

MARKET INSIGHT ALERT

Enter the Bull Market

From a recovery phase, we expect the Philippine market to enter the bull market phase in 2011 wherein valuations increase given strong evidence of growth. Economic growth is already gaining traction as evidenced by the 7.8% rise in 1H10 GDP, and should remain strong, driven by favorable economic conditions and improving investor confidence brought about by the new administration. Ample liquidity, strong upside risk for corporate earnings, and the PSEI's attractive valuation should also fuel the market's ascent. We expect the PSEI to end 2011 at 5,300, up 33% from its current level. Our best ideas are the following:

Top Picks

Banks: Play on higher investment and consumer spending

*Higher investment and consumer spending to fuel loan growth
End of balance sheet clean up efforts to also enhance profitability*

Stock	FV	Rating Price	Key Investment Highlights
MBT	77.50	96.00	Rating story 2011 ROAE to exceed 07 peak of 10.2%
SECB	78.00	110.00	Best asset quality (2.9% NPL, 209% NPL cover) Best profitability (20% ROE)

MARKET INSIGHT ALERT

Top Picks

Properties: Play on higher consumer spending

Demand driven by demographics, increasing wealth and availability of affordable payment terms

Stock	FV	Rating Price	Key Investment Highlights
MEG	2.54	6.06	Huge landbank in highly favorable locations Has the largest portfolio and landbank of office leasing properties located in Fort Bonifacio
RLC	19.22	34.63	Has enough landbank to supply 4-5 years worth of sales for high rise buildings Major beneficiary of REIT law (owns 60% of NAV)
FLI	1.58	3.81	Rating due to entry into mid rise building (MRB) business in Manila Has enough landbank to supply 3 years worth of sales for MRB Still trading below 11E BVPS of Php1.80/sh
ALI	19.75	27.38	Huge landbank, most aggressive in residential project launches Beneficiary of REIT law (owns 24% of NAV)

Top Picks

Other Growth Plays

Stock	FV	Rating Price	Key Investment Highlights
MER	258	268.42	PBR rate hikes and power generation business to drive earnings growth
MPI	4.48	4.91	Play on higher investment spending No more dilution risk Upside surprise from MER's entry into power generation business
DMC	26.10	30.50	Play on higher investment spending Business model now focused on higher value added services Upside surprise from expansion of power generation business

MARKET INSIGHT ALERT

Top Picks

Other Growth Plays

Stock	FV	Rating Price	Key Investment Highlights
ICT	41.00	67.83	Play on strong growth of developing and emerging economies Upside surprise from new ports
MWC	24.00	33.67	Example of how the government and the private sector can work together to improve infrastructure Earnings growth to accelerate in 2011 due to implementation of rate hike

Top Picks

Rotation to Value

Stock	FV	Rating Price	Key Investment Highlights
EEL	4.76	11.98	Play on global economic recovery Trading at only 6.8X 2011E P/E
EDC	7.54	7.63	No more liquidity problems
FGEN	19.00	20.29	Drop in 2011 earnings only temporary
FPH	91	101.78	Attractive valuation 2013 P/E: EDC 8.5X, FGEN 7.6X, FPH 10.3X

MARKET INSIGHT ALERT

Economy is well positioned for growth

Consumer spending and investments have ample room to grow. Consumer wealth has steadily improved as implied by the 3.7% CAGR of real GNP per capital during the past 11 years, driven by the strong growth in OFW remittances and the business process outsourcing (BPO) industry. Numerous investment opportunities are also available given that investment to GDP has been falling since the Asian crisis, dropping to only 14% in 2009, significantly lower than the 24% average of emerging Asian economies ex-China and India. Banks are also well positioned to fund growth in consumer spending and investments given their very healthy balance sheets, with the NPL ratio of 3.3% as of end June 2010, more than adequate NPL cover of 93%, and high level of capital adequacy ratio at 16.0% as of end 2009. Banks are also very liquid with loans to deposit ratio at 65% as of 2009.

The new administration - catalyst for growth

The new administration is expected to be the catalyst that will fuel economic growth as improvements in governance and implementation of economic reforms boost investor confidence, leading to higher investments. During his first few months in office, President Aquino appointed highly qualified and ethical leaders. The new administration also took initiatives to enhance tax collection efficiency and to attract investments from the private sector through public-private partnerships.

Stocks are still under-owned

Despite the significant run up in share prices, stocks remain under-owned. The portion of trust industry assets placed in investments such as stocks and bonds has shrunk to 39% from 65%. In fact, the size of the trust industry's investment portfolio has fallen by 3% in absolute terms as sentiment remained

MARKET INSIGHT ALERT

bearish, fueling continuous withdrawals of retain clients. Foreign investors, which in the past accounted for around 70% of daily volume, currently account for only 40% of daily volume. Moreover, foreign investors only started to enter the market on a consistent basis in November of 2009, with very thin volumes of only Php2.0 Billion monthly. In contrast, average monthly net foreign buying from January of 2006 to July of 2007 was Php7.1 Billion.

Valuations – cheap relative to earnings, interest rates

At 3,972.6, the PSEi is trading above its 07 high of 3,873.5. Nevertheless, valuation is not expensive. 2011 earnings of index constituents are projected to exceed their 07 earnings by an average of 37.7%. Moreover, the PSEi is only trading at a 2011E P/E of 13.4X, lower than its 17-year average P/E of 15.8X. This is despite the significant drop in interest rates recently. In fact, the gap between earnings yield and the 10-year T-bond has recently turned positive, strengthening the case for investments in stocks.

Enter the bull: PSEi 5,300

We expect the PSEi to end 2011 at 5,300, 33% higher than its current level. Our target is based on the assumption that 1.) the PSEi's 2011 EPS will already be 37.7% higher than its 07 EPS; and 2.) A rerating will take place, warranting a higher valuation multiple of 18.0X, similar to 07 levels. We think a multiple of 18X is reasonable given that the PSEi traded as high as 28X P/E during the pre-Asian crisis period. Interest rates are also much lower today, with the yield on the 10-year T-bond at 6.1% vs. mid teens during 1996. We also believe that our 8.2% 2011 EPS growth forecast has upside risk mainly driven by property and banking issues. During the second quarter, property companies reported significant increases in take up sales, while banks reported a pick up in loan demand. This could lead to significantly stronger earnings growth in 2011.