PHILEQUITY PSE INDEX FUND, INC.
(An Open-End Mutual Fund Company)

Financial Statements
December 31, 2005 and 2004 and
Years Ended December 31, 2005, 2004 and 2003

and

Report of Independent Auditors

COVER SHEET

A 1 9 9 8 - 1 6 2 2 1

SEC Registration Number

PHILEQUITY PSE INDEX FUND, INC. (An Open-End Mutual Fund Company)

(Company's Full Name)

2103-B, East Tower, Philippine Stock Exchange Centre, Exchange Road, Ortigas Center, Pasig City

(Business Address: No. Street City/Town/Province)

Ms. Violeta O. Luym	635-6963
(Contact Person)	(Company Telephone Number)

1 2	3 1	A A F S	0 6	
Month	*Day*	(Form Type)	*Month*	*Day*
(Fiscal Year)			(Annual Meeting)	

NA

(Secondary License Type, If Applicable)

Dept. Requiring this Doc.

Amended Articles Number/Section

Total Amount of Borrowings

	₱	₱
Total No. of Stockholders	Domestic	Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document ID

Cashier

S T A M P S

Remarks: Please use BLACK ink for scanning purposes.

SGV & Co

SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City
Philippines

Phone: (632) 891-0307
Fax: (632) 819-0872
www.sgv.com.ph

BOA/PRC Reg. No. 0001
SEC Accreditation No. 0012-F

Report of Independent Auditors

The Stockholders and the Board of Directors
Philequity PSE Index Fund, Inc.
2103-B, East Tower
Philippine Stock Exchange Centre
Exchange Road, Ortigas Center
Pasig City

We have audited the accompanying statements of assets and liabilities of Philequity PSE Index Fund, Inc. (an open-end mutual fund company) as of December 31, 2005 and 2004, and the related statements of operations, changes in net assets attributable to unitholders and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Philippines. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Philequity PSE Index Fund, Inc. as of December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the Philippines.

SYCIP GORRES VELAYO & CO.

Juanito A. Fullecido
Partner
CPA Certificate No. 25543
SEC Accreditation No. 0080-A
Tax Identification No. 102-086-897
PTR No. 4180839, January 2, 2006, Makati City

April 25, 2006

Report of Independent Auditors

The Stockholders and the Board of Directors
Philequity PSE Index Fund, Inc.

We have audited the accompanying statements of assets and liabilities of Philequity PSE Index Fund, Inc. (an open-end mutual fund company) as of December 31, 2005 and 2004, and the related statements of operations, changes in net assets attributable to unitholders and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Philippines. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Philequity PSE Index Fund, Inc. as of December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the Philippines.

SYCIP GORRES VELAYO & CO.

Juanito A. Fullecido
Partner
CPA Certificate No. 25543
SEC Accreditation No. 0080-A
Tax Identification No. 102-086-897
PTR No. 4180839, January 2, 2006, Makati City

April 25, 2006

PHILEQUITY PSE INDEX FUND, INC.
(An Open-End Mutual Fund Company)

STATEMENTS OF ASSETS AND LIABILITIES

	December 31	
	2005	2004
ASSETS		
Financial Assets at Fair Value through Profit or Loss (FVPL) (Notes 2, 3, 8 and 9)	**₱27,938,713**	₱–
Investments in Listed Securities (Notes 2 and 3)	–	23,785,347
Cash and Cash Equivalents (Notes 4, 8 and 9)	**2,908,719**	2,553,503
Receivables (Notes 8 and 9)	**86,465**	129,706
	30,933,897	26,468,556
LIABILITIES		
Accrued Expenses (Note 8)	**40,228**	40,665
NET ASSETS ATTRIBUTABLE TO UNITHOLDERS (Note 5)	**₱30,893,669**	₱26,427,891
Net Asset Value Per Share (Note 5)	**₱1.236**	₱1.057

See accompanying Notes to Financial Statements.

PHILEQUITY PSE INDEX FUND, INC.
(An Open-End Mutual Fund Company)

STATEMENTS OF OPERATIONS

	Years Ended December 31		
	2005	2004	2003
INVESTMENT INCOME			
Gain on market valuation of fair value through profit or loss (FVPL) financial assets (Notes 2 and 3)	**₱3,293,487**	₱–	₱–
Dividends	**727,868**	561,701	311,299
Net realized gain on sale of:			
Financial assets at FVPL	**419,566**	–	–
Investments in listed securities (Note 3)	**–**	67,065	–
Interest	**183,769**	155,614	206,899
	4,624,690	784,380	518,198
EXPENSES			
Professional fees	**104,500**	59,000	40,000
Taxes and licenses	**27,652**	12,653	77,903
Printing and reproduction	**20,828**	27,250	–
Advertising and promotions	**5,148**	24,750	–
Others	**784**	10,062	8,546
	158,912	133,715	126,449
INCREASE IN NET ASSET ATTRIBUTABLE TO UNITHOLDERS FROM OPERATIONS (Note 5)	**₱4,465,778**	₱650,665	₱391,749

See accompanying Notes to Financial Statements.

PHILEQUITY PSE INDEX FUND, INC.
(An Open-End Mutual Fund Company)

STATEMENTS OF CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS

	Years Ended December 31		
	2005	2004	2003
NET ASSETS ATTRIBUTABLE TO UNITHOLDERS AT BEGINNING OF YEAR	**₱26,427,891**	₱21,083,217	₱15,673,792
INCREASE IN NET ASSET ATTRIBUTABLE TO UNITHOLDERS FROM OPERATIONS (Note 5)	**4,465,778**	650,665	391,749
NET CHANGE IN UNREALIZED APPRECIATION OF INVESTMENTS IN LISTED SECURITIES (Note 5)	–	4,694,009	5,017,676
NET ASSETS ATTRIBUTABLE TO UNITHOLDERS AT END OF YEAR (Note 5)	**₱30,893,669**	₱26,427,891	₱21,083,217

See accompanying Notes to Financial Statements.

PHILEQUITY PSE INDEX FUND, INC.
(An Open-End Mutual Fund Company)

STATEMENTS OF CASH FLOWS

	Years Ended December 31		
	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES			
Increase in net assets attributable to unitholders	**₱4,465,778**	₱650,665	₱391,749
Adjustments for:			
Gain on market valuation of FVPL securities	**(3,293,487)**	–	–
Net realized gain on sale of:			
FVPL securities	**(419,566)**	–	–
Investments in listed securities	**–**	(67,065)	–
Operating income before working capital changes	**752,725**	583,600	391,749
Decrease (increase) in:			
Financial assets at FVPL	**(4,122,583)**	–	–
Investments in listed securities	**–**	(680,937)	(1,736,505)
Receivables	**43,241**	23,317	(71,287)
Proceeds from sale of:			
Financial assets at FVPL	**3,682,270**	–	–
Investments in listed securities	**–**	666,724	–
Increase (decrease) in accrued expenses	**(437)**	665	(40,000)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**355,216**	593,369	(1,456,043)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**2,553,503**	1,960,134	3,416,177
CASH AND CASH EQUIVALENTS AT END OF YEAR	**₱2,908,719**	₱2,553,503	₱1,960,134

See accompanying Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

Philequity PSE Index Fund, Inc. (the Fund) is incorporated in the Philippines. It was registered with the Securities and Exchange Commission (SEC) on February 22, 1999 as an open-end mutual fund company, the purpose of which is to, among others, engage in the sale of its capital stock and investing such proceeds in shares of stock that comprise the Philippine Stock Exchange (PSE) Composite Index.

The registered office address of the Fund is 2103-B East Tower, Philippine Stock Exchange Centre, Exchange Road, Ortigas Center, Pasig City.

The accompanying financial statements of the Fund were approved and authorized for issue by the Board of Directors (BOD) on April 25, 2006.

2. Summary of Significant Accounting and Financial Reporting Policies

Basis of Preparation
The financial statements of the Fund have been prepared on a historical cost basis, except for financial assets at fair value through profit or loss (FVPL), which are measured at fair value. The financial statements are presented in Philippine peso, which is the Fund's functional currency under PFRS, and all values are rounded to the nearest peso unless otherwise stated.

Statement of Compliance
The Fund prepares its financial statements following the accounting principles generally accepted in the Philippines (Philippine GAAP). The December 31, 2005 financial statements have been adjusted for the new Philippine Financial Reporting Standards (PFRS) and Philippine Accounting Standards (PAS) that became effective January 1, 2005. This is the Fund's first financial statements prepared in compliance with PFRS.

The Fund prepared its financial statements until December 31, 2004 in compliance with Statements of Financial Accounting Standards/International Accounting Standards (SFAS/IAS).

The Fund applied PFRS 1, "First-time Adoption of Philippine Financial Reporting Standards," in preparing its financial statements, with January 1, 2004 as the date of transition. The Fund applied the accounting policies to all the years presented except those relating to financial instruments. The Fund availed of the exemption under PFRS 1 and applied PAS 32 and PAS 39, the standards on financial instruments, beginning January 1, 2005.

Changes in Accounting Policies
The accounting policies adopted are consistent with those of the previous financial year except that the Fund has adopted the following new standards mandatory for financial year beginning on January 1, 2005:

- PAS 21, "The Effects of Changes in Foreign Exchange Rates," requires the Fund to determine its functional currency and measure its results of operations and financial position in that currency. Translation procedures are specified when the presentation currency used for reporting differs from the Fund's functional currency. Based on the economic substance of the underlying circumstances relevant to the Fund, the functional currency of the Fund has been determined to be the Philippine pesos. The adoption of this standard has resulted in additional disclosures being included for the years ended December 31, 2005 and 2004 but has no recognition or measurement impact.

- PAS 32, "Financial Instruments: Disclosure and Presentation," covers the disclosure and presentation of all financial instruments. The standard requires more comprehensive disclosures about the Fund's financial instruments, whether recognized or unrecognized in the financial statements. New disclosure requirements include terms and conditions of financial instruments used by the Fund, associated with both recognized and unrecognized financial instruments (credit risk, liquidity risk, market risk, fair value interest rate risk, and price risk), fair value information of both recognized and unrecognized financial assets and financial liabilities, and the Fund's financial risk management policies and objectives. The standard also requires financial instruments to be classified as liabilities or equity in accordance with their substance and not their legal form.

  Under PAS 32, open-end mutual funds and unit trusts, which provide their unitholders with a right to redeem their interests in the issuer at any time for cash equal to their proportionate share of the asset value of the issuer are considered as liabilities in substance although they take the legal form of equity. As such, the adoption of PAS 32 resulted in the Fund's statements of assets and liabilities distinguishing between (a) liabilities other than those attributable to the unitholders and (b) net assets attributable to unitholders.

- PAS 39, "Financial Instruments: Recognition and Measurement," establishes the accounting and reporting standards for recognizing and measuring the Fund's financial assets and financial liabilities. The standard requires a financial asset or a financial liability to be recognized initially at fair value. Subsequent to initial recognition, the Fund should continue to measure the financial assets at their fair values, except for loans and receivables and held-to-maturity investments, which are to be measured at cost or amortized cost using the effective interest rate method. Financial liabilities are subsequently measured at cost or amortized cost, except for liabilities classified at "fair value through profit and loss" and derivatives, which are subsequently measured at fair value.

  PAS 39 also covers the accounting for derivative instruments. The definition of a derivative instrument includes derivatives (and derivative-like provisions) embedded in nonderivative contracts. Under the standard, every derivative instrument is recorded in the statements of assets and liabilities as either an asset or liability measured at its fair value.

As permitted by the SEC, in its Resolution No. 331, series of 2005, mutual funds are allowed to (a) increase their authorized capital stock using the accrual valuation for their securities and sell up to September 30, 2005 said additional securities and all unissued/unsold securities and (b) use accrual valuation up to September 30, 2006 at which time such funds shall shift to mark-to-market valuation per PAS 39.

The Fund elected to adopt the provisions of PAS 39 on September 30, 2005. FVPL securities are recorded at fair value. Previously, investments in listed securities are stated at market values based on the current market quotations of the PSE. The change in accounting policy resulted in the restatement of "Unrealized appreciation of investments in listed securities" amounting to ₱1,461,660 as of December 31, 2004, respectively, previously included under changes in net asset, to retained earnings as of September 30, 2005 (see Note 5).

The Fund also adopted the following PAS based on revised IAS that are relevant to the Fund, beginning January 1, 2005:

- PAS 1, "Presentation of Financial Statements," provides a framework within which the Fund assesses how to present fairly the effects of transactions and other events; provides the base criteria for classifying liabilities as current or noncurrent; prohibits the presentation of income from operating activities and extraordinary items as separate line items in statements of operations. It also requires disclosure of key sources of estimation, uncertainty and judgments management has made in the process of applying the Fund's accounting policies.

- PAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors," removes the concept of fundamental errors and the allowed alternative to retrospective application of voluntary changes in accounting policies and retrospective restatement to correct prior period errors. It defines the material omission or misstatements, and describes how to apply the concept of materiality when applying accounting policies and correcting errors.

- PAS 10, "Events After the Balance Sheet Date," provides a limited clarification of the accounting for dividends declared after the balance sheet date.

- PAS 24, "Related Party Disclosures," provides additional guidance and clarity in the scope of the standard, the definitions and disclosures for related parties. It also requires disclosure of the total compensation of key management personnel by benefit type.

Adoption of the foregoing standards did not have any material effect on the financial statements. The required additional disclosures by these new standards were included in the financial statements and comparative figures have been amended as required.

Standards Not Yet Effective
The Fund did not adopt early PFRS 7, "Financial Instruments - Disclosures." The revised disclosures on financial instruments provided by this standard will be included in the financial statements when the standard is adopted in 2007.

Use of Estimates and Judgments
The Fund makes estimates and judgments that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Fund carries its FVPL financial assets at fair value, which requires the use of accounting estimates and judgments.

Fair Value of Financial Assets. Fair value determinations for the FVPL financial assets are based generally on quoted prices.

While significant components of fair value measurement were determined using verifiable objective evidence, the amount of changes in the fair value of these financial assets would affect net assets.

Impairment of Financial Assets. In determining the fair values, management evaluates the financial health of the issuer and the industry and sector performance like changes in operational and financial cash flows. Any indication of deterioration in the above factors can have a negative impact on the fair value. The carrying value of the Company's FVPL financial assets amounted to ₱27.9 million as of December 31, 2005.

Cash and Cash Equivalents
Cash includes cash in a bank. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less and that are subject to an insignificant risk of change in value.

Financial Assets

Accounting Policies Adopted Starting September 30, 2005
The Fund classifies its financial assets in the following categories: loans and receivables, fair value through profit and loss and held to maturity financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

Financial instruments are recognized initially at cost, which is the fair value of the consideration given (in the case of an asset) or received (in the case of a liability). The fair values of the consideration given or received are determined by reference to the transaction price or other market prices. If such market prices are not reliably determinable, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted using the prevailing market rates of interest for similar instruments with similar maturities. Investments are initially recognized at fair value plus transactions costs that are directly attributable to their acquisition, in the case of all financial assets not carried at fair value through profit or loss.

Financial instruments are recognized in the statements of assets and liabilities when the Fund becomes a party to the contractual provisions of the instrument. Financial assets are derecognized either when the Fund has transferred substantially all the risks and rewards of ownership or when the Fund has neither transferred nor retained substantially all the risks and rewards of ownership and no longer has control over the financial assets.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Financial instruments are offset when there is a legally enforceable right to offset and intention to settle either on a net basis or to realize the asset and settle the liability simultaneously.

The subsequent measurement bases for financial assets depend on classification.

Held-to-Maturity Investments. Held-to-maturity financial assets comprises fixed or determinable income securities that the Fund has the ability and intent to hold until maturity. Premiums and discounts are amortized over the life of the instrument using the effective interest rate method. The amortization of premiums and discounts is taken to the statements of operations.

Loans and Receivables. Loan and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Fund intends to sell in the short term or that it has designated as at fair value through income or available-for-sale. Loans and receivables financial assets are carried at amortized cost using the effective interest method.

FVPL. Financial assets at FVPL consists of equity securities purchased and held principally with the intention of selling them in the near term or are designated as FVPL at initial recognition. These securities are carried at fair market value, based primarily on quoted market prices. Realized and unrealized gains and losses on these instruments are recognized in the statements of operations. Interest earned on debt instruments is reported as interest income.

Impairment of Financial Assets
The carrying value of all financial assets is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The identification of impairment and the determination of recoverable amount is a process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, observable market prices and expected net selling prices.

In order to determine whether negative revaluations on investment securities correctly represent impairment, all investment securities for which the market value has been significantly below cost price for a considerable period of time, are individually reviewed. A distinction is made between negative revaluations due to general market fluctuations and due to issuer specific developments. The impairment review focuses on issuer specific developments regarding financial condition and future prospects, taking into account the intent and ability to hold the securities under the Fund's long-term investment strategy.

Assets Carried at Amortized Cost. For loans and receivables, carried at amortized cost, the amount of the loss is measured as the difference between the financial asset's carrying amount and the present value of the estimated future cash flows discounted at the financial assets' original effective interest rate. If a variable interest rate was used, the discounted rate for measuring the impairment loss is the current effective interest rate. Impairment loss is recorded in the statements of operations.

The Fund assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the statements of operations, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

Assets Carried at Cost. If there is an objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Derecognition of Financial Assets and Liabilities
A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired;

- the Fund retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or

- the Fund has transferred its right to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Fund has transferred its right to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Fund's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Fund could be required to repay.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or has expired.

When an existing financial liability is replaced by another form from the same lender on substantially different terms, or the terms of the existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the Fund's statements of operations.

Accounting Policies Prior to September 30, 2005

Investments are initially recorded at cost at the time of acquisition, which is generally measured by the purchase price of the security, or the fair value of the asset given up or the security received in the exchange and other costs directly related to the acquisition. Subsequent to acquisition, the carrying values of the investments in listed securities are stated at market values based on the current market quotations of the PSE. The difference between the aggregate market value of investments in listed securities at report date and the carrying value is shown as "Unrealized appreciation or depreciation of investments in listed securities." The difference between the selling price and the cost of listed securities sold, which is computed based on the moving average cost of all the shares of each security held at the time of sale, is shown as "Net realized gain (loss) from sale of investments in listed securities" in the statements of operations.

Revenue

Revenue is recognized when it is probable that the economic benefit associated with the transaction will flow to the Fund and the amount of revenue can be measured reliably. Revenues are recognized on the following bases:

a. Dividend, when the Fund's right to receive the payment is established;

b. Interest, on a time proportion basis taking into account the effective yield on the asset; and,

c. Gain on sale of FVPL financial assets, determined at the time of sale transaction calculated as the difference between the net sales proceeds and the net book value.

Net Asset Value (NAV) Per Share

NAV per share is computed by dividing net assets (total assets less total liabilities) by the number of shares issued and outstanding.

Transactions with Unitholders

Sales of fund shares are recorded by crediting capital stock at par value and additional paid-in capital (APIC) for the amount received in excess of the par value; redemptions are recorded by debiting those accounts. In the event that the APIC balance is exhausted as a result of redemptions, the retained earnings account is reduced by redemptions in excess of par.

Provisions

Provisions are recognized when the Fund has a present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

Income Tax

Current Tax. Current tax assets and liabilities for the current and prior periods are measured at the amounts expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the balance sheet date.

Deferred Tax. Deferred income tax is provided using the liability method on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for all deductible temporary differences and carryforward benefit of net operating loss carryover (NOLCO), to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences and carryforward benefit of NOLCO can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Related Parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. These include: (a) individuals owning, directly or indirectly through one or more intermediaries, control, or are controlled by, or under common control with, the Fund; (b) associates; and, (c) individuals owning, directly or indirectly, an interest in the voting power of the Fund that gives them significant influence over the Fund and close members of the family of any such individual.

Contingencies

Contingent liabilities are not recognized in the financial statements. These are disclosed unless the probability of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the financial statements but disclosed when an inflow of economic benefits is probable.

Events After the Balance Sheet Date

Post balance sheet events that provide additional information about the Fund’s financial position at the balance sheet date (adjusting events) are reflected in the financial statements. Post balance sheet events that are not adjusting events are disclosed in the notes to financial statements when material.

3. Financial Assets at Fair Value Though Profit or Loss/Investments in Listed Securities

This account consists of investments in the following:

	2005			2004		
	Number of Shares	**Cost**	**Market Value**	Number of Shares	Cost	Market Value
Philippine Long Distance Telephone Company	**2,930**	**₱2,666,901**	**₱5,376,550**	3,140	₱2,833,856	₱4,270,400
San Miguel Corporation "A"	**32,559**	**1,636,970**	**2,116,335**	36,290	1,807,938	2,141,110
Bank of the Philippine Islands	**38,664**	**1,727,403**	**2,107,188**	44,064	1,968,662	2,313,360
SM Investment Corporation	**8,500**	**2,039,065**	**2,040,000**	–	–	–
San Miguel Corporation "B"	**20,847**	**1,178,506**	**1,844,960**	20,770	1,135,892	1,557,750
Ayala Land, Inc.	**183,800**	**1,487,462**	**1,819,620**	196,800	1,594,856	1,436,640
Ayala Corporation	**5,590**	**2,099,488**	**1,760,850**	317,520	2,387,184	2,095,632
Globe Telecom, Inc.	**2,255**	**1,510,599**	**1,657,425**	2,875	1,925,930	2,745,625
SM Prime Holdings, Inc.	**170,000**	**1,179,877**	**1,343,000**	184,000	1,273,697	1,416,800
Metropolitan Bank & Trust Company	**27,900**	**1,317,723**	**892,800**	30,600	1,445,244	810,900
Equitable PCI Bank, Inc.	**12,400**	**372,335**	**731,600**	13,700	411,370	657,600
Petron Corporation	**160,000**	**317,645**	**720,000**	165,000	317,286	536,250
Jollibee Foods Corporation	**16,900**	**259,675**	**684,450**	17,900	275,040	510,150
Pilipino Telephone Corporation	**197,000**	**582,884**	**679,650**	–	–	–
Holcim Philippines, Incorporated	**130,000**	**103,811**	**572,000**	–	–	–
Banco De Oro	**15,000**	**478,925**	**510,000**	–	–	–
First Philippine Holdings Corporation	**9,580**	**220,203**	**469,420**	9,480	210,524	284,400
Aboitiz Equity Ventures, Inc.	**85,000**	**189,874**	**408,000**	96,000	214,446	307,200
International Container Terminal Services, Inc.	**40,000**	**138,840**	**372,000**	40,000	128,956	236,000
Megaworld Corporation	**201,000**	**162,108**	**241,200**	142,500	131,439	176,700
Manila Water Corporation	**32,000**	**211,830**	**198,400**	–	–	–
Filinvest Land, Inc.	**138,750**	**296,310**	**191,475**	138,750	296,310	155,400
ABS-CBN Broadcasting Corporation	**14,400**	**468,629**	**183,600**	14,400	468,628	266,400
Manila Electric Company "B"	**7,120**	**698,455**	**154,860**	7,120	698,455	176,220
Manila Electric Company "A"	**10,600**	**825,781**	**151,050**	10,600	825,781	164,300
DMCI Holdings, Inc.	**42,000**	**136,752**	**132,300**	8,000	8,888	30,400
Metro Pacific Corporation	**330,000**	**225,033**	**112,200**	330,000	225,033	105,600
Digital Telecommunications Phils., Inc.	**110,000**	**79,148**	**102,300**	110,000	79,148	191,400
Lepanto Consolidated Mining Company "B"	**390,000**	**109,157**	**97,500**	325,000	96,157	146,250
Belle Corporation	**84,000**	**157,394**	**85,680**	84,000	157,394	49,560
Benpres Holdings Corporation	**70,000**	**58,791**	**75,600**	70,000	58,791	47,600
Philex Mining Corporation "A"	**30,000**	**31,972**	**39,000**	–	–	–
Philex Mining Corporation "B"	**20,000**	**25,371**	**35,200**	–	–	–
Philippine National Bank	**700**	**47,303**	**22,050**	6,700	452,760	150,750
Ionics, Inc.	**9,500**	**141,346**	**10,450**	9,500	141,349	14,060
JG Summit Holdings, Inc.	–	–	–	133,200	470,230	359,640
Union Cement Corporation	–	–	–	130,000	103,811	257,400
Ginebra San Miguel, Inc.	–	–	–	5,700	178,632	173,850
		₱23,183,566	**₱27,938,713**		₱22,323,687	₱23,785,347

In 2004, investments in listed securities are stated at market values based on current market quotations of the PSE with changes in market values included under "Net change in unrealized appreciation (depreciation) of investments in listed securities" under statement of changes in net assets.

In 2005, upon adoption of PAS 39, investments in listed securities were designated as "Financial assets at FVPL" and changes in market values are included as "Gain on market valuation of FVPL securities" in the statements of operations.

As of April 25, 2006, the market value of financial assets at FVPL held as of December 31, 2005 amounted to ₱29.1 million.

Details of sale of investments in listed securities are as follows:

	2005	2004	2003
Proceeds from sale of:			
Financial assets at FVPL	**₱3,682,270**	₱–	₱–
Investments in listed securities	–	666,724	–
Less cost of investments sold	**3,262,704**	599,659	–
	₱419,566	₱67,065	₱–
Net realized gain on sale of:			
Financial assets at FVPL	**₱419,566**	₱–	₱–
Investments in listed securities	–	67,065	–
	₱419,566	₱67,065	₱–

4. Cash and Cash Equivalents

This account consists of:

	2005	2004
Cash in bank	**₱300,995**	₱216,212
Short-term deposits	**2,607,724**	2,337,291
	₱2,908,719	₱2,553,503

Cash in a bank earns interest at the prevailing bank deposit rates. Short-term deposits are made for varying periods of up to three months depending on the immediate cash requirements of the Fund, and earn interest at the prevailing short-term deposit rates.

5. Net Assets Attributable to Unitholders

As discussed in Note 2, under PAS 32, the units issued to shareholders are liabilities in substance. Accordingly, the accounting treatment and presentation of the units issued to shareholders are in accordance with PAS 32 for purposes of Philippine GAAP financial statements. However, under Republic Act No. 2629, Rules and Regulations Governing Investment Companies, investment companies including mutual funds shall be organized in the form of a stock corporation. Therefore, units issued to shareholders are legally considered as equity instruments.

This account consists of:

	2005	2004	2003
Capital stock - ₱1 par value			
Authorized - 100,000,000 shares			
Issued - 25,000,000 shares	**₱25,000,000**	₱25,000,000	₱25,000,000
Retained earnings (deficit):			
Balance at beginning of year	**(33,769)**	(684,434)	(1,076,183)
Effect of adoption of PAS 39 (see Note 2)	**1,461,660**	–	–
Net income	**4,465,778**	650,665	391,749
Balance at end of year	**5,893,669**	(33,769)	(684,434)
Unrealized appreciation (depreciation) of investments in listed securities:			
Balance at beginning of year	**1,461,660**	(3,232,349)	(8,250,025)
Effect of adoption of PAS 39 (see Note 2)	**(1,461,660)**	–	–
Net change in unrealized appreciation of investments in listed securities	**–**	4,694,009	5,017,676
Balance at end of year	**–**	1,461,660	(3,232,349)
	₱30,893,669	₱26,427,891	₱21,083,217
NAV per share	**₱1.236**	₱1.057	₱0.843

NAV per share is computed as follows:

	2005	2004	2003
Net assets	**₱30,893,669**	₱26,427,891	₱21,083,217
Number of shares outstanding	**25,000,000**	25,000,000	25,000,000
NAV per share	**₱1.236**	₱1.057	₱0.843

6. **Income Tax**

The details of deductible temporary difference and carryforward benefit of NOLCO, for which no deferred tax assets are recognized in the statements of assets and liabilities as management believes that future taxable profits will not be sufficient against which they can be utilized, are as follows:

	2005	2004
NOLCO	**₱699,343**	₱735,304
Unamortized organization costs	**–**	39,850
	₱699,343	₱775,154

As of December 31, 2005, the NOLCO that can be claimed as deduction from normal taxable income follows:

Year Incurred	Expiry Year	Amount
2003	2006	₱246,657
2004	2007	253,924
2005	2008	198,762
		₱699,343

NOLCO amounting to ₱234,723 incurred in 2002 expired in 2005.

A reconciliation between the Fund's provision for income tax computed at the statutory income tax rate to provision for income tax shown in the statements of operations is summarized as follows:

	2005	2004	2003
Income tax at statutory tax rate of 32.5% in 2005 and 32% in 2004 and 2003	**₱1,451,378**	₱208,213	₱125,360
Tax effects of:			
Net realized loss (gain) on sale of:			
Gain on market valuation of fair value through profit and loss securities	**(1,070,383)**	–	–
Financial assets at FVPL	**(136,359)**	–	–
Investments in listed securities	**–**	(21,461)	–
Dividend income exempt from tax	**(236,557)**	(179,744)	(99,615)
Expired NOLCO	**75,111**	76,682	25,630
Interest income subjected to final tax	**(59,725)**	(49,797)	(66,208)
Effect of change in tax rate	**(20,186)**	–	–
Change in unrecognized deferred tax assets	**(3,279)**	(33,893)	14,833
	₱–	₱–	₱–

7. **Management and Distribution Agreement (Agreement)**

The Fund has an existing Agreement with Philippine Management, Inc. (PMI). Pursuant to the terms of the Agreement, the Fund shall pay the following for services rendered by PMI:

a. Annual management fee of a maximum of 1.5% of the monthly average net asset value of the Fund's assets. The net asset value shall be determined in accordance with the procedures agreed upon by both parties.

b. Sales commission of a maximum of 3.5% of the cost of investment for every sale of the Fund's shares of stock.

As of December 31, 2005, the Agreement has not been made effective by the Fund and PMI.

8. **Financial Risk Management Objectives and Policies**

Governance Framework
The Fund has established a risk management function with clear terms of reference and with the responsibility for developing policies on market, credit, liquidity and operational risk. It also supports the effective implementation of policies.

The policies define the Fund's identification of risk and its interpretation, limit structure to ensure the appropriate quality and diversification of assets to the corporate goals and specify reporting requirements.

Regulatory Framework
The operations of the Fund are also subject to the regulatory requirements of the SEC. Such regulations not only prescribe approval and monitoring of activities but also impose certain restrictive provisions (e.g. investment portfolios, capital requirements, etc.).

Financial Risk
The Fund is exposed to financial risk through its financial assets and financial liabilities. The most important components of this financial risk are credit risk, liquidity risk and market risk. The BOD reviews and approves policies for managing these risks and they are summarized below:

Credit Risk. Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

In respect of investment securities, the Fund secures satisfactory credit quality by setting maximum limits of portfolio securities with a single or group of issuers. The Fund also transacts only with institutions with high credit worthiness.

The Fund sets the maximum amounts and limits that may be advanced to or placed with individual corporate counterparties which are set by reference to their long term ratings.

The Fund credit risk exposure as of December 31, 2005 represents the carrying value of cash and cash equivalents and FVPL financial assets.

The Fund did not have any significant concentration of credit risk with a single counterparty or group of counterparties, geographical and industry segments as of December 31, 2005.

Liquidity Risk. Liquidity or funding risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values, counterparty failing on repayment of a contractual obligation, or inability to generate cash inflows as anticipated.

The Fund is exposed to daily cash redemptions of redeemable participating shares. It therefore invests the majority of its assets in investments that are traded in an active market and can be readily disposed of and only a limited proportion of its assets in investments not actively traded on a stock exchange.

The Fund manages liquidity through a liquidity risk policy which determines what constitutes liquidity risk for the Fund; specifies minimum proportion of funds to meet emergency calls; setting up of contingency funding plans; specify the sources of funding and the events that would trigger the plan; concentration of funding sources; reporting of liquidity risk exposures and breaches to the monitoring authority; monitoring compliance with liquidity risk policy and review of liquidity risk policy for pertinence and changing environment.

The table below analyzes financial assets and liabilities of the Fund into their relevant maturity groups based on the remaining period at the balance sheet date to their contractual maturities or expected repayment dates as of December 31, 2005:

	Up to a year	2-5 years	Over 5 years	Total
FVPL financial assets	₱27,938,713	₱–	₱–	₱27,938,713
Cash and cash equivalents	2,908,719	–	–	2,908,719
Receivables	86,465	–	–	86,465
Total financial assets	₱30,933,897	₱–	₱–	₱30,933,897
Accrued expenses	₱40,228	₱–	₱–	₱40,228
Total financial liabilities excluding net assets attributable to unitholders	₱40,228	₱–	₱–	₱40,228

Market Risk. Market risk is the risk of change in fair value of financial instruments from fluctuation in foreign exchange rates (currency risk), market interest rates (interest rate risk) and market prices (price risk), whether such change in price is caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market.

The Fund structures levels of market risk it accepts through a market risk policy that determines what constitutes market risk for the Fund; basis used to fair value financial assets and liabilities; asset allocation and duration limit based on the Fund's chosen benchmark; diversification benchmarks by type of instrument and geographical area; sets out the net exposure limits by each counterparty or group of counterparties, geographical and industry segments; control over hedging activities; reporting of market risk exposures and breaches to the monitoring authority; monitoring compliance with market risk policy and review of market risk policy for pertinence and changing environment.

Price Risk. The Fund's price risk exposure at year-end relates to financial assets and liabilities whose values will fluctuate as a result of changes in market prices, principally FVPL equity securities.

Such investment securities are subject to price risk due to changes in market values of instruments arising either from factors specific to individual instruments or their issuers or factors affecting all instruments traded in the market.

The Fund's market risk policy requires it to manage such risks by setting and monitoring objectives and constraints on investment, diversification plan and limits on investments.

9. **Fair Value of Financial Instruments**

Fair value is defined as the amount at which the financial instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's-length transaction, other than in a forced liquidation or sale. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing models, as appropriate. The following table sets forth the carrying values and estimated fair values of financial assets recognized as of December 31, 2005.

	Carrying Value	Fair Value
FVPL financial assets	₱27,938,713	₱27,938,713
Cash and cash equivalents	2,908,719	2,908,719
Receivables	86,465	86,465
	₱30,933,897	₱30,933,897

Fair values of financial assets are estimated as follows:

	Methods and Assumptions
FVPL financial assets	Fair values are based on quoted prices.
Cash and cash equivalents	Due to the short term nature of the instrument, the fair value approximates the carrying amount.
Receivables	Due to the short term nature of the instrument, the fair value approximates the carrying amount.

10. **Related Party Disclosures**

Share held by directors totaled 25.0 million as of December 31, 2005 and 2004.