ING Investment Management Asia Pacific

July/August 2009

HOUSEVIEW

Global Economic Outlook

World

- Recent data releases continue to build the case for an upturn in global economic activity in 2H09. With 2Q GDP data mostly in, it is becoming clear that almost all G7 economies will have come out of technical recession by 3Q as will have countries in Asia.
- The improvement is, however, all based on a restocking cycle as inventories have been drawn down and production is expected to pick up for any rebuild. Any sustainable recovery will require a genuine pick up in consumption which is not yet in sight.
- With industrial production already recovering in Asia and anticipation of a recovery in the G7 economies in 2H2009 commodity prices have run up very hard. Commodity stocks have run harder and are due a correction.
- The major currencies have been rangebound for the past three months as relative prospects for real growth and inflation remain muted.

United States

- The unemployment rate dipped to 9.4% in July, the first decline in 15 months. The pace of job losses also slowed as payrolls fell by 247,000 after a 443,000 loss in June. While the worst in terms of job losses are behind us, the unemployment rate is sure to move higher in the coming months. The unemployment rate was also flattered by fewer people looking for jobs i.e. the labour participation rate also moved lower.
- If the employment news was upbeat, sales and income data were not so. Retail sales (ex autos) fell 0.6% in July against expectations of a small increase and nominal personal income fell by 1.3% MoM in June and is down 3.4% YoY – incidentally, the worst on record since the the monthly series began in 1959.
- More encouragingly, the various housing indicators have all been improving: new and existing home sales have picked up, housing starts are expanding and house price declines are moderating.

Europe

- France and Germany reported that their economies grew in the second quarter. The 16-nation Euro area however, shrank 0.1%, the best result in more than a year.
- In the UK, the Monetary Policy Committee surprised the market with its decision to extend asset purchases by GBP50bn to GBP175bn (12.6% of GDP).

Japan

- Japan's economy expanded 3.7% in 2Q (YoY) after declining 11.7% in the previous quarter. QoQ, the economy grew 0.9%, slightly below the 1% expected. Exports led the expansion contributing 1.6% to QoQ growth.
- Polls show that the ruling Liberal Democratic Party is likely to lose to the opposition Democratic Party of Japan, which has never held power before, in the lower house elections slated for the end of this month.
- The new government will have to tackle near record unemployment rates, currently at 5.4% and unprecedented wage cuts as monthly wages including overtime and bonuses dropped 7.1% in June. Japan's recovery is therfore expected to be weak as consumer spending will remain muted.

Global Market Insights

Equities

- Equity markets anticipated the bottoming out of global economic activity with remarkable prescience. Asian markets were the first to bottom out in October 2008, followed by the rest of the world in March 2009. Since the bottom, in October, Asia Pacific markets have outperformed developed markets by a very wide margin, gaining 78%. Over the same time frame Europe gained 35% followed by a 19% gain in the S&P500 in the US.
- While economies in Asia Pacific have better prospects for growth and are operating in a far better macroeconomic setting this is reflected in market valuations. Thus, Asia Pacific is trading at 19x 2009 and 15x 2010 earnings, about 2 to 4 points higher than the developed markets.
- If the global economic healing continues we would expect the marginal news flow from developed markets to improve in 2H09 while Asia consolidates its recent gains. Within Equities we prefer developed markets over Asian markets in the near term.

Bonds

- The outlook for the global economy has brightened in recent months on the back of a massive inventory correction, policy stimulus and easier financial conditions. For now this exerts upward pressure on bond yields, even if the lack of sustainable sources of private sector demand growth make a return to potential growth unlikely over the next year or two.
- With US monetary policy makers already having taken a lot of action, the majority of policy stimulus is likely to come from the fiscal side. We however do not expect any near-term tightening either and 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.
- After a strong performance of government bonds in recent weeks, the rally is likely to slow, as risk appetite recovers on the back of better than expected Q2 results. We favour European over US bonds.

Returns

- Buoyed by expectations of G7 economies emerging from recession in 2H09 global equities rallied strongly in July.
- Global government bonds started the month poorly with a sharp sell off mid-June before rallying in the 2nd half of the month on the back of weaker risk appettite and green shoot concerns.

Equities Benchmark	July	Year-to-Date	12 Months
MSCI World (USD terms)	8.47%	15.36%	-21.61%

Bond Benchmark	July	Year-to-Date	12 Months
World Govt Bond Index (USD terms, unhedged)	1.78%	0.25%	5.62%

Asia Pacific Economic Outlook

Overview

- Greenshots are manifesting themselves in better than expected economic data with the pace of decline slowing and in some cases moving into positive territory.
- So far, second quarter GDP growth for Asian economies are better than expectations.
- Second quarter earnings are also tracking better than expectations with aggressive cost cutting measures leading to margin expansion.
- Regional property markets continue to improve along with equity markets and sentiment. New property projects are being taken up quickly, indicating strong underlying demand.

China

- China's PMI stood at 53.3 in July and points to continued expansion.
- Second quarter GDP grew 7.9% on a YoY basis, outpacing the 6.1% performance in first quarter.
- Year-to-date industrial production is up 7%, in stark contrast to the contraction witnessed globally.

North Asia

- Hong Kong's exports fell only 5.4% in the month of June pointing towards potential recovery by the end of the year.
- Korea's second quarter GDP fell 2.5% from year ago though improved 2.3% compared to the previous quarter.
- Exports orders in Taiwan fell a moderate 10.9% in June, far outpacing expectations.

South Asia

- Providing signs that the economy has bottomed, Indonesia's consumer confidence index rose to 115.4.
- Malaysia's economy remained sluggish with industrial production dropping 11.1% in May though Singapore's economy rebounded sharply with advance GDP estimates up 20.4% on quarterly basis.
- Philippines' OFW remittance remained robust growing 3.7% in the month of May.
- India kept interest rate on hold and signalled that monetary tightening would eventually take place once the economy is on the mend.

Pacific

- Australia's house price index rose 4.2% QoQ signalling improvements in housing sector.

Asia Pacific Market Insights

Equities

- Anecdotal "green shots" are manifesting in better than expected economic data showing signs of global economic recovery.
- Domestic property markets are fast improving with increases in both number of transactions and price.
- Second quarter results are tracking better than expectations with analysts upgrading their overly bearish earnings numbers for 2009 and 2010.
- Second quarter GDP data for the regional economies are also likely to be better than expectations and upgrades to GDP forecasts are likely.
- Asia Pacific's 2009 estimated PE stands at 18.9X with an estimated earnings growth of 4.3% and 3 months earnings revision of 8.8%. Earnings growth estimate for 2009 is no longer negative.
- Earnings momentum is turning more positive as the market begins to discount better earnings for 2009 and 2010. With strong liquidity equity markets have rallied hard, we expect some consolidation in the regional markets.

Bonds

- Inflation has bottomed in Asia, and is bound to rise to more normal levels on the back of base effects and the YTD rise in commodity prices. A sharp rebound in asset prices is a source of concern in several countries, particularly Korea.
- The monetary easing cycle is over, with only the occassional rate cuts in Indonesia and the Philippines likely. Rate hikes within 2009 for the rest of Asia are unlikely. For 2010 we expect Korea and India to be among the first to start tightening policy.
- Macro-indicators across Asia point to a budding economic recovery, but after the impact of fiscal stimulus has worn off and the restocking process is completed, the outlook for domestic and external demand for Asia remains uncertain. This sets the stage for short term upward pressure on bond yields, but a relatively bond friendly environment in the longer term.
- Asian bond yields are well off their mid-June peaks, when fiscal sustaintability concerns, inflation fears, and noise about exit strategies from quant easing had an exaggerated impact on bond markets globally. At current levels we retain a more neutral outlook on Asian bond markets.
- We remain fundamentally bullish on Asian currencies medium term, but see near term risks as risk appettite consolidates.

Returns

- Since bottoming in October 2008 Asia Pacific equity markets have outperformed developed markets for nine months in row – a record.
- Asian local currency debt performed more or less in line with global bonds, with appreciating Asian currencies supporting the positive July return.

Equities Benchmark	July	Year-to-Date	12 Months
MSCI Asia Pacific Ex Japan (USD terms)	12.27%	49.33%	-10.26%

Bond Benchmark	July	Year-to-Date	12 Months
HSBC Asia Local Bond Index (USD terms)	1.68%	3.37%	2.48%

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

ING IMAP Houseview

	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 revision	• Earnings downgrades surprise on the downside • Availability of credit diminishes	High Medium
Global Bonds	• Accomodative monetary stance • Deficit spending and bond supply • Weak growth, despite recent green shoots • Increased G-20 and IMF support to EM economies	• Return of risk appettite/ demand for risky assets • Inflation worries escalating • Increasing fiscal deficits, rising public debt	Medium Low 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	• Bond supply and deteriorating fiscal dynamics • Accomodative monetary stance • Weak growth, despite recent green shoots • Increased G-20 and IMF support to EM economies	• Increased bond supply • Higher G3 bond yields • Increased inflation (due to higher commodity prices)	Low Low Low