



# HOUSEVIEW

## Global Economic Outlook

### World

- Recent data releases point to global economic stabilization with selected emerging market countries, such as China and India, showing accelerated growth while the G7 economies appearing to have stabilized.
- The longevity of the current economic revival however remains uncertain as the improvement in industrial production is grounded upon an inventory restocking cycle and on massive government stimulus measures which are more of a one off in nature.
- The deleveraging of household balance sheets by debt reduction in developed economies will necessarily continue in the years to come though consumer confidence can rebound in the near term as asset prices have appreciated significantly in recent months.
- With greater risk appetite and abundant liquidity, the US dollar continues to weaken against major currencies and commodities.

### United States

- Second quarter GDP growth in the US fell 1% QoQ, performing better than market expectations with personal consumption holding up better than forecast. The ISM Manufacturing Index in August pushed through the 50 level to 52.9 signalling expansion for the first time since January 2008.
- After witnessing a moderate improvement in the unemployment rate during the month of July at 9.4%, the August figure of 9.7% reminded market participants that the unemployment situation in the country continues to worsen and will likely breach the 10% mark before this recession is over.
- Encouragingly, the fragile housing market continues to see signs of improvement with new home sales and pending home sales climbing 9.6% and 3.2% MoM, respectively.

### Europe

- Euro-Zone industrial production continued to struggle in the month of July, falling 0.3% MoM and 15.9% over 12 months.
- The Euro-Zone economy fell 0.1% QoQ in the second quarter of 2009 which was a substantial improvement over the 2.5% fall in the previous quarter. The economy nevertheless contracted 4.7% YoY during the quarter.

### Japan

- In a sea changing event, the opposition Democratic Party of Japan won a majority in the House of Representatives, ending the Liberal Democratic Party's almost continuous reign since 1955. The party aims to reduce the bureaucracy of the Japanese government, improve efficiency and introduce transparent and decentralized government agencies.
- While improving 1.9% MoM in July, industrial production in Japan remains 23% below previous year level signalling economic improvements are currently tentative at best.
- The unemployment rate hit 5.7% in the month of July, which is the highest rate since the series began in 1953. The prospects of a quick recovery in employment appear elusive as the jobs to applicant ratio fell to a record 0.42 reflecting the current scarcity of job openings.

## Global Market Insights

### Equities

- Global equity markets continue to push higher with the prevailing consensus view that the global economy has bottomed and will begin to improve in the second half 2009 and start growing again in 2010. Amidst this seemingly bullish backdrop, it remains uncertain what the impact on the global economy will be when governments begin to reverse monetary policy and remove fiscal stimuli.
- Asia Pacific economies are expected to perform better going forward as modest leverage within the economies and strong domestic consumption should ensure that the region outpaces its developed nation counterparts in terms of economic growth. However, valuations reflect this with the region trading at 16.9X 2010 PE, a premium to the US and European markets.
- Asian economies have rebounded faster than developed economies and as such Asian equity market performances have far outpaced developed market peers. However, further evidence of G7 countries recovery will likely trigger a reversal in relative performance.

## Bonds

- Global macro data confirm a strong cyclical rebound. The improving data flow, particularly in manufacturing, is likely to lead to increased focus on policy tightening and exit strategies, thereby exerting upward pressure on bond yields
- Global bond markets have been resilient so far however, as output gaps in developed markets are to sustain well into 2010 and more likely 2011. Financial sector deleveraging, high unemployment and limited consumer spending are likely to make the recovery relatively shallow.
- Near-term G3 policy tightening is highly unlikely. We expect the Fed to keep interest rates in the 0-0.25% range until at least Q3'10, and only to modestly increase the policy rate thereafter. We project the ECB to keep the refinance rate at 1% until late 2010, and Japan to keep overnight rates at 0.1% throughout 2009 and 2010.
- A sharp sell off in bond markets is unlikely. Beyond the sharp stimulus and inventory driven rebound, we expect bonds to perform relatively well as financial markets transition into a slower, broader recovery, where demand-pull inflation is not a near-term problem.

## Returns

- Equity markets continued to climb in August, buoyant by continued optimism that the global economy has bottomed and potentially returning to growth in 2010.
- Global government bonds had another good month on the back of lower yields, in spite of an improved macro backdrop.

Equities Benchmark	August	Year-to-Date	12 Months
<b>MSCI World</b> (USD terms)	4.13%	20.12%	-17.21%
Bond Benchmark	August	Year-to-Date	12 Months
<b>World Govt Bond Index</b> (USD terms, unhedged)	1.98%	2.23%	9.86%

## Asia Pacific Economic Outlook

### Overview

- Second quarter GDP growth rates were generally better than expectation across the region.
- The absolute level and rate of increase in unemployment is also much lower than beginning of the year forecasts.
- Second quarter earnings surprised positively with aggressive cost cutting helping to sustain profitability.
- Potential policy tightening by the Chinese government appears to be the key concern among investors with the local A share market particularly vulnerable to rumours regarding policy.

### China

- China's PMI stood at 54 in August, retaining the path of expansion.
- Industrial production was up 10.8% in July bring the year-to-date total to up 7.5%.
- As evidence of domestic consumption strength, retail sales grew 15.2% in July.

### North Asia

- Hong Kong's second quarter GDP improved on a sequential basis up 3.3% QoQ and down 3.8% YoY.
- Korea's unemployment rate improved to 3.8% in July from the 4% reached in June.
- While second quarter GDP growth fell 7.5% YoY in Taiwan, it was nonetheless an improvement over the 10.2% fall witnessed in the first quarter.

### South Asia

- Second quarter GDP grew a respectable 2.3% QoQ in Indonesia, registering a 4% growth YoY.
- Malaysia's economy remained sluggish with industrial production dropping 9.6% in June. However, Singapore saw a substantial rebound in industrial production, jumping 12.4% YoY.
- Philippines' OFW remittance remained robust, growing 3.3% in the month of June.
- India's total rainfall this monsoon season was 22.7% below normal, pointing towards a drop in farming incomes for the year.

### Pacific

- Australia's private sector credit grew a mere 3% in the month of July, indicating the cautious stance of both private borrowers and bank lenders.

## Asia Pacific Market Insights

### Equities

- While it is now market consensus that the global economy is on the mend, the key concern for investors is the potential policy tightening by China.
- Nevertheless, second quarter earnings showed higher than expected profitability due to aggressive cost cutting and generally more positive business outlook.
- Earnings revisions maintain an upward bias with analysts factoring in a better economic environment for the remainder of 2009 and 2010.
- Second quarter GDP growth data showed sequential improvements in Asian economies, with the rate of unemployment increase slowing.
- Asia Pacific's 2009 estimated PE stands at 17.9X with an estimated earnings growth of +9.4% and 3 months earnings revision of +10.8%.
- While markets continue to move higher, any renewed fears over China policy tightening could have a negative effect on markets. Liquidity continues to triumph over fundamentals currently.

### Bonds

- Headline inflation across Asia will rise from Q4 onward on the back of base effects and higher commodity prices. With a more synchronized global cyclical upturn and output gaps closing in several Asian countries in 2010, this will probably lead regional central banks to hike policy rates next year, ahead of the FED and ECB.
- We however expect the amount of rate hikes to be modest, and believe the degree of tightening priced into most yield curves is exaggerated as the longer term growth outlook, and final demand from the developed world remains uncertain.
- Ample liquidity will continue to support most bond markets, whereas valuations are unchallenging given expected growth and inflation trajectories across the region.
- We remain fundamentally bullish on Asian currencies medium term.

### Returns

- The Asian equity market took pause in the month of August as China tightening concern took its toll on the markets.
- Asian local currency bonds had a flat month performance wise. Somewhat weaker Asian currencies led to a modest negative monthly return.

Equities Benchmark	August	Year-to-Date	12 Months
<b>MSCI Asia Pacific Ex Japan</b> (USD terms)	-0.25%	48.95%	-4.60%
Bond Benchmark	August	Year-to-Date	12 Months
<b>HSBC Asia Local Bond Index</b> (USD terms)	-0.61%	1.32%	3.85%

Recommended Asset Exposures	
<b>International Equities</b>	Neutral
<b>Asian Equities</b>	Underweight
<b>International Bonds</b>	Overweight
<b>Asian Bonds</b>	Neutral
<b>Cash</b>	Neutral

	Key Drivers	Key Risks	Risk Rating
<b>World Economy</b>	<ul style="list-style-type: none"> <li>Deleveraging of consumer, financial and corporate sectors</li> <li>Continued co-ordinated approach to the financial and economic crises</li> </ul>	<ul style="list-style-type: none"> <li>Emerging markets decline into recession</li> <li>Protectionism emerges</li> </ul>	<p>High</p> <p>Low</p>
<b>Global Equities</b>	<ul style="list-style-type: none"> <li>Prospects for economic growth</li> <li>Earnings growth and the extent of revision</li> </ul>	<ul style="list-style-type: none"> <li>Earnings downgrades surprise on the downside</li> <li>Availability of credit diminishes</li> </ul>	<p>High</p> <p>Medium</p>
<b>Global Bonds</b>	<ul style="list-style-type: none"> <li>Accommodative monetary stance</li> <li>Deficit spending and bond supply</li> <li>Weak growth, despite recent green shoots</li> <li>Increased G-20 and IMF support to EM economies</li> </ul>	<ul style="list-style-type: none"> <li>Return of risk appetite/ demand for risky assets</li> <li>Exit of accommodative monetary policies</li> <li>Inflation worries escalating</li> <li>Increasing fiscal deficits, rising public debt</li> </ul>	<p>Medium</p> <p>Low</p> <p>Low</p> <p>Low</p>
<b>Asian Equities</b>	<ul style="list-style-type: none"> <li>Extent Asia is impacted by the global economic slowdown</li> <li>International investors appetite for risk</li> </ul>	<ul style="list-style-type: none"> <li>Earnings revisions surprise to the downside</li> <li>Valuations fail to halt market slide</li> </ul>	<p>High</p> <p>High</p>
<b>Asian Bonds</b>	<ul style="list-style-type: none"> <li>Bond supply and fiscal stance</li> <li>Accommodative monetary policy and excess liquidity</li> <li>Extent of growth rebound</li> </ul>	<ul style="list-style-type: none"> <li>Higher G3 bond yields</li> <li>Increased inflation and higher commodity prices</li> <li>Increasing fiscal deficits, rising public debt</li> </ul>	<p>Low</p> <p>Medium</p> <p>Low</p>

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