



HOUSEVIEW

Global Economic Outlook

World

- While the global economy suffered in 2009, global equity markets surged on the back of stimulus measures, abundant financial liquidity and prospects of economic recovery.
- There was strong divergence in economic performance between countries, with China leading the recovery and returning to growth while the US, Europe and Japan merely saw a stabilisation in economic performance.
- GDP growth will return in 2010, though only moderately in most developed economies, as economic activity is propped up by large amounts of debt financed government spending.
- Private consumption will take time to recover given the still difficult labour markets and lack of access to consumer credit.
- Paradoxically, low interest rates in US, Europe and Japan could potentially create overheating in Emerging and Asian economies and the potential formation of an asset bubble in 2010.
- Exit strategies remain the prime focus for 2010.

United States

- The turn of the new year brought along with it a strong set of ISM manufacturing data of 55.9, indicating that manufacturing continued to recover in the month of December.
- While the unemployment rate improved moderately in November, this month's unemployment figures remained stubbornly high at 10% and a greater number of people are becoming unemployed as non-farm payrolls declined by a further 85k this month.
- As an indication of how much the US economy has weakened, domestic vehicle sales in December were 11.23 million annualised, a long slide from the above 16 million figure registered only two years ago.

Europe

- Industrial production numbers in the Eurozone continue to point towards a weak picture with the headline year-over-year number falling 11.1% in October, a sequential decline of 0.6%.
- Characteristic of the current situation in developed economies, the employment picture shows few signs of improvement with the Eurozone employment falling 0.5% quarter-on-quarter in the third quarter.
- While domestic demand remained anaemic, with retail sales down 4% year-over-year in November, sentiment appears to be improving, with the Eurozone economic sentiment index reaching its highest level since the middle of 2008.

Japan

- While the market was greeted initially with strong 3Q GDP figures, the revised numbers fell short of market expectation and indicated that Japan's economy grew at an annual rate of 1.3% compared to the 4.8% reported in the preliminary figures.
- The raft of poor economic data continues with little to suggest a strong underlying economic recovery unlike most other Asian economies. Machine orders, industrial production and nationwide department store sales fell 8.4%, 15.1% and 11.8% respectively in the latest data release.
- The jobless rate, which had been improving over the past several months, resumed its deteriorating trend, falling to 5.2% in November.

Global Market Insights

Equities

- Global equity markets rallied strongly in 2009 though individual market performance was divergent. Emerging markets performed the best as their underlying economies rebounded sharply. The US and Europe also performed well with the latter benefiting from a weaker USD. Japan was the underperformer for the year as political uncertainty, the strong yen and a very anaemic economic revival kept investors at bay.
- With the global economy basking under large stimulus spending and record low interest rates, asset prices have recovered globally.
- Given the fragile nature of developed economies, the significant tightening of monetary policy appears unlikely in the first half of 2010 and liquidity will continue to flow towards emerging markets and Asia.
- Policy risk will play an important role in developed markets in 2010 as waning government popularity might result in populist policies that play well with voters but are economically unsound.
- The exit strategy from central banks and governments remains a key investment theme this year and will likely determine the economic performance of the global economy in the second half of 2010.

Bonds

- Global macro data point to further economic recovery, but inflation is not a major concern, with unemployment at elevated levels and as ample slack remains.
- Although the FED may hike rates later this year, aggressive tightening from G7 central banks remains highly unlikely.
- The end of quantitative easing within 2010 by the FED and the BOE will negatively impact supply-demand dynamics in the US and UK bond markets, but substantially higher issuance has been well absorbed so far, and the risks of a sharp sell-off in bond markets remains unlikely for now: near term funding risks remain limited.
- Deteriorating sovereign risk profiles and worsening fiscal dynamics remain a serious problem however, near term for the likes of Greece and similar weaker Eurozone members, and more medium to long term for the US and Japan.

Returns

- Global equity markets posed strong returns in 2009 as government stimulus spending and ultra loose monetary policy averted a global economic collapse.
- Global government bonds had another good month on the back of lower yields, in spite of an improved macro backdrop.

Equities Benchmark	December	Year-to-Date	12 Months
MSCI World (USD terms)	1.80%	29.99%	29.99%
Bond Benchmark	December	Year-to-Date	12 Months
World Govt Bond Index (\$ terms, unhedged)	-5.03%	2.55%	2.55%

Asia Pacific Economic Outlook

Overview

- Economic indicators in Asia is likely to show exception improvements over the next few months as the moderate global recovery and low base effect flatter year over year comparison.
- Reorientation of Asian economies towards domestic consumption would be a long term and gradual process. It will also bring about greater structural stability.
- Asian currencies will likely witness greater appreciation pressures in 2010 due to both liquidity inflows and economic growth differential between Asia and western economies.
- Central bank inactivity can potentially lead to renewed bout of inflation pressures, especially in the case where it actively intervenes to surpass currency strength.
- The ingredients for potential asset bubble in Asia in place, regulators and central bankers must navigate carefully in 2010 to prevent overheating of asset prices.

China

- China's loan growth remains very robust with CNY 295 billion of new loans extended in November providing ample support to the economy.
- While Chinese exports saw a dramatic collapse for most of 2009, as the global economic recovery gains traction, exports saw only modest drop of 1.2% in the month of November.
- The PMI index of 56.6 in November signals continued expansion in the manufacturing sector.

North Asia

- Hong Kong's unemployment rate drifted lower to 5.1% in November as the rebounding economy helps to alleviate the unemployment situation.
- Rebounding off a low base, Korea's industrial production grew 17.8% from year ago levels in November.
- Taiwan's exports and industrial production were up 37.1% and 31.5% respectively from year ago levels in November.

South Asia

- Similar to the rest of the region, Indonesia saw exports grow by 10.1% in October and the trend is expected to improve due to higher commodity prices and more favorable statistical comparisons.
- Unlike the rest of Asia, Malaysia's headline economic data is showing only small gradual improvements, with industrial production and exports only up 0.7% and 1.6% respectively.
- Philippines' OFW remittance rose to US\$1.53 billion up 6.7% and continues to surprise investors with its resiliency.
- India's monthly wholesale prices rose 4.8% in the month of November though measures such as primary articles WPI rose a worrying 15% in the latest reading, adding further pressure on the RBI to act in order to manage inflation expectations.

Pacific

- Australia 3Q GDP grew by 0.5% and 0.2% on a yearly and sequential basis respectively.

Asia Pacific Market Insights Equities

- Year-over-year comparison in economic indicators will increasingly indicate a rebounding Asian economic region though statistical comparisons could exaggerate the magnitude of improvement due to the base effect.
- Structurally, the Asian growth model will have to be reoriented from an export led model to one that is more grounded on increasing domestic consumption. This however, will be a long term and gradual process and cannot be expected to resolve the current global imbalances overnight.
- Asian currency appreciation will be an inescapable element if domestic consumption's share of GDP is to increase and we expect upward currency pressures to mount in particular due to the economic growth differential between Asian and western economies.
- Policy maker action in 2010 will likely determine whether Asian economies can enjoy sustainable and rapid long term economic growth. The ingredients of an asset bubble in Asia are currently in place and policy makers must be proactive in order to avert a boom bust scenario.
- Asia Pacific ex-Japan's 2010 estimated PE stands at 15.2X with an estimated earnings growth of +24.8% and three months earnings revision of +3.7%.

Bonds

- The recovery in Asian economies is likely to result in Asian central banks withdrawing accommodative monetary policy ahead of developed market central banks.
- We expect the amount of rate hikes to be modest: headline inflation will drift higher in the region, but core inflationary pressures remain muted.
- The degree of tightening priced into most yield curves remains exaggerated, even as the growth outlook and final demand from the developed world have recently improved. Moreover, Asian policy makers are likely to resort to other tightening options, with China now having initiated their tightening cycle.
- We remain fundamentally bullish on Asian currencies, and expect China to move back to a crawling peg sometime in 2010. Other Asian currencies will most likely follow.

Returns

- Asia Pacific ex Japan rose in the month of December to finish the year strongly and recovered a significant amount of the losses incurred in 2008.
- Asian government bonds had a flat month in December, but substantially outperformed global bonds.

Equities Benchmark	December	Year-to-Date	12 Months
MSCI Asia Pacific Ex Japan (USD terms)	3.59%	73.22%	73.22%

Bond Benchmark	December	Year-to-Date	12 Months
HSBC Asia Local Bond Index (\$ terms)	-0.24%	6.33%	6.33%

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

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

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