ING Investment Management Asia Pacific

December/January 2009

HOUSEVIEW

Global Economic Outlook

World

- Extreme anxiety and severely depressed sentiment in the aftermath of the Lehman Brothers bankruptcy has given way to a sense of relief as further disruptions of a similar scale have since been avoided.
- The sense of relief is palpable in all asset classes: stock markets have rallied, market volatility has eased, currency pairs have moved towards levels prior to the Lehman crisis, credit conditions have improved and bond yields reflect a less deflationary environment.
- While sentiment has clearly improved the economies have not. Data releases from the developed as well as emerging economies have shown no let up in deteriorating economic news flow.
- Commodity prices have stabilized after big declines in the prior months but any recovery in a sharply declining demand scenario is bound to be technical. Oil prices have found some support as OPEC decided to cut supply by 2.5m barrels per day to 24.8m bpd as well as increased political tensions between Hamas and Israel.

United States

- The strong downward momentum in economic activity currently under way will be sustained through the first quarter of 2009. Some moderation in contraction is expected as aggressive pro-growth policies begin to take hold in the second quarter.
- US employers are accelerating the pace of firings as the year-old recession deepens. This trend is expected to continue over the coming months pushing the unemployment rate close to the psychologically critical level of 10%.
- Households faced with credit tightening, a record decline in wealth and an unemployment rate almost certainly exceeding 8% are expected to cut back on spending dramatically. High unemployment and depressed domestic demand will keep inflation close to 0% levels.
- Some help is on the way for the household sector by way of policy help for credit markets. Most significant of which would be a lowering of mortgage rates and the expected tax cuts. But public finances will take a beating with the fiscal deficit easily clearing the $1 tn. mark.

Europe

- The economic scenario unfolding in Europe is not materially different to that in the US. Retail sales, consumer confidence and business sentiment indicators are all tumbling to all time or multi decade lows without any clear trigger for a sustainable rebound in the near term.
- The first two quarters of 2009 will be spent in negative territory in terms of real economic growth with a return to modest growth in Q3. Exports are expected to play a key role in this recovery and therefore remain a big uncertainty as import demand from the rest of the world is also expected to be weak.
- The Bank of England has reduced its benchmark interest rate to 1.5%, this is the lowest level of official interest rates in the 315 year history of the Bank of England. We expect rates to be lowered further in the coming months.

Japan

- Following weak growth in 2008, we expect downside risks to Japanese economic growth to remain strong throughout 2009. A sharp fall in the value of the Yen against the USD and EUR may provide some cushion.
- Factory output plunged in the last quarter of 2008 and companies plan to reduce output further. Exports, a key driver of economic activity in Japan, fell a record 26.7% in November.
- CPI excluding fresh food rose only 1% yoy in November, indicating the problem for Japan is once again the spectre of deflation.

Global Market Insights

Equities

- We expect a global recession in 2009, notwithstanding countervailing policy actions. In turn, this is likely to increase the risks to corporate earnings and will keep valuations low. Furthermore, we believe there are sufficient reasons to examine the possibility that the global downturn will be more prolonged than consensus currently expects.
- A feature of 2008 was increasing correlations between stock markets across regions and countries with US equity markets as anchor. We expect this to continue and therefore the policy response of the US government in particular has now become the key variable for investors.
- We expect 2009 to be a low return, wide range year with the potential for further downside in the course of the year because of significant macroeconomic headwind, still optimistic earnings expectations and a difficult environment for valuation expansion. We recommend cutting back exposure to international equities to underweight from neutral.

Bonds

- Central Banks across the globe are in the midst of aggressively cutting policy rates. We expect more rate cuts in virtually every market, accompanied by quantitative easing measures notably in countries where interest rates approach the 'zero bound'.
- Extensive "Keynesian" fiscal stimulus is being used to fill the gap left by collapsing private sector spending. This is contributing to budget deficits, and much higher government bond issuance.
- We expect these deficits and increased bond supply to represent medium-term risks, but to have limited impact on bond yields for now: near term, bonds remain firmly supported by disinflation/ deflation fears and flight to safety flows.
- Valuations have become less attractive as yields have retreated to extremely low levels: US treasury yields are now back to levels not seen since the early 1950's, and the yield on Citi's World Government Bond index was a mere 2.79% as of the end of November.
- We recommend a modest underweight exposure to international bonds.

Returns

- Global equities put on a positive return in the last month of 2008 as large policy commitments from governments across the globe boost investor sentiment. However, the full year returns were the worst since global indices were established.
- Global bonds had a very good month, with US Treasuries outperforming with a 5.4% return. All major bond markets have managed positive returns year to date.

Equities Benchmark	**December**	**Year-to-Date**	**12 Months**
MSCI World (Local currency terms)	3.62%	-42.20%	-42.20%
Bond Benchmark	**December**	**Year-to-Date**	**12 Months**
World Govt Bond Index ($ terms, unhedged)	7.11%	10.89%	10.89%

Asia Pacific Economic Outlook

Overview

- Export growth deceleration has turned into negative export growth among many Asian countries.
- The potential for intra-Asian trade to boost economic growth will take time to play out.
- The financial and liquidity situation of the banking system around the region has improved as global capital market stablised.
- Asia should retain the status as fastest growing region of the world in 2009 and also stands to be a beneficiary of falling commodity prices.

China

- China's economy is showing significant deceleration with industrial production up only 5.4% in November, the slowest in seven years.
- The Central Bank is attempting to compensate with another 27bps cut in policy rate to 5.31%.
- We expect real GDP growth in 2009 to be in the range of 7% to 8%.

North Asia

- The uemployment rate climbed to 3.8% in Hong Kong and retail sales rose an anemic 0.3%, further highlighting a slowing economy.
- The Korean won rallied strongly in December as the central bank provided US$4billion FX lines to local banks. The central bank also cut the policy rate to 3%, which is currently a record low in an effort to revive the sagging economy.
- Tawian exports fell 23.3% as demand for electronics in developed markets grounded to a halt.

South Asia

- Indonesian exports rose only 4.9% in October as compared to 28.5% in the previous month as the value of its exports fell along with collasping commodity prices.
- Industrial Production in Malayisa declined in October by falling 3.1%. Exports also fell by 2.6%.
- Thailand's market rallied hard as there was temporary clarity on the political situation with newly elected Prime Minister, Abhisit Vejjajiva.
- The Phillipines economic outlook remains weak as the government forcecasts a meagre 1.8% growth in 2009.

Pacific

- Collasping global commodity prices will lead to a worsening current account situation in Australia thereby exertirng presussure on the curency. Slowing exports will detract from economic growth and mute domestic demand.

Asia Pacific Market Insights

Equities

- The traditional export destinations of Asian exports, i.e. US, Europe and Japan, continue to suffer from decelerating economies and collapsing consumer demand. While intra-Asian trade will provide some cushion, it is unlikely to offset falling demand from developed economies in the near term.
- Financial liquidity and credit markets have seen improvements over the past month and central banks around the region have cut interests rates aggressively in order to unlock credit markets.
- Earnings estimates remain on a downtrend and a focus on balance sheet strength remain paramount for investors.
- Expectations are low and any positive surprise could spark a powerful rally in equity prices.
- Asia Pacific's 2009 estimated PE stands at 11.4x with an estimated earnings growth of -24%. While PE multiples do not appear to be significantly below average, average earnings estimates have been reduced substantially providing a much better base for investor expecations for 2009.
- In 2009, Asia is likely to be the region that will exhibit the fastest economic growth globally, led by China and India. Both countries have aggressively loosened monetary policy in order to revive demand and stimulus measures have also been put in place. Despite declining growth rates relative to their own history, absolute growth rates in 2009 will remain the envy of many developed market economies.
- Current market expecations of a second half economic recovery in 2009 have provided some stablisation for the equity markets though a longer than expected downturn could trigger another round of sell offs. However, given the dramatic sell off in equity markets, 2009 provides ripe opportunities for the diligent Asian equity investor.

Bonds

- The current crisis is a global crisis, and not EM originated, and Asia entered this crisis with - on average - solid fundamentals. Whereas in typical EM crises, central banks have to significantly tighten monetary policy to stabilise the macro situation, virtually every Asian central bank now has the flexibility to ease monetary policy to help sustain growth.
- With commodity prices collapsing and domestic demand decelerating rapidly, inflation in Asia is no longer a concern. Similar to their global counterparts, regional central banks are aggressively cutting rates and pumping liquidity into systems to help ease strains in domestic money markets.
- Most Asian countries were in decent fiscal shape going into the crisis, and with Asian banking systems less exposed to sub-prime, bank recapitalization needs are limited. We therefore expect increased fiscal pump priming to represent only a modest risk for Asian bond markets.
- Asian local currency bond markets will continue to be driven by declining inflation expectations, flight to safety and more dovish central banks. Further deterioration in foreign investor appetite may negatively impact markets with higher foreign participation, such as Indonesia and Malaysia.
- We recommend being neutral on this asset class.

Returns

- Asian markets performed well in December as risk aversion declined and the region saw net inflows from foreign investors. Indonesia and Korea were the best performers.
- Due to weaker Asian currencies, Asian bond posted only modestly positive returns over 2008. Asian bonds nevertheless clearly outperformed equities.

Equities Benchmark	December	Year-to-Date	12 Months
MSCI Asia Pacific Ex Japan (Local currency terms)	9.90%	-52.38%	-52.38%

Bond Benchmark	December	Year-to-Date	12 Months
HSBC Asia Local Bond Index ($ terms)	9.40%	0.98%	0.98%

Recommended Asset Exposures	
International Equities	Underweight
Asian Equities	Underweight
International Bonds	Underweight
Asian Bonds	Neutral
Cash	Overweight

	Key Drivers	Key Risks	Risk Rating
World Economy	• Deleveraging of consumer, financial and corporate sectors • Continued co-ordinated approach to the financial and economic crises	• Emerging markets decline into recession • Protectionism emerges	High Low
Global Equities	• Prospects for economic growth • Earnings growth and the extent of revisions	• Earnings downgrades surprise on the downside • Availability of credit diminishes	High Medium
Global Bonds	• Monetary policy easing • Disinflation • Deficit spending bond issuance	• Government bond issuance resulting from record fiscal spending may crowd out non-governement guaranteed paper	Low
Asian Equities	• Extent Asia is impacted by the global economic slowdown • International investors appetite for risk	• Earnings revisions surprise to the downside • Valuations fail to halt market slide	High High
Asian Bonds	• Monetary policy easing • Disinflation	• Currency weakness	Low

Key Forecasts

	Real GDP				Inflation				90 Day Interest Rates*		10 Year Bond Yields	
	2008E#	ING	2009E#	ING	2008E#	ING	2009E#	ING	Actual 31-Dec-08	ING Forecast For Next 3 Months	Actual 31-Dec-08	ING Forecast For Next 3 Months
The World	3.4	-	2.0	-	4.6	-	3.4	-				
USA	1.4	-	-0.6	-	4.3	-	2.8	-	0.08	Steady	2.21	Lower
Europe	1.0	-	-0.2	-	3.5	-	2.6	-	1.66	Lower	2.95	Lower
Japan	0.6	-	0.1	-	1.4	-	1.0	-	0.77	Steady	1.17	Steady
Australia	2.5	-	2.5	-	4.2	0	3.2	-	4.15	Lower	3.99	Lower
China	9.5	-	8.1	-	7.0	-	4.8	-	2.25	Lower	2.76	Lower
Hong Kong	3.6	-	1.4	-	4.7	-	4.3	-	0.95	Steady	1.19	Steady
India	7.1	-	6.6	-	7.8	-	6.6	-	4.65	Lower	5.26	Lower
Indonesia	6.0	-	4.7	-	10.5	-	8.2	-	12.13	Lower	11.89	Lower
Malaysia	5.3	-	3.3	-	5.8	0	4.1	-	3.37	Steady	3.22	Steady
Philippines	4.2	-	3.6	-	9.9	-	7.1	-	5.75	Lower	7.44	Lower
Singapore	2.5	-	1.2	-	6.4	-	3.0	-	0.96	Steady	2.05	Lower
South Korea	4.2	-	2.8	-	4.8	-	3.6	-	3.93	Lower	4.22	Lower
Taiwan	3.7	-	2.5	-	3.8	-	2.5	-	1.09	Steady	1.41	Steady
Thailand	4.5	-	3.2	-	6.5	-	3.7	+	2.95	Lower	2.66	Lower

Consensus Forecast, ING Bias ("+" Higher, "0" in line, "-" Lower than Consensus Forecast)

* *Australia 90 day BBSW Rate, Hong Kong, Malaysia, Singapore, Indonesia and Thailand 90 Day Interbank Rate, Japan and Korea 3 months CD Rate, China 1 Year Deposite Rate, India 90 Day Treasury Bill and Taiwan 90 Day Commercial paper Secondary Mkt*

 # Asia Pacific Consensus Forecasts - Consensus Economics Inc.

INVESTMENT MANAGEMENT