

March/April 2008

### Global Economic Outlook

#### World

- The flow-on impact of loose lending standards in the US continues to reverberate globally, now impacting not only lending standards and the cost of funding, but also the likely growth path of the US and other economies.
- Economic indicators have fallen away and are likely to further disappoint, enough to see global economic growth slow to its long-term average of 3.7% over 2008.
- A number of major central banks have eased monetary policy; an easing bias remains despite heightened inflation expectations.
- However if interest rate and economic growth differentials widen, \$US weakness will continue.
- The risk of the US consumer turning from a spender to a saver, represents a deflationary shock for the world economy and in particular export-driven Asia.

#### United States

- The economy has weakened - recent labour market, manufacturing and housing sector data have deteriorated. Confidence surveys remain downbeat.
- Existing and new home sales are down 22% and 34% respectively from year-ago levels.
- Economic data foreshadow an economic recession through H1'08. Policymakers have responded, with the Federal Reserve easing monetary policy aggressively (lowering interest rates from 5.25% to 3% currently) and also adjusting a range of other policy levers focussed on addressing bank-sector lending and liquidity concerns.
- We expect further policy easing to avoid a deep, protracted economic recession. A V-shaped recovery is not expected.

#### Europe

- Even though growth is slowing, there are still no indications of the kind of decline being seen in the US. Business confidence indicators have been mixed but remain consistent with or only slightly below, potential growth levels. This picture is confirmed by hard industrial production data as well as labour market conditions.
- Hard evidence of a credit crunch continues to remain elusive as indicated by recent corporate credit growth data which remains buoyant.
- Wage developments as well as global inflationary pressures point firmly to the upside risk to inflation. The ECB hurdle for an interest rate cut, we believe is higher than the market expects.

#### Japan

- The economy continues to look weak - measures of consumer confidence have deteriorated by up to 25% from the peaks reached in early 2006 and the corporate sector has reined in capital spending. The large number of negative economic data numbers in recent months indicates cyclical economic momentum is cooling. The main question is whether a recession will be avoided.
- At this point, employment and export numbers remain relatively healthy.
- A higher yen and raw material costs are weighing on company profits.
- Inflationary pressures are expected to moderate ensuring that the Bank of Japan will be in no hurry to raise interest rates.

### Global Market Insights

#### Equities

- A US recession is our central scenario – aggressive Fed monetary policy and government fiscal stimulus should prevent a deep recession.
- Corporate earnings are at risk, especially for cyclicals. We expect significant downwards earnings revisions later this year as higher credit and input costs weigh on (historically high) profit margins.
- Markets are incorporating an earnings slowdown of 5% to 10%. However visibility is low and markets can overshoot because risk aversion is high.
- Considerable market volatility should be expected in the months ahead. Markets are closer to forming a bottom than they were last month, however positive news momentum is weak.
- Valuations are not compulsive - current market multiples are higher than their historic averages.
- All of these factors point to a heightened need to preserve capital. For that reason we recommend an underweight exposure to International Equities.

#### Bonds

- Credit market worries dominate the outlook for financial markets and economies. Policy markets have been willing to respond positively judging by the aggressive rate cuts and the "rescue" of Bear Stearns.
- While a number of government bond markets have sold off in recent weeks, valuation models are still at levels which suggest they remain richly priced – a US recession and weaker global growth are more than adequately discounted in yields.
- Partly this has been in response to the fact global headline inflation is above its long term average. The oil price is near an all time high. Commodity prices are strong. Labour markets are still buoyant. Valuations have become unattractive
- An underweight position should be maintained for this asset class.

#### Returns

- Only three markets in Asia and some Latin American countries managed positive returns. Of the major markets, the US fared best being down only 0.42%. Asia was the worst of the emerging regions.

Benchmark	Mar	YTD	12 mths
MSCI World (Local currency terms)	-2.13%	-11.9%	-9.67%

- The Canadian and Australian markets performed best in March. The US had a positive return but most European markets experienced negative returns.

Benchmark	Mar	YTD	12 mths
World Govt Bond Index (Local currency terms)	0.08%	2.44%	5.73%

Asia Pacific Economic Outlook

China

- Severe snowstorms brought economic dislocation across large areas of China during January/February. The economies of China's major export markets – in particular the US - continued to slide. Mainland equity markets sold off sharply as growth fears came to the fore and investor's risk appetite subsided.
- Policymakers have thus reversed the credit tightening of the last half of 2007 to promote recovery from these adverse outcomes.
- Even so, high inflation is still perceived as a near term threat. Headline CPI jumped sharply again in February due to weather-related shortages and damages to winter crops ... from this perspective the aforementioned disruption may have been indeed a fortunate event.

North Asia

- The record 2007-08 Hong Kong Budget surplus has prompted a raft of tax cuts and one-off rebates along

with waivers on taxes for property and alcoholic beverages, none of which will be adverse for economic activity going forward.

- Korea economic data has surprised on the upside – industrial production, service sector activity and consumer demand – though weakening external sector is increasing the pressure to reduce rates.
- The Taiwan government lowered its 2008 GDP projection slightly reflecting the likely deceleration in export demand and manufacturing output. Inflation is at elevated levels and a rate hike is not out of the question.

South Asia

- The Indian economy recorded its slowest growth in nine quarters but still was at 8.4% YoY at the end of December. Going forward the economy will have to contend with high interest rates and a slowing external sector.
- Economic growth continues at a steady pace in Malaysia, though the political backdrop as a result of recent elections

has raised significant uncertainty and may have implications for economic policy making.

- The Thai economy ended 2007 on a strong note with GDP accelerating faster than expected. Exports were major contributors despite a strengthening baht. Inflation rose to its fastest in 20 months ensuring interest rates were kept on hold.

Pacific

- The fundamentals of the Australian economy remain robust, with a strong domestic sector supported by the ongoing global demand for commodities. Real GDP grew 3.9% over calendar 2007, well above par. The Reserve Bank has raised the cash rate to an 11 year high. Further monetary tightening, albeit modest, is anticipated.
- Record high interest rates in New Zealand, a cooling housing market and rising fuel and food prices appear to be reining in domestic activity. Indeed consumer sentiment slipped to an 18 month low in February.

Asia Pacific Market Insights

Equities

- Asia is a safe haven from the world economy because its consumer, corporate and government balance sheets are not dangerously leveraged – in fact they are not leveraged at all and as such are not vulnerable to the chief risk of forced deleveraging.
- But the rate of regional economic growth will slow for a period - that is the reality, and the downside, of globalisation. On the other hand, that is not to imply Asia will experience a recession. Indeed economic history suggests that Asia in these circumstances will merely incur a growth slowdown.
- The continuing risk for equity investors is that Asian stock markets will correct more than is justified by the ultimate aftermath and that is what is happening currently as Asian markets underperform the US.
- The arguments are that it is natural for investors to take profits on their largest gains, that it is clear there is a risk to earnings expectations given the commodity-driven margin squeeze and slowing external demand, and that the general rise in risk aversion causes investors to reduce exposures to supposedly, higher beta emerging markets.

- We believe that Asian stock markets will continue to decline, though ultimately this will still prove to be a correction in a secular bull market. Capital conservation is our major theme and as such, an underweight exposure to Asian equities is recommended.

Bonds

- Our expectation is that Asian economic growth will not subside into a recession – to the contrary, it will be a growth slowdown. Domestic economic drivers (via easy fiscal and monetary policies) will partially offset the headwinds from softening export demand from offshore.
- Our view is that the direct impacts on the region of the sub-prime mess will prove to be limited and a credit crunch in the region is unlikely. In essence, we believe the credit markets have more than priced in an elevated level of defaults associated with a recession and questionable credit risk management practices. There is room therefore for yields to improve.
- Strong economic fundamentals and the prospect of further rate cuts in the US, should provide impetus for a strengthening of a number of Asian currencies – this will also assist the attractiveness of Asian bond markets.
- The major market risk is heightened inflation but slowing growth will help in that regard. We recommend an overweight exposure to Asian Bonds.

Returns

- Asia outperformed Pacific markets, though both fell a long way behind the US. The stand out markets were Korea, Taiwan and Singapore. Double digit negative returns were not uncommon.

Benchmark	Mar	YTD	12 mths
MSCI Asia Ex-Japan (Local currency terms)	-5.75%	-14.31%	18.19%

- Sovereign securities outperformed credit. China had a particularly poor month while the Philippines was the regions best bond market performer.

Benchmark	Mar	YTD	12 mths
JACI Composite Index (USD terms)	-0.11%	0.12	3.60

Recommended Asset Exposures

International Equities	Underweight
Asian Equities	Underweight
International Bonds	Underweight
Asian Bonds	Overweight
Cash	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>Credit/mortgage crisis impacts real economy.</li> </ul>	<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 in the US, especially Financials</li> </ul>	<p>High</p>
<b>Global Bonds</b>	<ul style="list-style-type: none"> <li>Pace of global economic slowdown.</li> <li>Degree to which inflation expectations are further heightened.</li> </ul>	<ul style="list-style-type: none"> <li>Inflation surprises on the upside</li> <li>US\$ falls faster than expected</li> </ul>	<p>High</p> <p>Low/Medium</p>
<b>Asian Equities</b>	<ul style="list-style-type: none"> <li>The extent to which Asian markets are dependent on exports.</li> <li>International investors appetite for risk.</li> <li>Whether Asian stockmarkets can “de-couple” from developed markets.</li> </ul>	<ul style="list-style-type: none"> <li>Export generated earnings declines at greater pace than expected</li> <li>Asian central banks choke off the wall of liquidity</li> </ul>	<p>Medium</p> <p>Medium</p>
<b>Asian Bonds</b>	<ul style="list-style-type: none"> <li>Extent of inflationary pressure.</li> <li>Foreign capital flows.</li> </ul>	<ul style="list-style-type: none"> <li>Contagion effect of US sub-prime market difficulties</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 31-Mar-07	ING Forecast For Next 3 mths	Actual 31-Mar-07	ING Forecast For Next 3 mths
The World	2.9		3.2		3.5		2.7					
USA	1.4	0	2.3	-	3.4	0	2.3	0	1.35	Falling	3.41	Rising
Europe	1.9	+	2.0	+	2.7	0	2.1	0	4.73	Steady	3.90	Steady
Japan	1.3	0	1.8	0	0.6	0	0.5	0	0.84	Steady	1.36	Steady
Australia	3.3	0	3.2	0	3.3	+	2.8	+	7.86	Rising	6.05	Rising
China	10.2	+	9.6	0	5.0	0	3.6	-	7.47	Rising	7.83	Rising
Hong Kong	4.8	+	5.1	+	3.7	-	3.8	-	1.98	Falling	2.58	Rising
India	8.0	0	8.4	0	5.8	0	5.1	0	7.22	Steady	7.96	Rising
Indonesia	6.2	+	6.0	+	7.0	-	6.4	-	6.80	Steady	11.72	Rising
Malaysia	5.6	0	5.8	-	2.9	0	2.7	-	3.61	Falling	3.79	Steady
Philippines	5.6	0	5.8	0	4.1	0	3.8	0	6.44	Steady	7.27	Falling
Singapore	5.2	0	5.9	+	4.7	0	2.3	+	2.72	Falling	2.25	Rising
South Korea	4.6	-	5.0	0	3.3	0	2.9	+	5.38	Steady	5.14	Steady
Taiwan	4.3	+	4.6	+	2.2	+	2.0	+	2.23	Rising	2.47	Steady
Thailand	4.6	0	4.9	-	3.4	0	2.8	-	3.26	Steady	4.61	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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