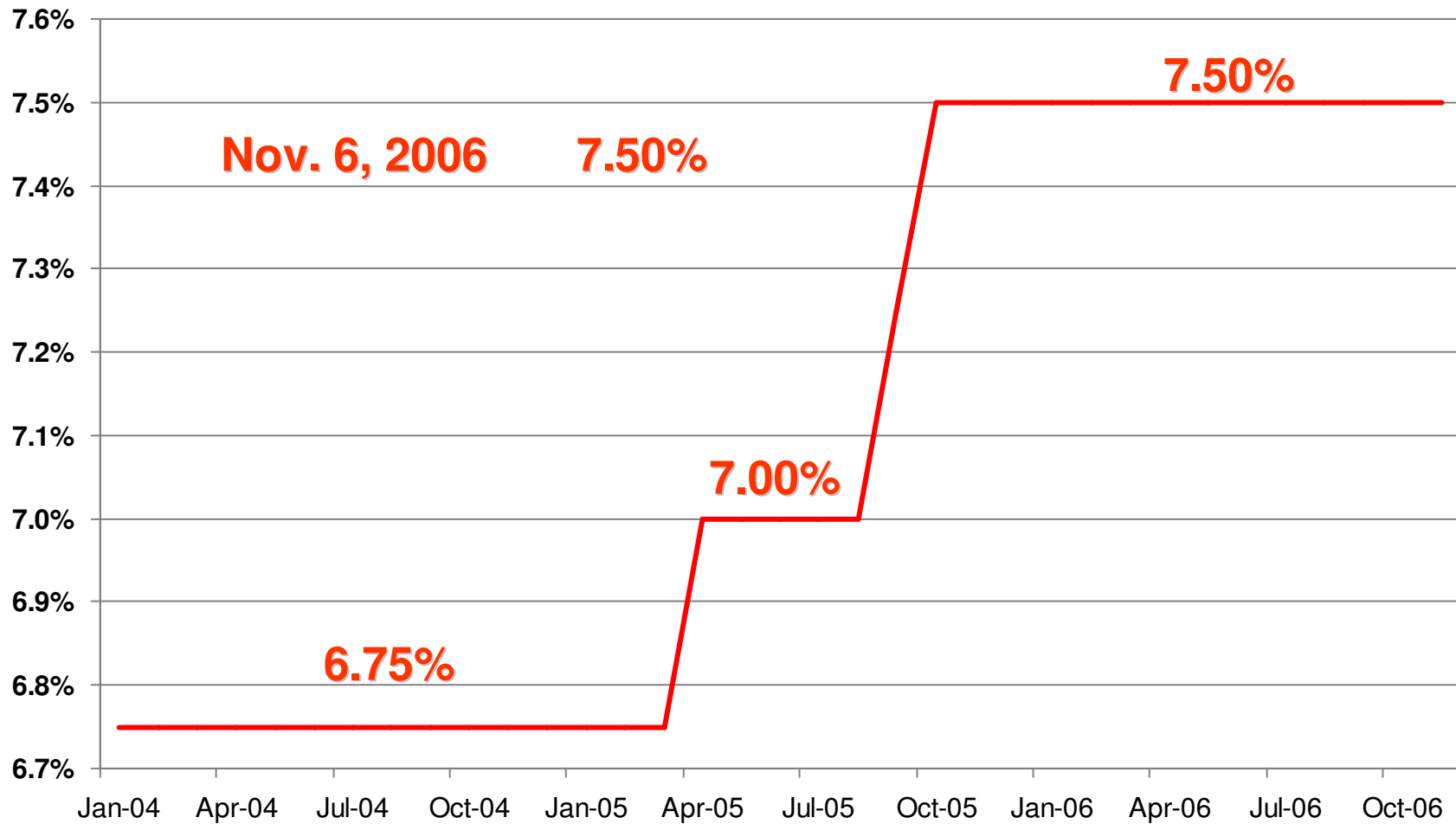
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- Strength of the peso and other Asian currencies, with the local unit reaching a 4-year high of US\$1.00:PhP49.73
- Better-than-expected EVAT collections of government, resulting in Sept. YTD budget deficit of P50 billion, which is 47% below target.

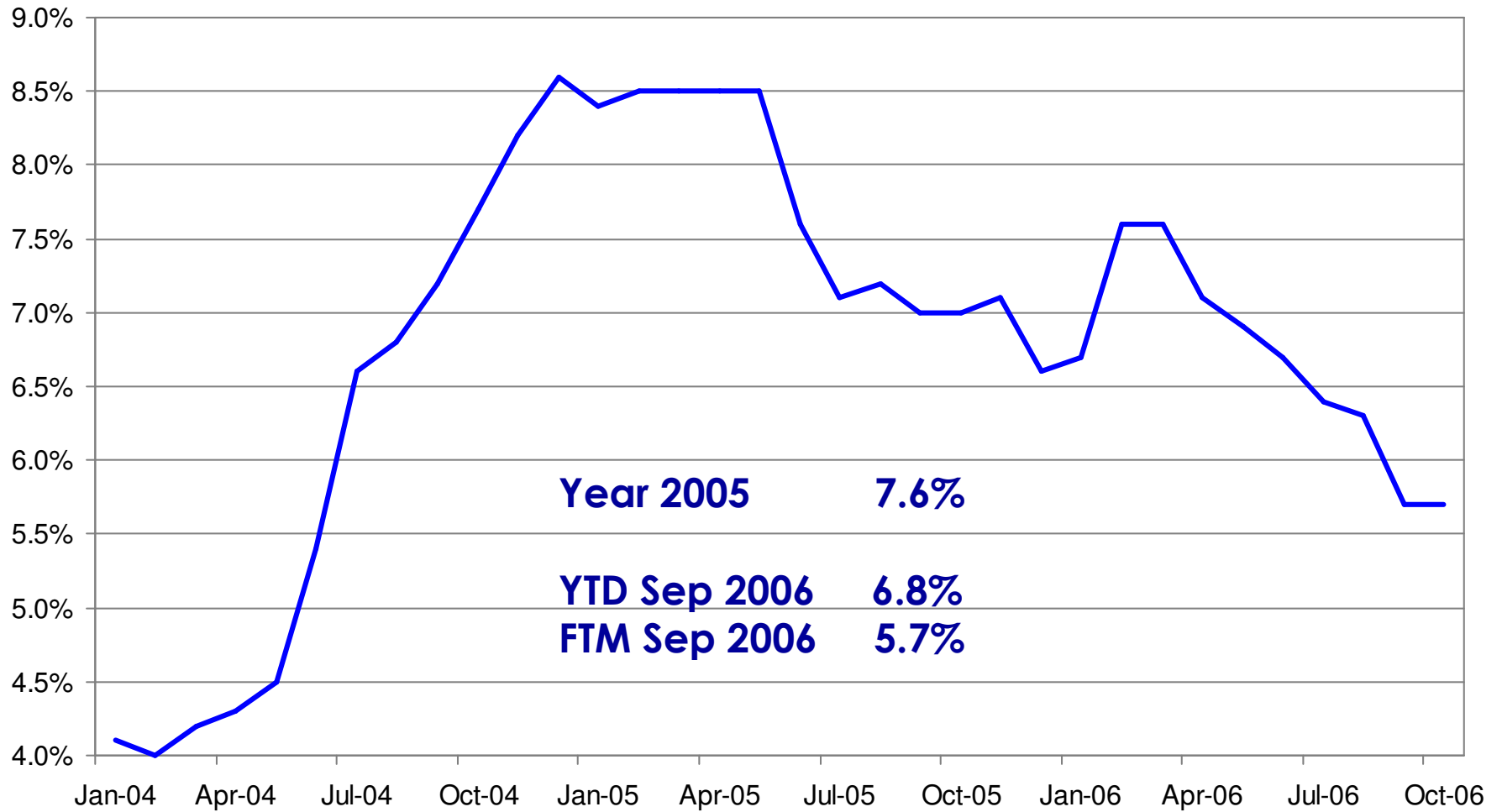
# Average 91-day T-Bill Rate



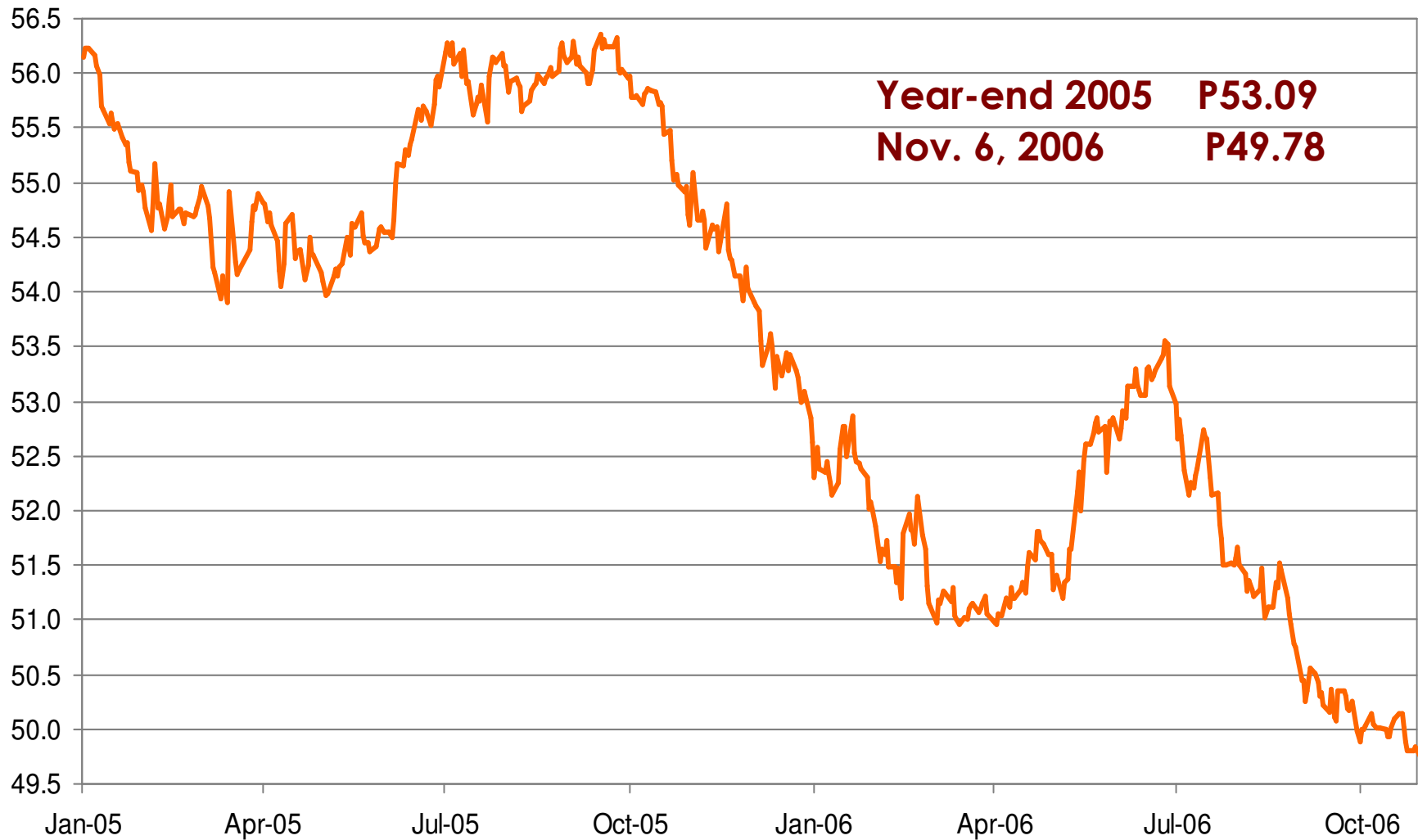
# BSP Overnight Rate



# Inflation Rate



# US\$:PhP Exchange Rate





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# **THE FUNDS INDUSTRY**

# Mutual Funds Regulatory Framework

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- **Philippine Investment Company Act (1960)**
  - covers only the corporate investment fund structure
  - patterned after the **U.S. Investment Company Act (1940)** which covers both the corporate and contractual fund structures
- Implementing Rules & Regulations (“IRR”) Governing Investment Companies (1989)
- IRR amended in **1998** and referred to as the “**Investment Company Rule**”

# Mutual Funds Regulatory Framework

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- Investment Companies are registered under the **Corporation Code**
  - Further registered under the **Investment Company Act**
- Shares issued are registered under the **Securities Regulation Code**
- Distributed by non-bank distributors
- Mutual Fund salesmen and Fund Management Companies are licensed by the SEC
- Regulator: Securities & Exchange Commission

# Taxation

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- Gains realized by investors from the sale of mutual fund shares are tax-exempt
  - per the **Tax Reform Act of 1997**, implemented in 1998
- Mutual Fund companies are subject to the corporate income tax rate of **35%**

# Valuation of Fund Assets

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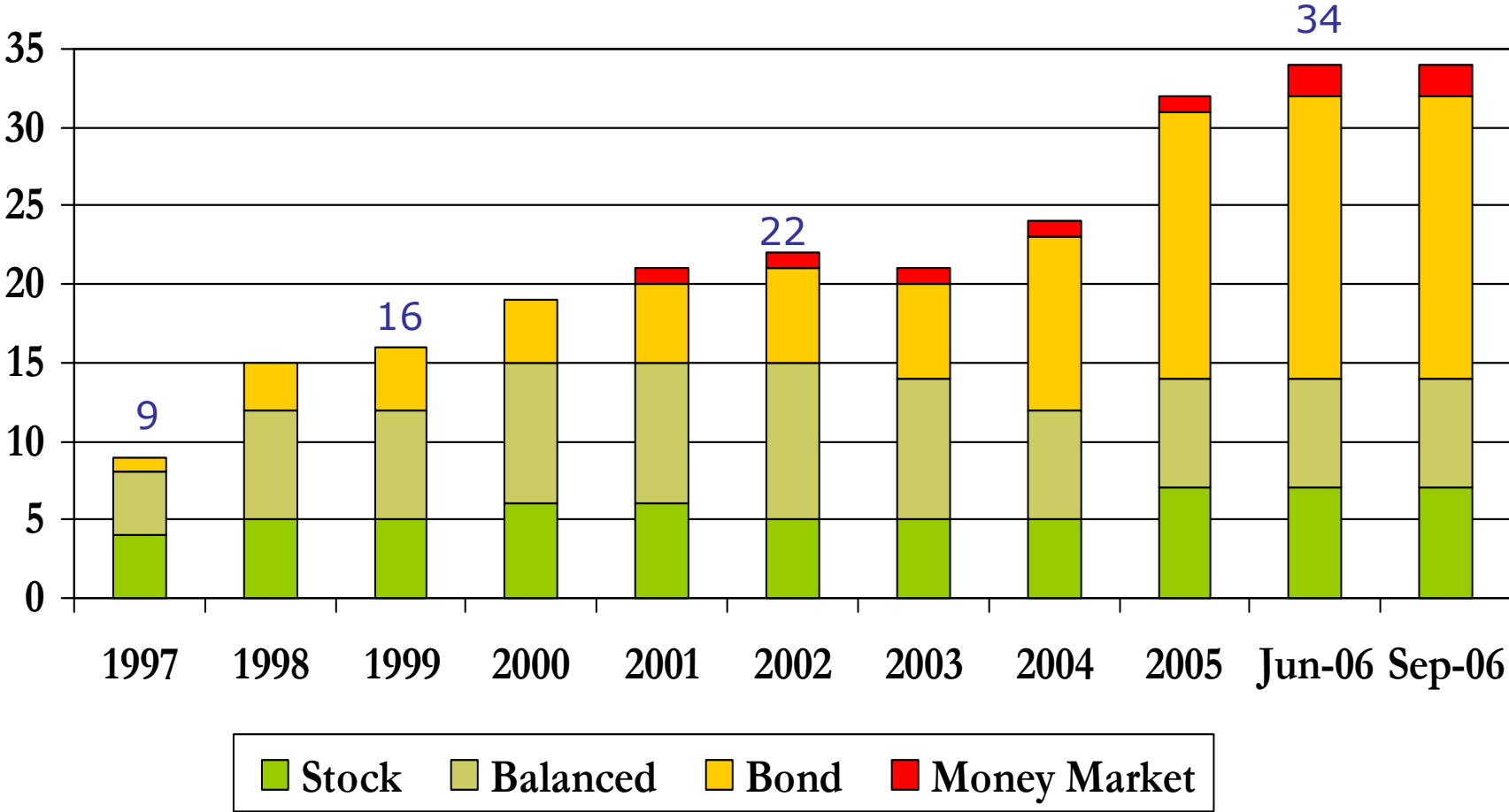
- The SEC gave a 1-year transition period to adopt the **International Accounting Standards (IAS)** of asset valuation
  - Voluntary, effective Sept. 30, 2005 (but no further sales)
  - Mandatory, effective Sept. 30, 2006
  
- Prior to Sept. 30, 2005, the bond funds were valued using the amortized cost method

# Industry Association

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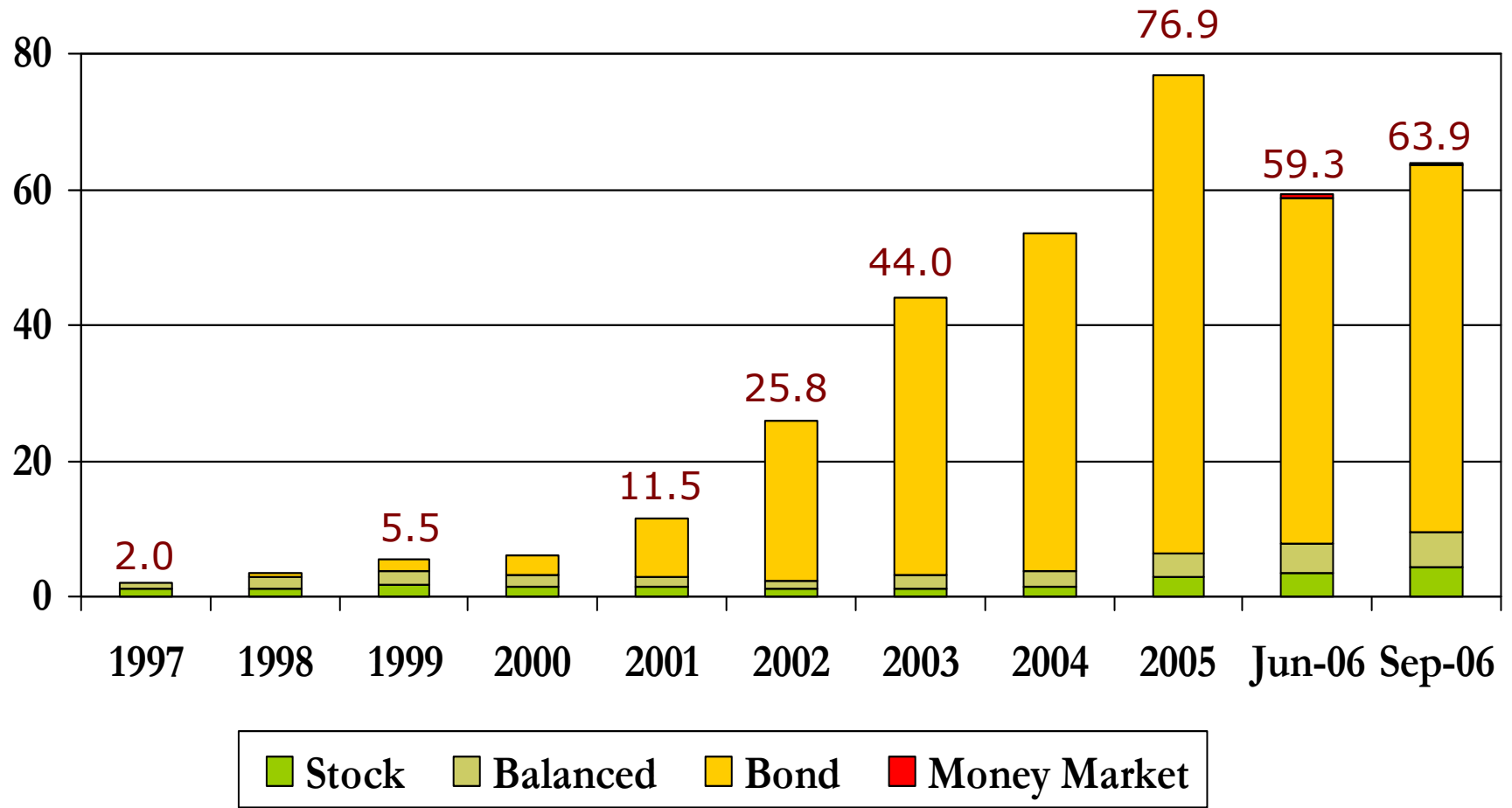
- **Investment Company Association of the Philippines (ICAP)**
  - organized in 1995
  - does not have SRO status
- Membership consists of the **34** mutual funds at present

# Number of Mutual Funds



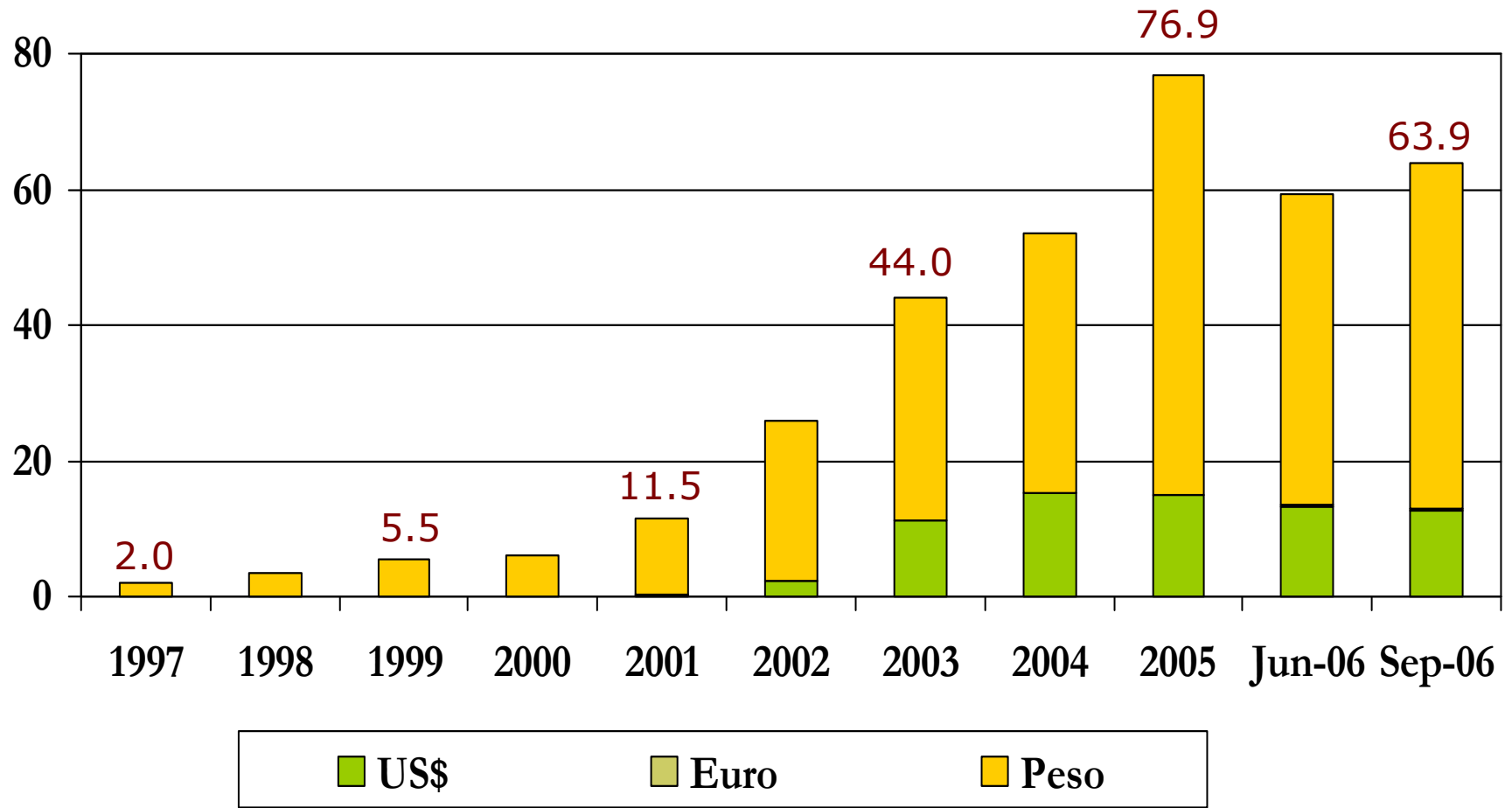
# Net Asset Value (by Fund Type)

PhP Bn.

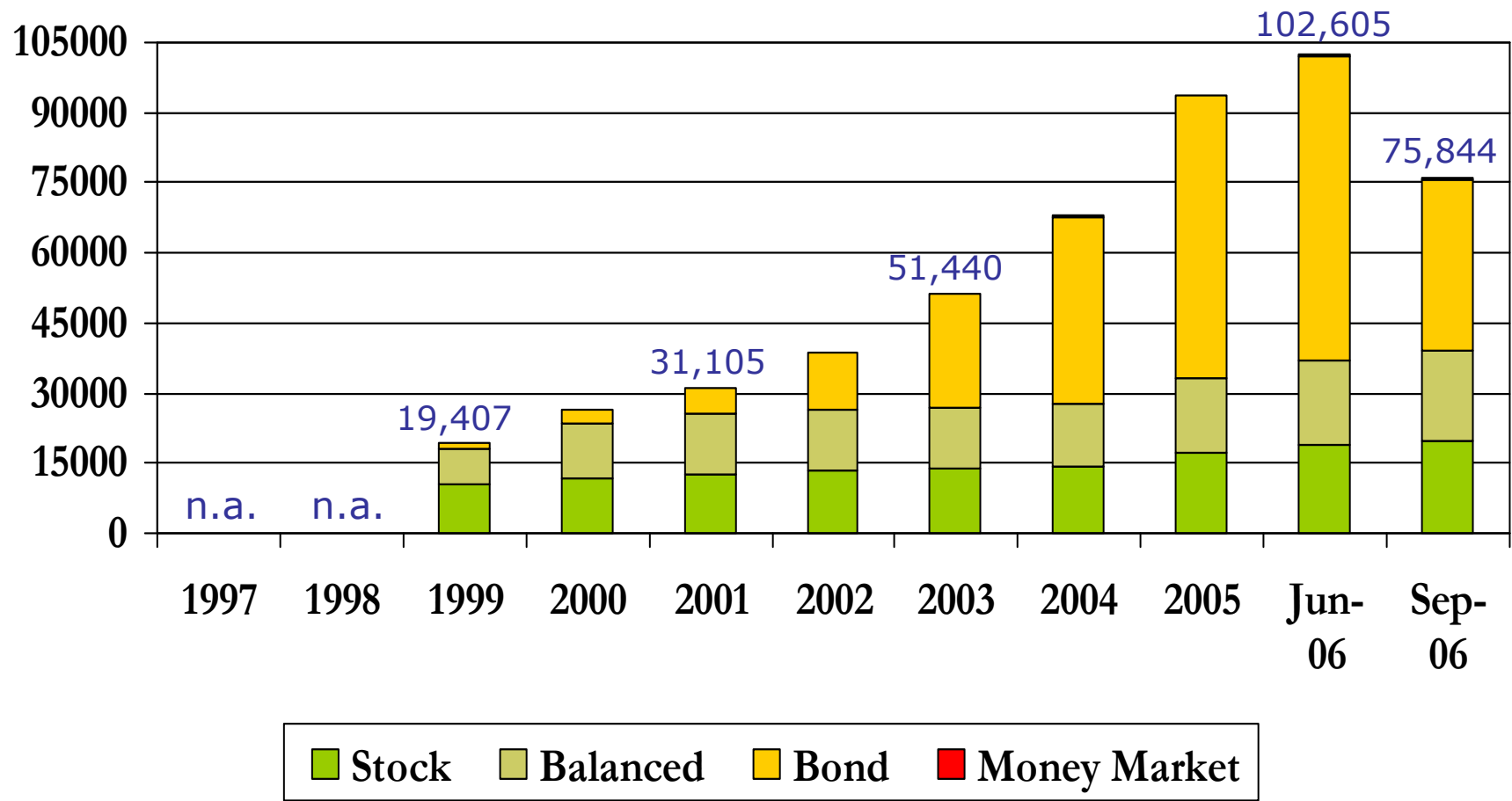


# Net Asset Value (by Currency)

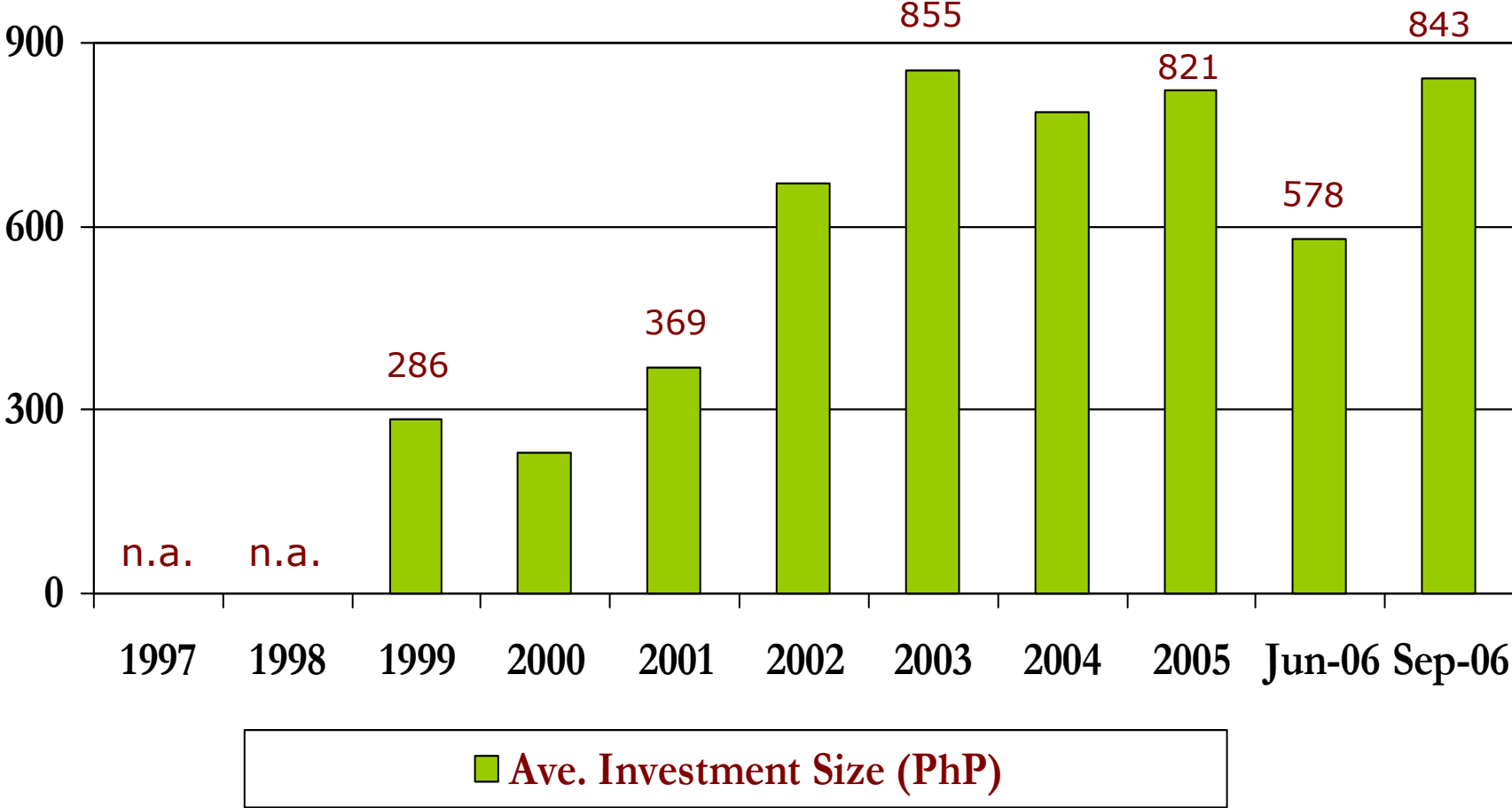
PhP Bn.



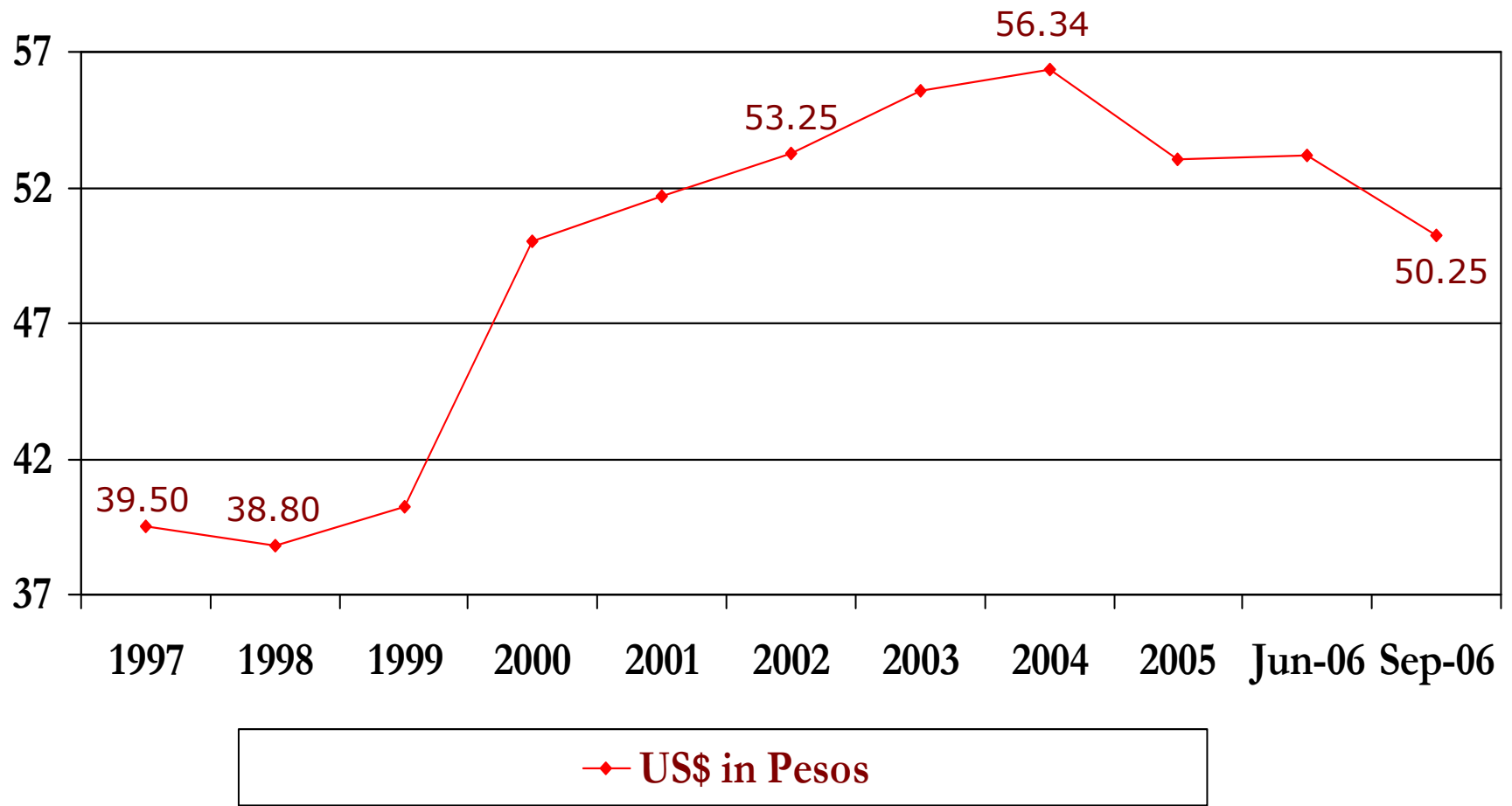
# Number of MF Shareholders



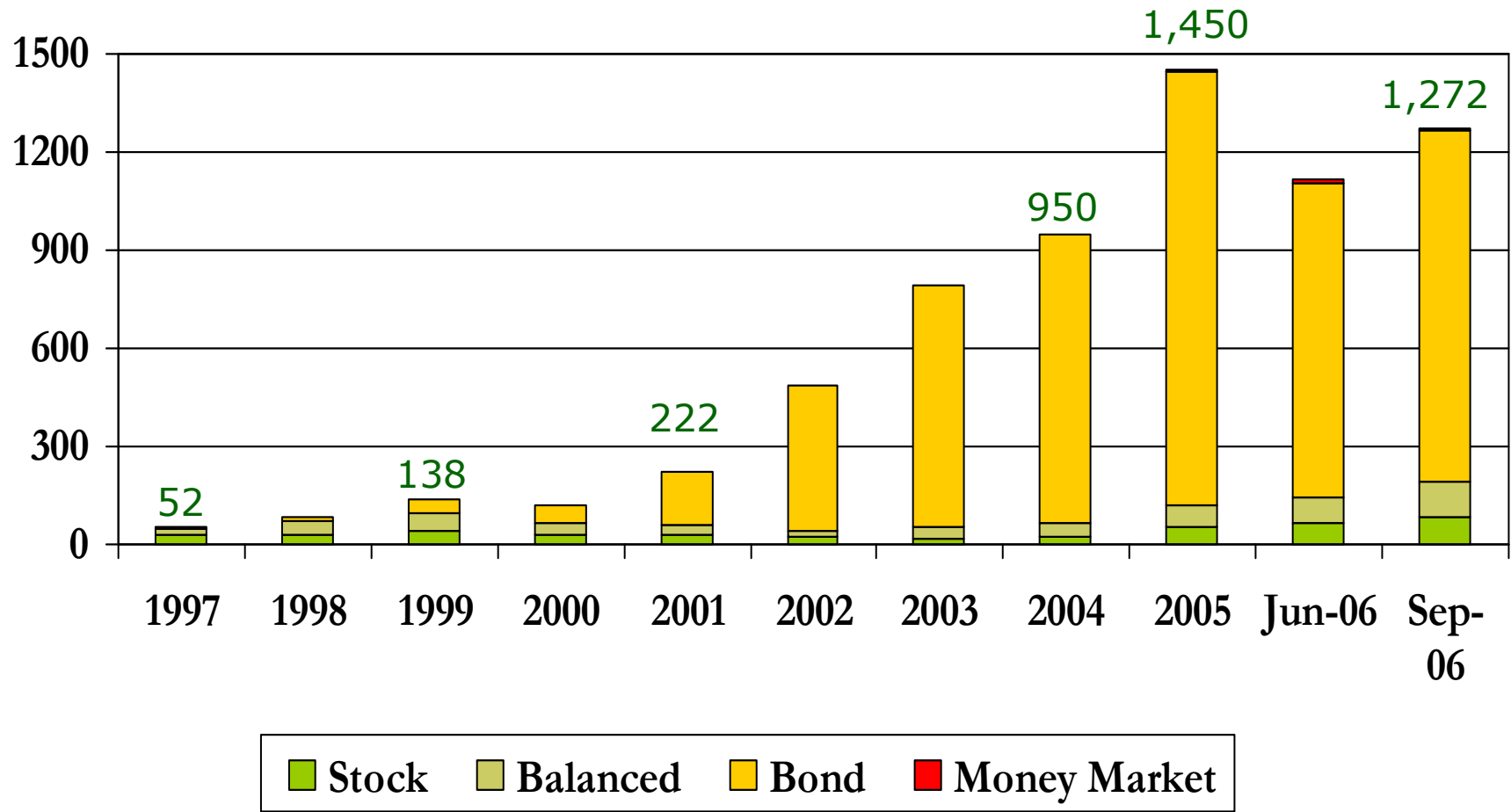
# Average Investment Size (PhP '000)



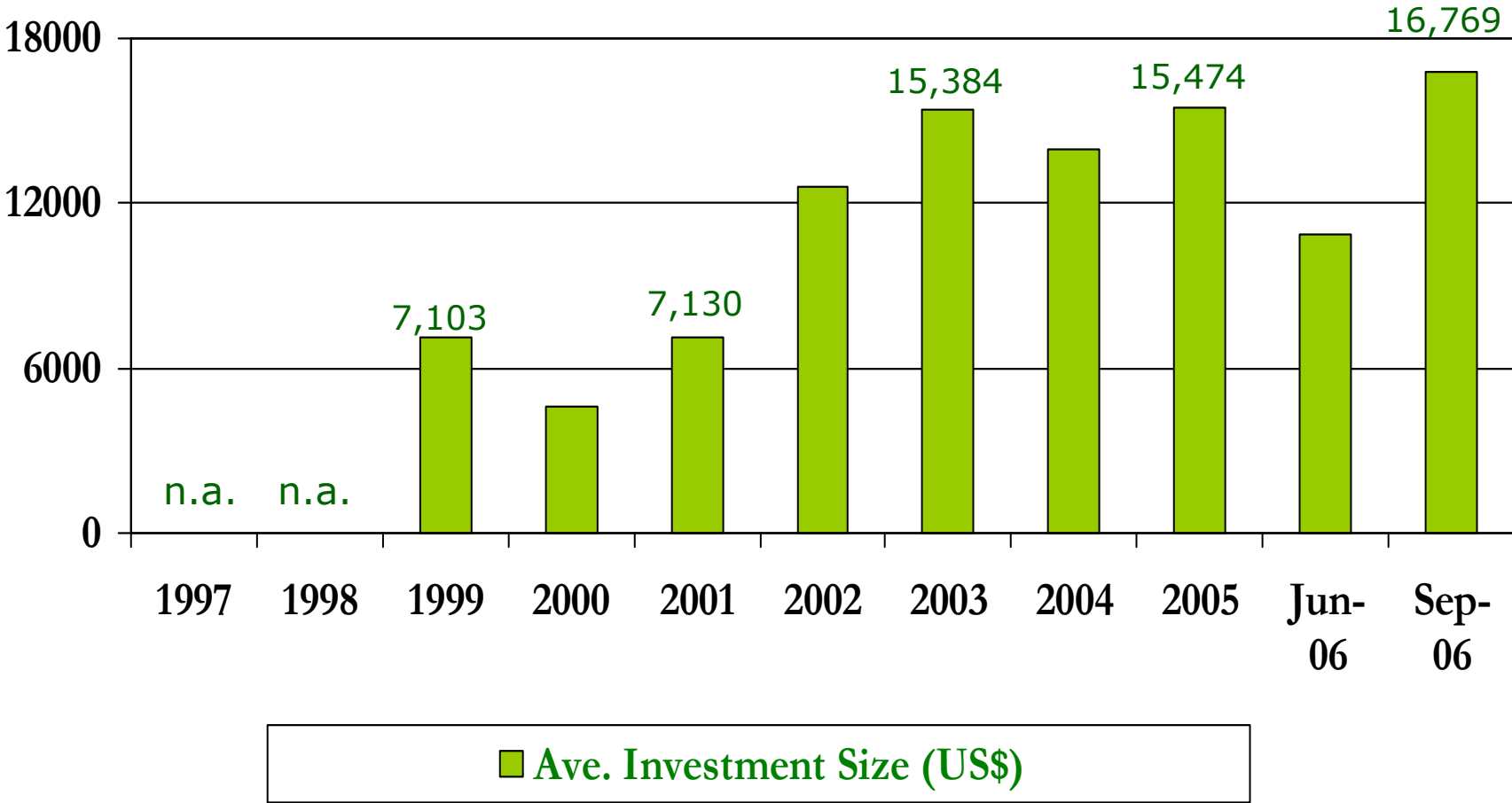
# US\$:PhP Exchange Rate



# Net Asset Value (US\$ Millions)



# Average Investment Size (US\$)



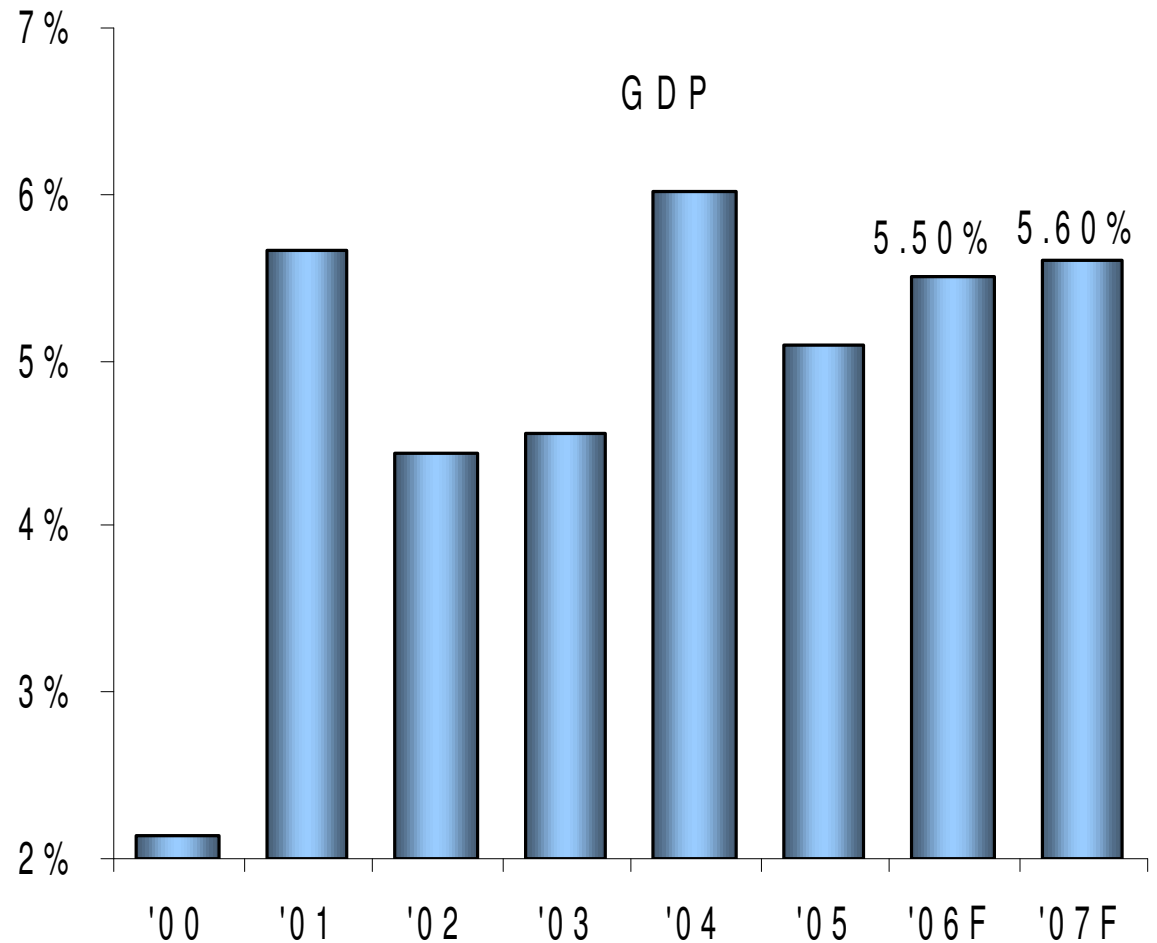


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# OUTLOOK

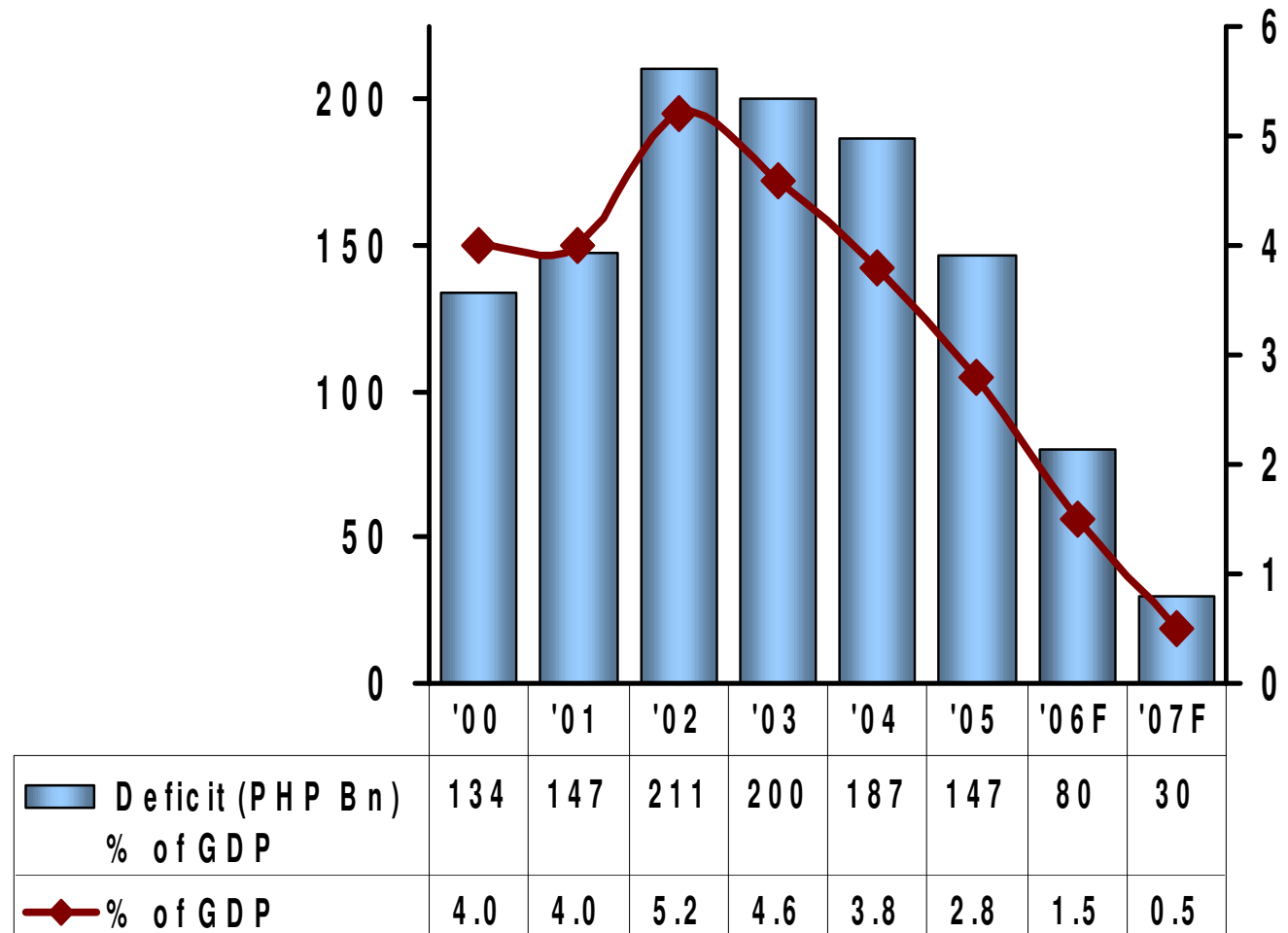
# Improving Economic Growth in 2007

- Continued strong consumption and investments inflow expected to be the main engines for growth
- Pick-up in demand of semiconductors to boost exports
- Continued low interest rate environment



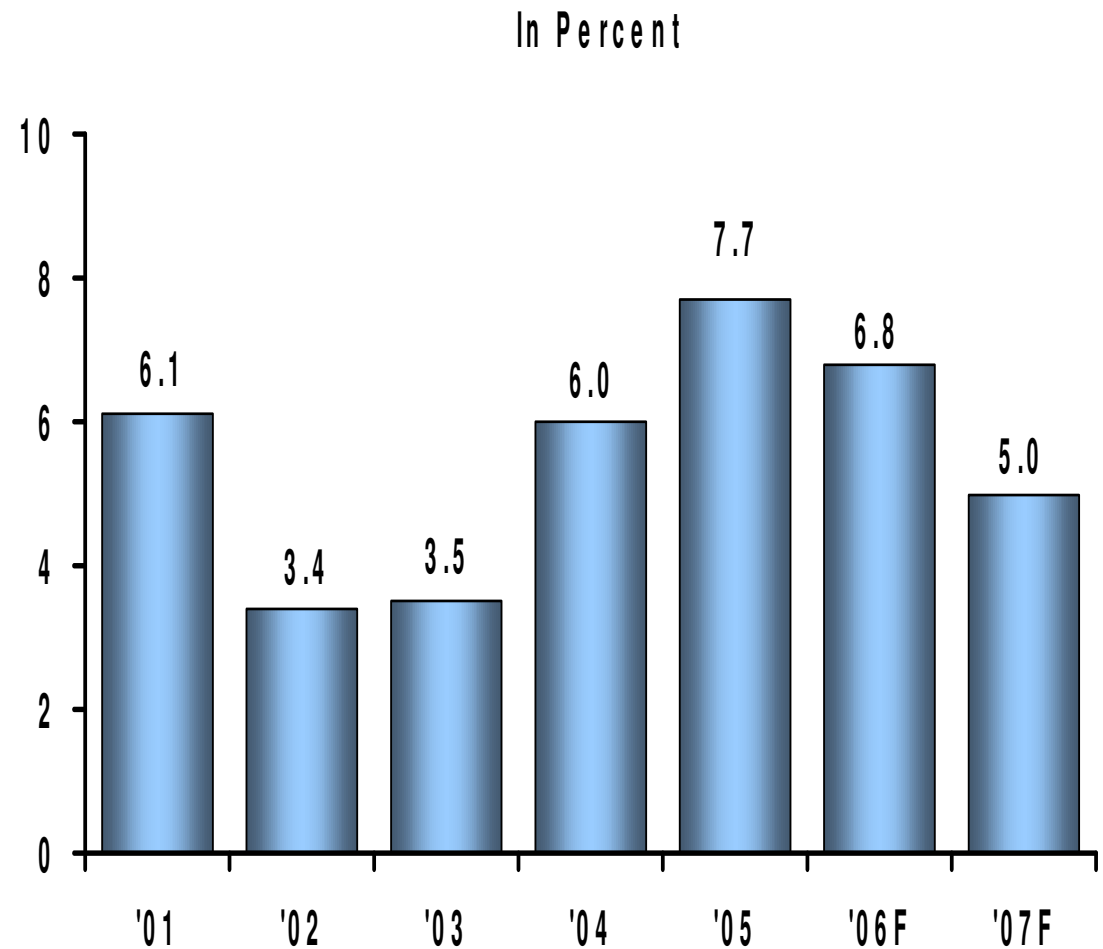
# Improving Fiscal Performance

- Government expected to beat its PhP125 Billion deficit target in 2006
- Fiscal reforms on track to balance the budget by 2008



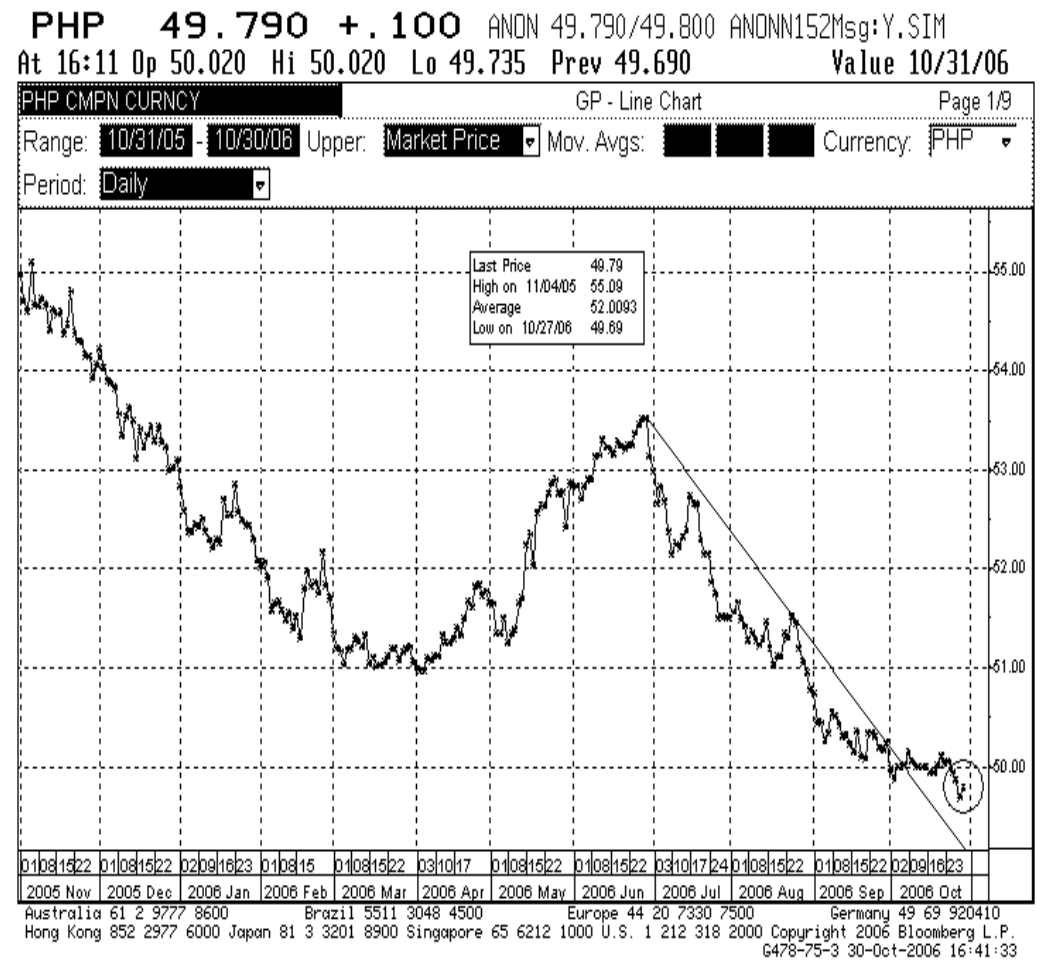
# Moderate inflation in 2007

- Higher farm output underpins lower food inflation
- Softening of crude oil prices
- Stronger local currency contributes to lower inflation



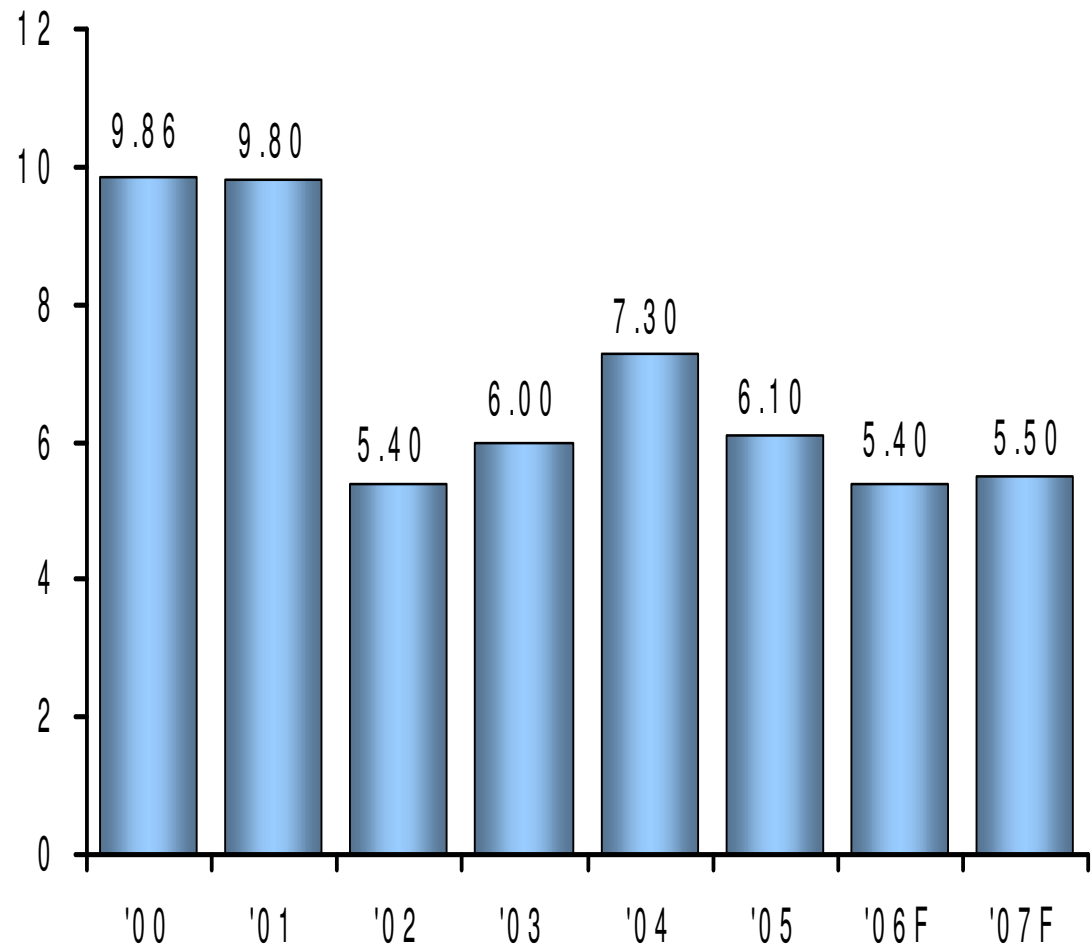
# Continuing Strong Peso

- Strong OFW remittances and portfolio-investment inflows will lend support to the Peso
- End in the Fed tightening cycle point to a weaker U.S. dollar
- We forecast US\$:PhP to end 2006 at PhP49.00 and 2007 at PhP48.00

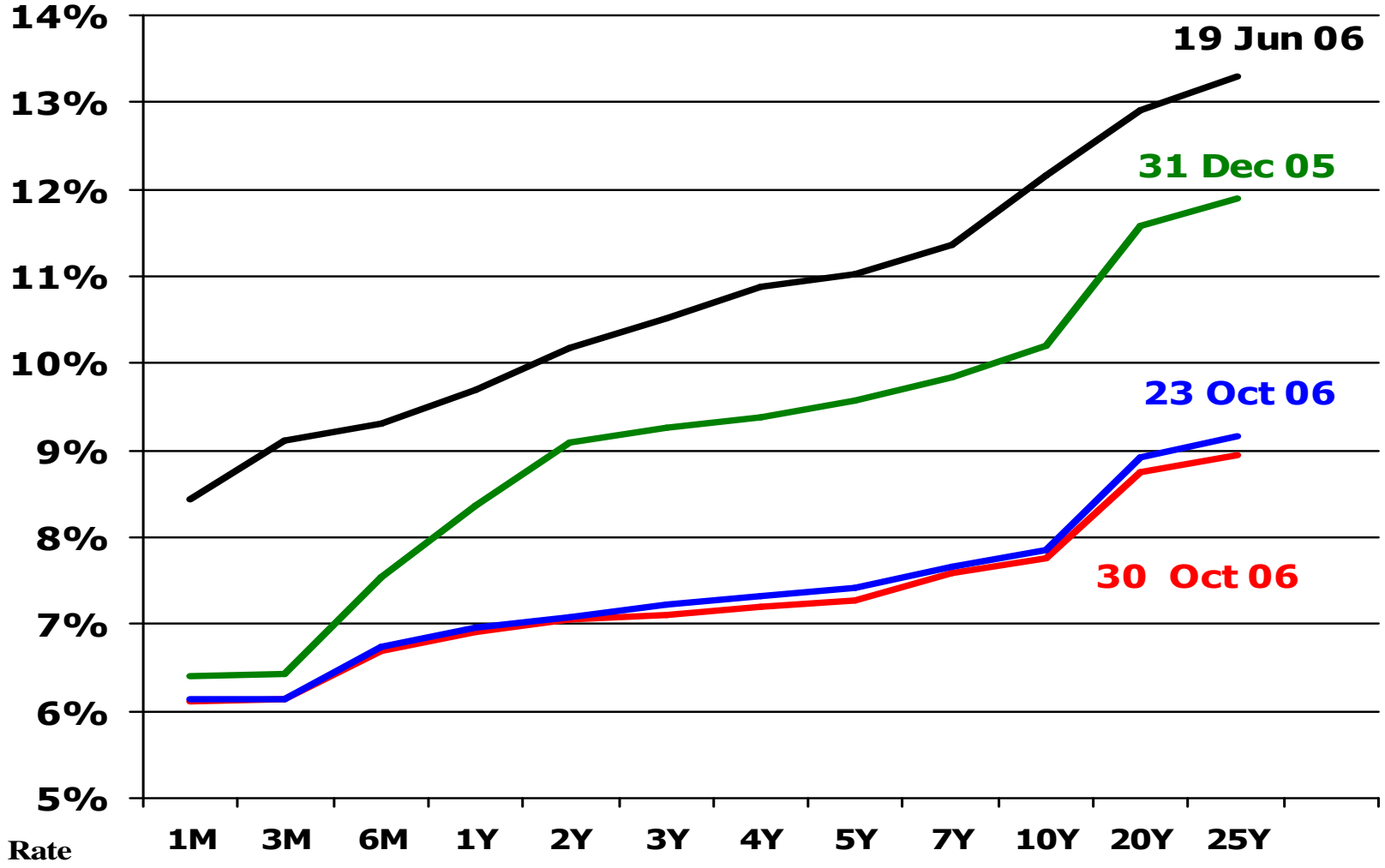


# Stable short-term interest rates

- Peso liquidity and favorable inflation supportive of low interest rate environment
- End in U.S. Fed rate hikes eases pressure on BSP to increase policy rates
- Structural reforms to increase liquidity expected to maintain rates at low levels

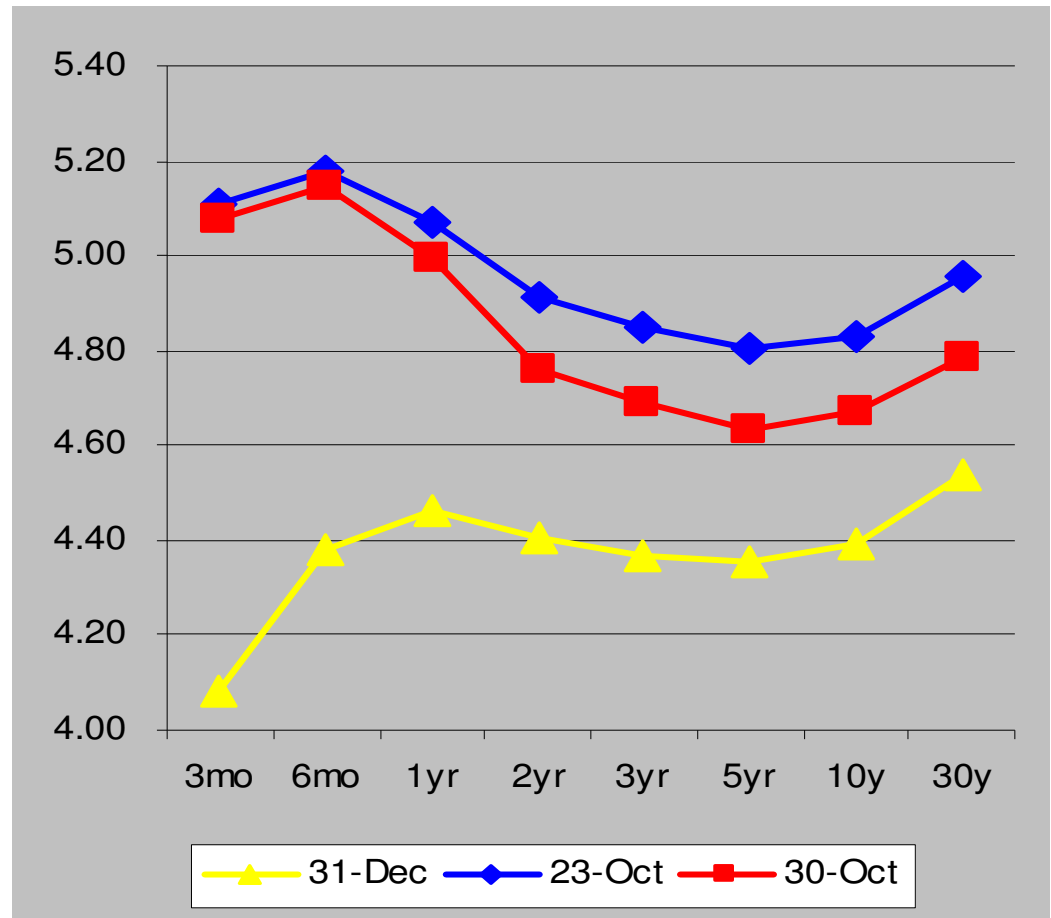


# MART1 bid rates decreasing



# U.S. Interest Rates

- U.S. Fed to cut interest rates by 2Q 2007; 4.50% by end 2007
- Moderating U.S. inflation to support lower U.S. interest rate environment



# JP Morgan Chase EMBI

## JPMORGAN CHASE EMBI GLOBAL COMPOSITION

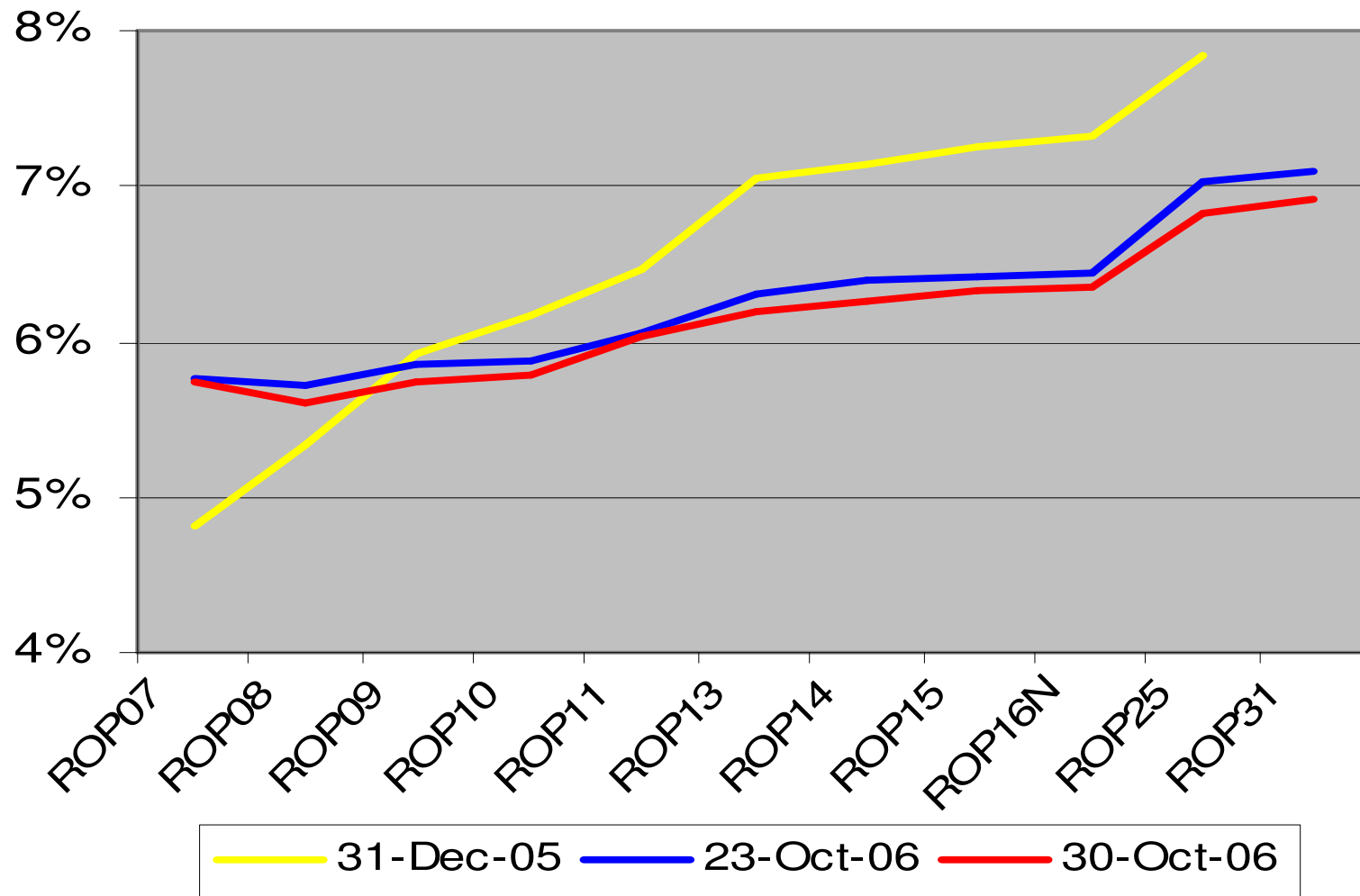
As of October 31, 2006

COUNTRY	RATING		INDEX WEIGHT	M-O-M RETURN	Y-T-D RETURN	SPREADS		
	MOODY'S	S&P				SEPT 06	OCT 06	CHANGE
MEXICO	Baa1	BBB	16.04%	1.42%	4.53%	141	132	(9)
BRAZIL	Ba2	BB	15.85%	1.74%	11.84%	232	222	(10)
RUSSIA	Baa2	BBB+	11.79%	0.89%	3.89%	115	115	-
TURKEY	Ba3	BB-	8.52%	2.30%	3.65%	256	236	(20)
<b>PHILIPPINES</b>	<b>B1</b>	<b>BB-</b>	<b>7.04%</b>	<b>3.34%</b>	<b>12.81%</b>	<b>232</b>	<b>197</b>	<b>(35)</b>
VENEZUELA	B2	BB-	6.56%	1.48%	8.73%	233	225	(8)
MALAYSIA	A3	A-	3.24%	1.12%	3.33%	89	79	(10)
COLOMBIA	Ba2	BB	2.98%	1.91%	7.75%	202	197	(5)
PERU	Ba3	BB	2.82%	1.99%	12.03%	169	150	(19)
LEBANON	B3	B-	2.56%	1.72%	3.87%	366	350	(16)
CHINA	A2	A	2.45%	0.92%	3.43%	67	59	(8)
PANAMA	Ba1	BB	2.25%	1.46%	9.11%	187	181	(6)
ARGENTINA	B3	B+	2.10%	8.15%	37.53%	342	294	(48)
INDONESIA	B1	BB-	2.06%	1.50%	11.33%	205	197	(8)
URUGUAY	B3	B+	1.98%	3.26%	11.30%	254	229	(25)
<b>EMBI GLOBAL</b>	<b>Ba1</b>	<b>BB+</b>	<b>100.00%</b>	<b>5.09%</b>	<b>7.78%</b>	<b>208</b>	<b>194</b>	<b>(14)</b>

# JP Morgan Asia Credit Index

JPMORGAN ASIA CREDIT INDEX COMPOSITION								
As of October 31, 2006								
COUNTRY	RATING		INDEX WEIGHT	M-O-M RETURN	Y-T-D RETURN	SPREADS		
	MOODY'S	S&P				SEPT 06	OCT 06	CHANGE
SOUTH KOREA	A3	A	23.61%	0.29%	3.65%	97	9	(88)
HONG KONG	Aa3	AA	18.59%	0.42%	3.69%	121	114	(7)
<b>PHILIPPINES</b>	<b>B1</b>	<b>BB-</b>	<b>15.41%</b>	<b>3.06%</b>	<b>12.51%</b>	<b>216</b>	<b>176</b>	<b>(40)</b>
MALAYSIA	A3	A-	11.14%	0.54%	3.35%	90	82	(8)
SINGAPORE	Aaa	AAA	10.97%	0.35%	3.43%	91	85	(6)
CHINA	A2	A	7.38%	0.51%	3.38%	105	96	(9)
INDONESIA	B1	BB-	6.14%	1.21%	9.64%	237	220	(17)
INDIA	Baa2	BB+	2.55%	0.65%	5.12%	152	144	(8)
THAILAND	Baa1	BBB+	1.56%	0.73%	4.00%	165	157	(8)
PAKISTAN	B2	B+	0.93%	2.85%	6.44%	263	215	(48)
TAIWAN	Aa3	AA-	0.90%	0.58%	3.81%	161	153	(8)
VIETNAM	Ba3	BB	0.56%	1.11%	4.61%	165	148	(17)
MACAU	Aa1	NR	0.27%	1.43%	11.10%	350	308	(42)
<b>JACI</b>	<b>Baa1</b>	<b>BBB+</b>	<b>100.00%</b>	<b>0.90%</b>	<b>5.29%</b>	<b>130</b>	<b>118</b>	<b>(12)</b>

# ROP Bonds Yield Curve

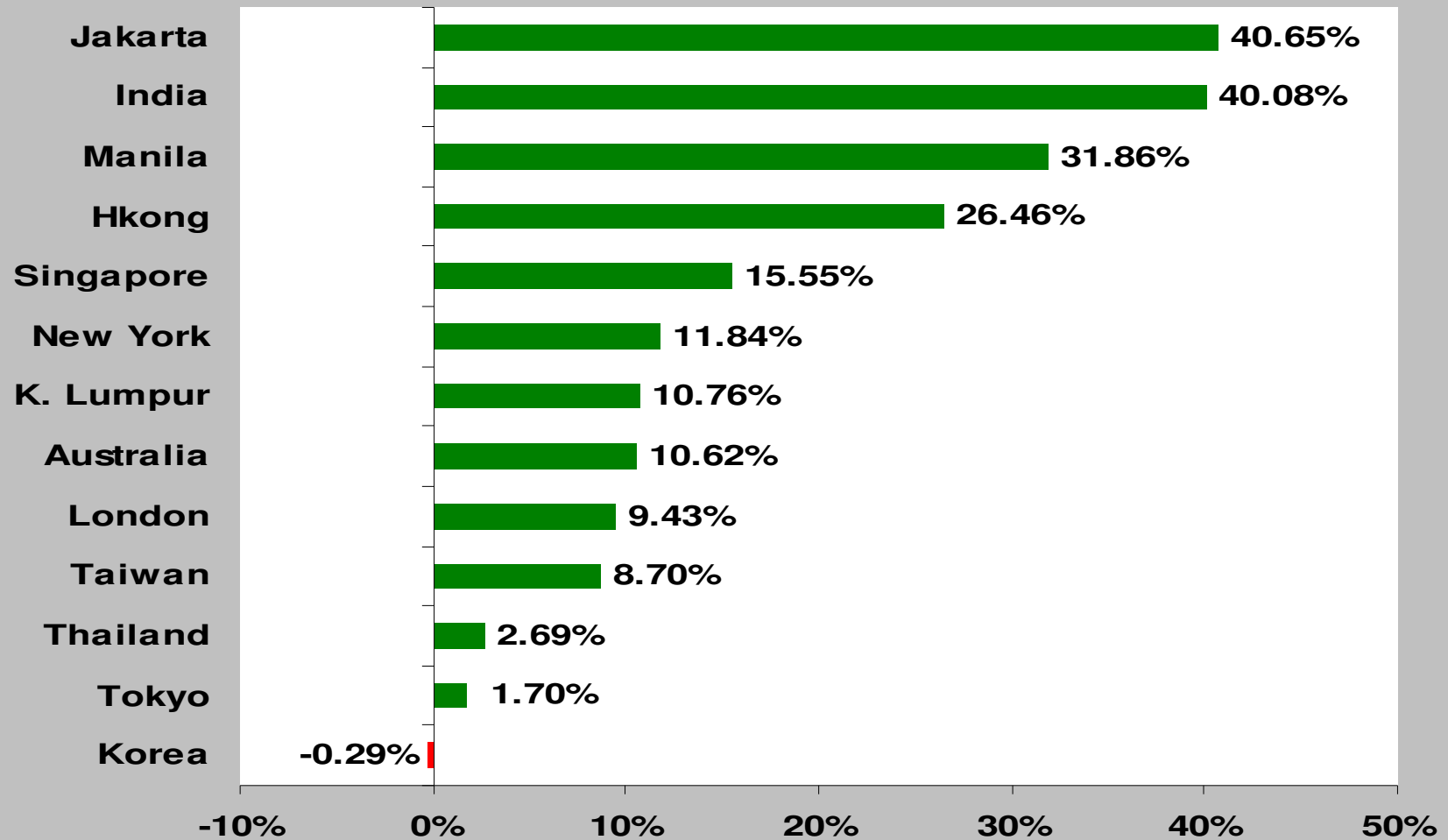


# PSEi expected to hit the 2,900 level

- Sustained improvement in fiscal condition to boost local equities, robust corporate earnings and low interest rate environment to underpin the local stock market
- Banking and property sectors to lead the market



# The PSEi is ranked 3<sup>rd</sup> (as of Nov. 6, 2006)



# Regulatory Outlook

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- a Senate Technical Working Group is drafting legislation to amend the Investment Company Act of 1960
- The draft bill in progress is referred to as the “**Collective Investment Schemes Law**”
- The proposed **CIS Law** seeks to cover both the **corporate** and **contractual** investment fund structures under a single regulator

# Major Challenges

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- Continuing **investor education** especially on the marked-to-market concept of fixed-income assets valuation
- Completion and passage of the “**CIS Law**” by both houses of Congress
- adoption of best **global practice** - - one regulation, one regulator, for the investment funds industry.



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**THANK YOU**