

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

Financial Statements
December 31, 2002 and 2001
and Years Ended December 31, 2002, 2001 and 2000

and

Report of Independent Auditors

SEC Number **A1998-16221**
File 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 Centre, Pasig City

(Company's Address)

635-3963

(Telephone Number)

December 31

(Year Ending)
(month & day)

Annual Audited Financial Statements

Form Type

Amendment Designation (If applicable)

December 31, 2002

Period Ended Date

(Secondary License Type and File Number)

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, 2002 and 2001, and the related statements of operations, changes in net assets and cash flows for each of the three years in the period ended December 31, 2002. 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, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the Philippines.

J. J. M. SEBASTIAN
Partner
CPA Certificate No. 61687
Tax Identification No. 104-597-500
PTR No. 7612883
January 2, 2003
Makati City

March 7, 2003

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, 2002 and 2001, and the related statements of operations, changes in net assets and cash flows for each of the three years in the period ended December 31, 2002. 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.

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PTR No. 7612883
January 2, 2003
Makati City

March 7, 2003

PHILEQUITY PSE INDEX FUND, INC.**(An Open-end Mutual Fund Company)****STATEMENTS OF ASSETS AND LIABILITIES****DECEMBER 31 2002 AND 2001**

| | 2002 | 2001 |
|--|--------------------|--------------------|
| ASSETS | | |
| Investments in Listed Securities - net of unrealized depreciation of ₱8,250,025 in 2002 and ₱6,164,185 in 2001 (Note 3) | ₱12,255,879 | ₱11,968,379 |
| Cash and Cash Equivalents (Note 4) | 3,416,177 | 4,886,616 |
| Receivables | 81,736 | 686,669 |
| Organization Costs - net of accumulated amortization of ₱320,444 in 2002 and ₱200,237 in 2001 | 280,266 | 400,473 |
| | 16,034,058 | 17,942,137 |
| LIABILITIES | | |
| Accounts Payable and Accrued Expenses | 80,000 | 145,845 |
| NET ASSETS (Note 5) | ₱15,954,058 | ₱17,796,292 |
| Net Asset Value Per Share | ₱0.638 | ₱0.712 |

See accompanying Notes to Financial Statements.

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

STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001
AND THE PERIOD MAY 5, 2000 TO DECEMBER 31, 2000

| | 2002 (One Year) | 2001 (One Year) | 2000* (Eight Months) |
|--|----------------------------------|----------------------------------|---------------------------------------|
| INVESTMENT INCOME | | | |
| Dividends | ₱314,547 | ₱197,443 | ₱137,765 |
| Interest | 193,567 | 434,943 | 875,089 |
| | 508,114 | 632,386 | 1,012,854 |
| OPERATING EXPENSES | | | |
| Amortization of organization costs | 120,207 | 120,142 | 80,095 |
| Taxes and licenses | 57,064 | 8,702 | — |
| Professional fees | 46,361 | 110,329 | — |
| Net realized loss on sale of investments in listed securities (Note 3) | 29,785 | 2,820,932 | 2,692,392 |
| Others | 11,091 | 458 | — |
| | 264,508 | 3,060,563 | 2,772,487 |
| NET INVESTMENT INCOME (LOSS) (Note 5) | 243,606 | (2,428,177) | (1,759,633) |
| CHANGES IN UNREALIZED DEPRECIATION OF INVESTMENTS IN LISTED SECURITIES (Note 5) | | | |
| End of year | 8,250,025 | 6,164,185 | 4,105,911 |
| Less beginning of year | 6,164,185 | 4,105,911 | — |
| UNREALIZED DEPRECIATION OF INVESTMENTS IN LISTED SECURITIES | 2,085,840 | 2,058,274 | 4,105,911 |
| NET DECREASE IN NET ASSETS | ₱1,842,234 | ₱4,486,451 | ₱5,865,544 |

*The Fund was incorporated on February 22, 1999 and started commercial operations on May 5, 2000

See accompanying Notes to Financial Statements.

PHILEQUITY PSE INDEX FUND, INC.**(An Open-end Mutual Fund Company)****STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001
AND THE PERIOD MAY 5, 2000 TO DECEMBER 31, 2000**

| | 2002 | 2001 | 2000* |
|---|--------------------|-------------------|-----------------------|
| | (One Year) | (One Year) | (Eight Months) |
| FROM INVESTING ACTIVITIES | | | |
| Net investment income (loss) (Note 5) | ₱243,606 | (₱2,428,177) | (₱1,759,633) |
| Net change in unrealized depreciation of investments in listed securities (Note 5) | 2,085,840 | 2,058,274 | 4,105,911 |
| NET DECREASE IN NET ASSETS | 1,842,234 | 4,486,451 | 5,865,544 |
| NET ASSETS AT BEGINNING OF YEAR | 17,796,292 | 22,282,743 | 28,148,287 |
| NET ASSETS AT END OF YEAR (Note 5) | ₱15,954,058 | ₱17,796,292 | ₱22,282,743 |

*The Fund was incorporated on February 22, 1999 and started commercial operations on May 5, 2000

See accompanying Notes to Financial Statements.

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

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2002 AND 2001
AND THE PERIOD MAY 5, 2000 TO DECEMBER 31, 2000

| | 2002 (One Year) | 2001 (One Year) | 2000* (Eight Months) |
|--|----------------------------------|----------------------------------|---------------------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net investment income (loss) | ₱243,606 | (₱2,428,177) | (₱1,759,633) |
| Adjustments for: | | | |
| Net change in unrealized depreciation of investments in listed securities | (2,085,840) | (2,058,274) | (4,105,911) |
| Amortization of organization costs | 120,207 | 120,142 | 80,095 |
| Dividends | (314,547) | (197,443) | (137,765) |
| Interest income | (193,567) | (434,943) | (875,089) |
| Net realized loss on sale of investments in listed securities | 29,785 | 2,820,932 | 2,692,392 |
| Operating loss before working capital changes | (2,200,356) | (2,177,763) | (4,105,911) |
| Proceeds from sale of investments in listed securities | 371,092 | 3,502,787 | — |
| Decrease (increase) in: | | | |
| Investments in listed securities | (688,377) | (8,491,683) | 4,151,497 |
| Receivables | 642,135 | (642,135) | (16,644,304) |
| Increase (decrease) in accounts payable and accrued expenses | (65,845) | 65,845 | 80,000 |
| Net cash used in operating activities | (1,941,351) | (7,742,949) | (16,518,718) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Interest received | 204,359 | 492,932 | 971,574 |
| Dividends received | 266,553 | 202,157 | 116,751 |
| Increase in organization costs | — | — | (600,710) |
| Net cash provided by investing activities | 470,912 | 695,089 | 487,615 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | | | |
| | (1,470,439) | (7,047,860) | (16,031,103) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | | | |
| | 4,886,616 | 11,934,476 | 27,965,579 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | | | |
| | ₱3,416,177 | ₱4,886,616 | ₱11,934,476 |

*The Fund was incorporated on February 22, 1999 and started commercial operations on May 5, 2000

See accompanying Notes to Financial Statements.

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

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, among others, to 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 Fund did not employ any personnel as of December 31, 2002 and 2001. Administrative functions are outsourced to Philequity Management, Inc.

2. Summary of Significant Accounting Policies

The principal accounting policies adopted in preparing the financial statements of the Fund are as follows:

Basis of Preparation

The accompanying financial statements have been prepared in conformity with the generally accepted accounting principles in the Philippines under the historical cost convention.

Adoption of New Statements of Financial Accounting Standards (SFAS)/
International Accounting Standards (IAS)

The Fund adopted SFAS 24/ IAS 24, "Related Party Disclosures," which became effective on January 1, 2002.

Adoption of SFAS 24/IAS 24 in 2002 did not result in restatement of prior year financial statements. Additional disclosures required by the new standard, however, were included in prior year financial statements, where applicable.

New Accounting Standards Effective Subsequent to 2002

The Accounting Standards Council has approved the following accounting standards which will be effective subsequent to 2002:

- SFAS 10/IAS 10, "Events After the Balance Sheet Date," which prescribes the accounting and disclosure related to adjusting and non-adjusting subsequent events. The Fund will adopt SFAS 10/IAS 10 in 2003.

- SFAS 37/IAS 37, “Provisions, Contingent Liabilities and Contingent Assets,” which provides the criteria for the recognition and bases for measurement of provisions, contingent liabilities and contingent assets. It also specifies the disclosures that should be included with respect to these items. The Fund will adopt SFAS 37/IAS 37 in 2003.
- SFAS 38/IAS 38, “Intangible Assets,” which establishes the criteria for the recognition and measurement of intangible assets. Intangible assets that are recognized should be amortized generally over 20 years. The new standard also requires that expenditures on research, start-up, training, advertising and relocation be expensed as incurred. The Company will adopt SFAS 38/IAS 38 in 2003. This will result in a retroactive adjustment to beginning retained earnings of 2003 of about ₱0.3 million relating to the write off of organization costs. Comparative prior period financial statements presented will be restated accordingly.

Investments in Listed Securities

Investments in listed securities are stated based on the current market quotations of the PSE. The difference between the aggregate cost of investments in listed securities and the market value as of the end of the year is shown as unrealized appreciation or depreciation of investments in listed securities. The cost of listed securities sold is computed based on the moving average cost of all the shares of each security held at the time of sale.

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.

Organization Costs

Organization costs incurred prior to the start of commercial operations have been capitalized and are being amortized on a straight-line basis over 5 years up to 2005. SFAS 38/IAS 38, “Intangible Assets”, effective in 2003, requires start-up costs to be expensed as incurred. This will result in a retroactive adjustment to beginning retained earnings of 2003 of about ₱0.3 million relating to write off of organization costs. Comparative prior period financial statements presented will be restated accordingly.

Net Asset Value Per Share

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

Revenue

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Fund and the revenue can be measured reliably. Revenues are recognized on the following bases: (a) gain or loss from sale of investments in listed securities as determined at the time of sale of such investments; (b) interest, on a time proportion basis taking into account the effective yield on the asset; and, (c) dividend, when the Fund’s right to receive the payment is established.

Income Tax

Deferred income tax is provided using the liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to: (a) temporary differences between the financial reporting bases of assets and liabilities and their related tax bases; and (b) net operating loss carryover (NOLCO). Deferred tax assets and liabilities are measured using the tax rate

applicable to taxable income in the years in which those temporary differences are expected to be recovered or settled and NOLCO is expected to be applied. A valuation allowance is provided for deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized in the future.

3. Investments in Listed Securities

This account consists of investments in the following:

| | 2002 | | | 2001 | | |
|--|---------------------|--------------------|--------------------|---------------------|--------------------|--------------------|
| | Number of Shares | Cost | Market Value | Number of Shares | Cost | Market Value |
| San Miguel Corporation "A" | 36,290 | ₱1,807,938 | ₱2,177,400 | 34,190 | ₱1,712,043 | ₱1,470,170 |
| Bank of the Philippine Islands | 36,720 | 1,887,384 | 1,230,120 | 34,100 | 2,103,261 | 1,960,750 |
| Ayala Corporation | 264,600 | 2,387,184 | 1,137,780 | 249,600 | 2,292,309 | 1,173,120 |
| San Miguel Corporation "B" | 13,870 | 703,153 | 915,420 | 13,870 | 703,153 | 728,175 |
| Metropolitan Bank and Trust Company | 28,700 | 1,391,589 | 904,050 | 5,740 | 1,391,589 | 1,176,700 |
| Ayala Land, Inc. | 196,800 | 1,594,856 | 895,440 | 186,800 | 1,529,600 | 905,980 |
| Philippine Long Distance Telephone Company | 3,140 | 2,833,856 | 847,800 | 2,960 | 2,741,794 | 1,235,800 |
| SM Prime Holdings Corporation | 175,000 | 1,212,255 | 831,250 | 175,000 | 1,212,255 | 1,102,500 |
| Globe Telecom, Inc. | 1,825 | 1,125,261 | 816,687 | — | — | — |
| Jollibee Foods Corporation | 17,900 | 275,040 | 326,675 | 17,900 | 275,040 | 219,275 |
| Equitable PCI Bank, Inc. | 11,200 | 320,926 | 302,400 | — | — | — |
| Petron Corporation | 165,000 | 317,286 | 257,400 | 165,000 | 317,286 | 237,600 |
| Aboitiz Equity Ventures, Inc. | 96,000 | 214,446 | 216,960 | 96,000 | 214,446 | 151,680 |
| La Tondeña Distillers, Inc. | 5,700 | 178,632 | 199,500 | 5,700 | 178,632 | 133,950 |
| JG Summit Holdings, Inc. | 133,200 | 470,230 | 186,480 | 133,200 | 470,230 | 215,784 |
| Philippine National Bank | 6,700 | 452,760 | 157,450 | — | — | — |
| ABS-CBN Holdings, Inc. | 7,200 | 266,400 | 115,200 | 800 | 39,775 | 19,200 |
| Filinvest Land, Inc. | 138,750 | 296,310 | 115,163 | 75,000 | 296,310 | 124,500 |
| International Container Terminal Services, Inc. | 40,000 | 128,956 | 96,800 | 40,000 | 128,956 | 84,000 |
| Manila Electric Company "A" | 10,600 | 825,781 | 86,920 | 10,600 | 825,781 | 241,150 |
| Megaworld Corporation | 142,500 | 131,439 | 82,650 | 142,500 | 131,439 | 101,175 |
| First Philippine Holdings Corporation | 9,480 | 210,524 | 76,788 | 7,900 | 210,524 | 201,450 |
| Manila Electric Company "B" | 7,120 | 698,455 | 62,656 | 7,120 | 698,455 | 210,040 |
| Metro Pacific Corporation | 330,000 | 225,033 | 52,800 | 330,000 | 225,033 | 99,000 |
| Digital Telecommunications Phils., Inc. | 110,000 | 79,148 | 44,000 | 110,000 | 79,148 | 41,800 |
| Lepanto Consolidated Mining Company "B" | 175,000 | 47,874 | 36,750 | 175,000 | 47,874 | 26,250 |
| Union Cement Corporation | 80,000 | 56,766 | 36,000 | — | — | — |
| Belle Corporation | 84,000 | 157,394 | 29,400 | 84,000 | 157,394 | 47,040 |
| Ionics, Inc. | 9,500 | 141,349 | 9,120 | 9,500 | 141,349 | 59,850 |
| Benpres Holdings Corporation | 70,000 | 58,791 | 7,700 | — | — | — |
| DMCI Holdings, Inc. | 8,000 | 8,888 | 1,120 | 8,000 | 8,888 | 1,440 |
| | | ₱20,505,904 | ₱12,255,879 | | ₱18,132,564 | ₱11,968,379 |

As of March 7, 2003, the market value of investments in listed securities held as of December 31, 2002 amounted to ₱12,146,076.

In the normal course of business, the Fund recognizes the difference between the selling price and the cost of listed securities sold, as "Net realized loss on sale of investments in listed securities" shown in the statements of operations.

| | 2002 | 2001 | 2000 |
|-----------------------------------|-----------------|-------------------|-------------------|
| Proceeds from sale of investments | ₱371,092 | ₱3,502,787 | ₱4,151,497 |
| Less cost securities sold | 400,877 | 6,323,719 | 6,843,889 |
| | ₱29,785 | ₱2,820,932 | ₱2,692,392 |

4. Cash and Cash Equivalents

This account consists of:

| | 2002 | 2001 |
|---------------------|-------------------|-------------------|
| Cash in banks | ₱198,934 | ₱— |
| Short-term deposits | 3,217,243 | 4,886,616 |
| | ₱3,416,177 | ₱4,886,616 |

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

5. Net Assets

This account consists of:

| | 2002 | 2001 | 2000 |
|---|--------------------|--------------------|--------------------|
| 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 period | (1,039,523) | 1,388,654 | 3,148,287 |
| Net investment income (loss) | 243,606 | (2,428,177) | (1,759,633) |
| Balance at end of period | (795,917) | (1,039,523) | 1,388,654 |
| Unrealized depreciation of investments in listed securities: | | | |
| Balance at beginning of period | (6,164,185) | (4,105,911) | — |
| Net change in unrealized depreciation of investments in listed securities | (2,085,840) | (2,058,274) | (4,105,911) |
| Balance at end of period | (8,250,025) | (6,164,185) | (4,105,911) |
| | ₱15,954,058 | ₱17,796,292 | ₱22,282,743 |

6. Income Tax

There was no provision for income tax in 2002 and 2001 since interest income have already been subjected to final tax at a lower rate while dividend income is exempt from tax.

The carryforward benefits of the NOLCO were set up as deferred tax assets. A corresponding valuation allowance has been established since management believes that it is more likely than not that the carryforward benefits of NOLCO will not be realized prior to their expiration.

As of December 31, 2002, the NOLCO that can be claimed as deduction from normal taxable income follows:

| Year Incurred | Expiry Year | Amount |
|---------------|-------------|----------|
| 2000 | 2003 | ₱80,095 |
| 2001 | 2004 | 239,631 |
| 2002 | 2005 | 264,508 |
| | | ₱584,234 |