

### Global Economic Outlook

#### World

- The global economic environment remains punctuated by a sub-prime crisis, a credit crunch, a housing market collapse and strong inflationary pressures.
- Inflation is being driven by food, energy and raw material prices in the face of strong demand growth, mainly from emerging countries.
- Monetary conditions in these economies remain loose and seem unlikely to be tightened at any time soon, so a world of high oil and commodity prices may be around for some time.
- After years in which the effect of globalisation was deflationary, the West is now importing inflation from emerging markets.
- Central bank policy is asynchronous - the US Fed is positioned, via easy monetary conditions, to avert a recession rather than beat inflation. The European Central Bank stance is the reverse.
- Persistent inflation will ultimately require the US and emerging economies to change their stance to more restrictive policy settings/controls - lower rates of economic growth will ensue.

#### United States

- Partial indicators of demand remain generally weak – the manufacturing and housing sectors, the labour market and confidence levels.
- Economic concerns and record high energy costs have contributed to consumer confidence falling in April to a 28 year low.
- With the homeowner vacancy rate (2.9%) and the existing home sales inventory both at all-time highs, the pain in the housing market is likely to continue in the months ahead.
- Further weakness in economic indicators is expected as tight credit conditions and sharply higher energy prices undermine confidence and spending activity

#### Europe

- The European economy grew by 0.8% in Q1'08 (2.2% yoy). Domestic demand was supported by robust capital expenditure.
- A slowdown in economic growth to a sub-par 1-1.5% pace is likely in 2008.
- The labour market remains resilient - the unemployment rate has held steady at 7.1%.
- Headline inflation (3.3% yoy) is running near a 15-year high.
- The ECB has signalled its desire to tighten monetary policy as per its anti-inflation resolve, this, despite defacto tightening provided by Euro currency strength.

#### Japan

- Current partial indicators remain biased on the side of weakness and point to economic growth of 1-1.5% in 2008.
- Consumer confidence has fallen abruptly and business conditions for the manufacturing sector have eased.
- With the official interest rate at 0.5%, the current negative real interest rate environment should provide some support to the economy.
- Domestic and external demand concerns will likely see the Bank of Japan hold to its current monetary policy stance.

#### Equities

- The stock market rally from March to May stalled as investors risk appetite evaporated – the bear market reasserted itself.
- Investors became and remain worried about the state of the financial system, deterioration in the prospects for economic growth, the pressure on earnings, the elevated levels of inflation and the increased risk that interest rates would be raised.
- Consensus earnings expectations for 2008 are still in positive territory and 10% growth expected in 2009. This is a remarkably optimistic viewpoint with room for significant downgrades, making valuations less attractive than they appear.
- Oil and commodity prices, though high and rising, show no signs of fatigue.
- Cash levels in mutual funds are now well above (15%+) their cycle lows which was around 5%.
- Stock markets have fallen substantially already and have discounted much bad news. However the fundamental drivers of equity markets – earnings, interest rates, investor sentiment and monetary conditions – all remain stalled, or have little positive impetus.
- We continue to recommend preservation of capital. Exposure to international equities should remain below its benchmark weight and overweight cash.

#### Bonds

- The trend of recent months of rising yields was reversed in June to varying degrees. This was not related to improved bond fundamentals because inflation expectations did not change.
- Rather, the concerted and widespread decline in equity markets pushed investors into less risky and safe haven assets - cash in particular and to a lesser extent bonds.
- The June FOMC statement was clearly hawkish, with greater emphasis on inflation than growth. However we believe the determination to raise rates in the short term is tempered by adverse liquidity conditions in the US economy.
- In Europe, the situation is clearer by virtue of the ECB's hardened resolve to tame inflation – rates will go higher.
- Global growth is slowing as lending restrictions and the "oil tax" bite. Whilst this growth trajectory supports bonds, elevated oil, food and commodity prices offset this.
- Continued volatility in bond markets can be assured. We recommend an underweight exposure and overweight cash.

#### Returns

- A uniformly atrocious month for equities around the globe. Year-to-date, Latin America is the only region to post a positive return. Asia has underperformed the global benchmark over June, the last three months and year to date. It has been the worst performing emerging market region over those periods.

Benchmark	Jun	YTD	12 mths
MSCI World (Local currency terms)	-8.23%	-12.81%	-15.02%

- The sanctuary offered by bonds in June is evident in the performance of the asset class. However the topline figures disguise the poor performance of European markets which succumbed to hawkish ECB inflation-related comments.

Benchmark	Jun	YTD	12 mths
World Govt Bond Index (Local currency terms)	-0.03%	0.09%	4.67%

## Asia Pacific Economic Outlook

### Overview

- For most of the first half of 2008 Asian exports have done better than expected due to US growth slowing less than expected and Europe and Japan taking up the slack. The multiplier effect has helped domestic demand hold up well.
- Intra-Asian trade remained robust as Asian central banks maintained pro-growth monetary policies.
- Central banks need to tighten monetary policies in order to ensure inflation does not become entrenched. Asian economic growth must slow.

### China

- Petrol prices were lifted by 16%, recognition of the mounting costs of price distortion – oil subsidies have risen from 0.2 % of GDP to over 1% in 12 months.
- May inflation numbers provided some (temporary) relief for policymakers but we expect monetary tightening to continue.
- Export growth continued to decline.

- GDP growth in 2008 will be lower than last year, though should be a respectable 9% plus.

### North Asia

- With further rate cuts unlikely or limited, and consumer confidence under threat from a weakening global economy and rising inflation, **Hong Kong** economic activity will moderate. Export slowdown will intensify in coming months.
- The hike in oil prices has had a delayed impact on **Taiwanese** growth. The mounting inflation pressure will likely trigger the central bank to tighten.
- Sub-par growth should be expected in **Korea** this year, though this will be more related to domestic demand than exports, which should hold up due to a strong shipbuilding sector. Won weakness and sustained strength in credit growth are negative for the inflation outlook.

### South Asia

- The unsustainable subsidisation of the petrol price in **India** was partially addressed by a series of measures

including a small rise in retail fuel prices. Rising twin deficits have put pressure on the rupee.

- Manufacturing and exports in **Malaysia** will face headwinds this year from a weak global economy. A 41% increase in the price of petrol will erode consumer discretionary income. GDP growth will slow to the trend rate or below.
- In **Thailand**, inflation is the main challenge for policymakers. Negative real interest rates need to be addressed. Politics remain an adverse influence.

### Pacific

- Notwithstanding the impact of the global economic growth slowdown on **Australia**, domestic economic resilience, fiscal policy easing, capacity pressures, high consumer price inflation and strong money growth point to further modest monetary tightening.
- Already the indications are that there will be a significant economic slowdown in **New Zealand** - a recession is distinctly possible. The central bank will cut rates.

## Asia Pacific Market Insights

### Equities

- Asia's safe haven status has not held up. Year to date performance has been less than the global benchmark, so the notion of "market decoupling" has been put to rest conclusively, at least for this cycle.
- Valuations, encapsulated in various composite indicators, still look unattractive even though they are down from their peaks.
- Earnings forecasts are still too optimistic. At the start of 2008 they were +11%. They are now down to +6%. But with input costs rising and volumes slowing there is a clear message that further EPS downgrades are on the way. Looked at another way, commodity prices are up 25% year to date and export prices are up a meagre 2%.
- As a larger percentage of disposable income in Asia is spent on food and basic necessities, the region is and has been harder hit by inflation than mature economies. Lead indicators bode poorly for consumption.
- The trade-off between safeguarding export growth and fighting inflation becomes increasingly obvious and higher interest rates are essential.
- Continued uncertainties and market volatility dictate a cautionary approach to Asian equity exposures. We recommend an underweight exposure at this point and overweight cash.

### Bonds

- There is a tendency at present by Asian policymakers to explain the various shocks pushing up inflation as temporary (as there was in the US in the 1970's), resulting in monetary policy being accommodative and real interest rates hovering in negative territory.
- As a result, fiscal and monetary policy in Asia is aligned with sustaining growth, rather than containment of price pressures and wage demands.
- But the rising cost of energy and agricultural goods is unlikely to fade soon – two thirds of Chinese energy consumption can be attributed to heavy industries, rather than factory inefficiencies or retail demand.
- What is required is for central banks to focus on restraining money supply growth and establishing a relatively high short term real interest rate environment in order to push inflation expectations downward.
- High oil, food, commodity and fertiliser prices have had a budgetary impact because of subsidies. Though many countries have moved to ease the fiscal strain, they remain behind the curve in the reflection of market prices. Additional funding will be required.
- Governments are behind the curve in fighting inflation and funding their budgets. We recommend being underweight this asset class and being overweight cash.

### Returns

- No market managed a positive return in June or year-to-date. The best markets so far in 2008 have been Thailand (-9.71%) and Korea (-10.30%). The worst performing market year-to-date has been India (-36.01%).

Benchmark	Jun	YTD	12 mths
MSCI Asia Ex-Japan (Local currency terms)	-9.59%	-17.20%	-7.62%

- Credits have clearly outperformed sovereigns over all periods. This in turn reflects the liquidity of government bonds which permits their higher level of volatility than credits. The best performing market year-to-date was India (+1.81%) and the worst was Indonesia (-4.33%).

Benchmark	Jun	YTD	12 mths
JACI Composite Index (USD terms)	-1.35%	-1.04%	2.88%

### Recommended Asset Exposures

<b>International Equities</b>	Underweight
<b>Asian Equities</b>	Underweight
<b>International Bonds</b>	Underweight
<b>Asian Bonds</b>	Underweight
<b>Cash</b>	Overweight

	Key Drivers	Key Risks	Risk Rating
<b>World Economy</b>	<ul style="list-style-type: none"> <li>Sustainability of consumer expenditure in US, Japan and Europe</li> <li>Stance of central banks – fight inflation or lower risk of recession?</li> </ul>	<ul style="list-style-type: none"> <li>US economy falls into recession</li> <li>US slowdown is longer than expected</li> <li>Credit/mortgage crisis impacts real economy</li> </ul>	<p>High</p> <p>High</p> <p>High</p>
<b>Global Equities</b>	<ul style="list-style-type: none"> <li>Extent and spread of world economic slowdown</li> <li>Earnings growth and the extent of revisions</li> <li>Extent to which financial sector is impacted by credit crisis</li> </ul>	<ul style="list-style-type: none"> <li>Earnings downgrades surprise on the downside</li> <li>Interest rates rise</li> </ul>	<p>High</p> <p>High</p>
<b>Global Bonds</b>	<ul style="list-style-type: none"> <li>Pace of global economic slowdown</li> <li>Degree of inflation expectations</li> </ul>	<ul style="list-style-type: none"> <li>Inflation surprises on the upside</li> <li>Inflation spills over into wages</li> <li>US\$ falls faster than expected</li> </ul>	<p>High</p> <p>Medium</p> <p>Low</p>
<b>Asian Equities</b>	<ul style="list-style-type: none"> <li>Economic growth slows - slowly</li> <li>International investors appetite for risk</li> <li>Impact of inflation</li> </ul>	<ul style="list-style-type: none"> <li>Earnings revisions surprise to the downside</li> <li>Interest rates rise</li> <li>Valuations fail to halt market slide</li> </ul>	<p>High</p> <p>High</p> <p>High</p>
<b>Asian Bonds</b>	<ul style="list-style-type: none"> <li>Extent of inflationary pressure</li> <li>Foreign capital flows</li> <li>Bond issuance to cover fiscal deficit</li> </ul>	<ul style="list-style-type: none"> <li>Central banks tighten monetary conditions - though not enough</li> <li>Inflation higher than expected</li> </ul>	<p>High</p> <p>Medium</p>

## Key Forecasts

	Real GDP				Inflation				90 Day Interest Rates*		10 Year Bond Yields	
	2007E Consensus#	ING	2008E Consensus#	ING	2007E Consensus#	ING	2008E Consensus#	ING	Actual 30-Jun-07	ING Forecast For Next 3 mths	Actual 30-Jun-07	ING Forecast For Next 3 mths
The World	2.9	+	2.8	+	4.3	0	3.1	0				
USA	1.5	-	1.7	0	4.0	+	2.5	0	1.84	Rising	3.97	Rising
Europe	1.9	0	1.7	0	3.2	+	2.4	0	4.95	Rising	4.62	Rising
Japan	1.3	-	1.5	0	1.1	-	0.8	0	0.86	Steady	1.67	Rising
Australia	2.9	-	2.8	0	4.0	+	3.2	+	7.84	Rising	6.45	Steady
China	10.1	-	9.4	0	7.0	+	4.5	+	7.47	Rising	7.83	Rising
Hong Kong	4.9	0	4.9	0	4.7	0	4.3	0	2.31	Rising	3.48	Rising
India	7.6	-	8.1	-	7.1	0	5.9	0	8.82	Rising	8.70	Rising
Indonesia	5.9	-	5.9	0	10.2	-	8.0	-	7.12	Steady	13.38	Steady
Malaysia	5.5	-	5.5	0	4.1	+	3.4	+	3.69	Rising	4.77	Rising
Philippines	5.3	0	5.4	0	7.3	0	5.4	0	6.06	Rising	9.43	Steady
Singapore	5.1	-	5.5	0	5.9	0	2.9	0	2.81	Rising	3.58	Rising
South Korea	4.5	0	4.9	0	4.1	0	3.3	0	5.37	Rising	5.93	Rising
Taiwan	4.4	0	4.8	0	3.3	0	2.7	0	2.25	Rising	2.69	Steady
Thailand	4.9	-	5.0	+	6.1	0	3.8	0	3.64	Rising	5.94	Rising

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

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

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## INVESTMENT MANAGEMENT



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