



HOUSEVIEW

Global Economic Outlook

World

- While definitions differ, the economies of the US, the Euro area and Japan fell into a recession in this year, making this the first simultaneous recession in the three regions in the postwar era.
- The pace of economic deterioration has increased over the month of November with virtually all economic indicators across all regions indicating a sharp slowdown in economic activity, rising unemployment and consumption retrenchment.
- Inflation is falling away rapidly across the globe with commodity prices in retreat including oil. Weak demand from not only the developed economies but emerging markets which were expected to be resilient has sent commodity prices tumbling.
- Central banks and governments in economies large and small have accelerated their policy response in keeping with a sharply deteriorating economic scenario.

United States

- The long feared recession in the key US economy has now become reality. NBER, the official arbiter of the state of the US economy has declared that the US economy entered a recession in December 2007, making this contraction already the longest since 1982.
- The current quarter and the next are expected to be the most difficult periods with the economy contracting around 5 percent pace. Only a weak recovery may be anticipated in late 2009.
- The eternally resilient US consumer is showing signs of fatigue with retail sales dropping by the most on record. We expect this trend to continue as unemployment picks up in the coming quarters.
- Credit conditions have improved somewhat with closely watched TED spreads coming down to 2.2% levels from a high of 4.63% reached in mid-October. However, it is still at highly elevated levels.

Europe

- Macroeconomic data show the Euro area economy falling deeper into recession with November PMI falling to a record low of 38.9.
- The European Central Bank has delivered the biggest rate cut ever by lowering the benchmark rate by 75bps to 2.5%. While more cuts are expected over the course of 2009 we do not see scope for such large reductions from the ECB in the future.
- The Euro area economies are making individual choices for their respective fiscal stimulus plans rather than a common approach with France opting for a large fiscal boost while Germany remains more conservative.
- Nation wide house prices are continuing to fall at a record rate in the UK declining 14.9% yoy in November, we expect this trend to continue in the coming months.

Japan

- Real GDP contracted 0.4% q/q in 3Q after a 3.7% plunge in 2Q reaffirming that the economy is in recession.
- Both exports and retail sales dropped in October, confirming that external demand and domestic consumption are weakening simultaneously.
- A strong currency is certainly not helping Japanese exports as the Yen has appreciated 21% against the USD and 35% against the EUR. There are no clear factors to support growth in the near future, except fiscal stimulus which is unlikely to materialize soon.

Global Market Insights

Equities

- We expect marginal news flow to remain weak be it at the economic level or earnings guidance from companies. While a lot of bad news is priced in, confirmation of the worst fears will still lead investors to react negatively.
- Equity markets look attractively priced relative to their own history but corporate bond markets are certainly displaying a far more extreme undervaluation. We do not expect equity markets to rally sustainably without a clear tightening in credit spreads.
- Earnings growth and earnings visibility will become more uncertain in the coming months. This should lead to outperformance of high yielding stocks where the dividend payments are secure.
- Recent policy actions from central banks and governments have committed more than USD 2 trillion to resurrect confidence and capital markets. This should provide some support to equity markets.
- Investor sentiment is extremely depressed and cash levels with fund managers are at elevated levels. We recommend closing the underweight position in international equities and approach the new year with a neutral weighting.

Who Said That?

"Policies announced so far in the West are far from perfect. But by being so sweepingly large, they should save the financial system from imminent meltdown and should allow Western banks to roll over their maturing debt. But the cost will be a dramatically longer period of subpar growth and the potential erosion of the dynamic free-market model which has served the Anglo-Saxon countries well for so many years."

By Chris Wood, CLSA Chief Asia Strategist

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 with quantitative easing measures notably in countries where interest rates approach the 'zero bound'.
- Extensive "Keynesian" fiscal stimulus is used to fill the gap left by collapsing private sector spending. This contributes 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 end of November.
- We recommend a modest underweight exposure to international bonds.

Returns

- Equity markets have now declined for six months in a row. There were no clear outperformers in November with all developed market regions as well as emerging markets falling between 6% - 8% range.
- 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	November	Year-to-Date	12 Months
MSCI AC World USD terms, unhedged	-6.52%	-43.95%	-44.95%
Bond Benchmark	November	Year-to-Date	12 Months
CITI World Govt Bond Index USD terms, unhedged	3.70%	3.53%	3.00%

Overview

- Export growth rates from Asian countries have begun to decline and this trend will continue over the coming months depressing economic growth rates.
- Weak economies and falling inflation rates are prompting the central banks across Asia to reduce interest rates to support economic growth rates, however, this will also lead to softer currencies.
- The domestic sector in Asia remains strong and the financial sector appears solid with liquidity and capital ratios remaining at comfortable levels and little exposure to exotic derivative instruments and securities.
- While economic growth rates in Asia will be lower than prior years it would still be higher than any other region and a repeat of the Asian financial crisis is not on the cards due to a strong financial system, better fiscal management and much larger foreign reserves

China

- China has announced aggressive policy measures which include a 108 basis points cut in interest rate as well as a RMB4tn fiscal stimulus package in order to promote economic growth.
- Domestic financial system remains sound with the banking system still enjoying excess liquidity.
- We expect real GDP growth in 2009 to be in the range of 6% to 8%.

North Asia

- The Hong Kong economy will head further into recession in 2009, led by financial and property sector. Unemployment will continue to trend higher with increasing corporate retrenchments. Consumption and discretionary spending will also be slower.
- Korea remains in a difficult situation and the turn of the New Year is likely to provide little reprieve. The economy will continue to be weighed down by declining exports, foreign debt roll over and potential current account deficit.
- Economic weakness in developed countries is hurting export demand in Taiwan. Banking sector is also affected by the worsening global capital market conditions.

South Asia

- Financial liquidity and credit spreads will show improvements in India as the Reserve Bank of India continues to ease monetary policy. Infrastructure spending could resume from government stimulation plan. However, any further terrorist attacks will severely dent investor and consumer confidence.
- Government pump priming will lead to some cushioning of economic growth in Malaysia though export contribution to GDP will likely shrink especially in light of falling commodity prices.
- Political uncertainty will remain centre stage in Thailand and a new government needs to be formed. Policy stimulus is not likely forthcoming, given the political situation and tourism and export sectors will be significantly negatively affected.
- The key to the Philippines economy remains inward remittances which has so far proved resilient. Any weakness would affect consumption which remains the largest driver within the economy.

Pacific

- The Australia economy is likely to remain sluggish next year weighed down by weakness in the export sector where sharply lower commodity prices are exacting its toll. The property market is also likely to weaken further.

Asia Pacific Market Insights Equities

- Key export markets for Asia, namely US, Europe and Japan are all in recession which will reduce exports and the contribution to GDP growth. Fortunately, intra Asia trade is expected to hold up better as China and India continue to witness structural growth.
- Financial liquidity and credit availability is slowly improving as central banks aggressively cut interest rates and governments introduce economic stimulus plans. In Asia, banking system remains healthy, showing little evidence of over leverage or exposure to toxic assets.
- As earnings estimates become increasingly volatile and erratic, investors will focus on liquidity, balance sheet strength and franchise value instead of earnings growth. Large companies with stable business models and strong cash flows are expected to do well in this environment.
- Asia Pacific's 2009 estimated PE stands at 9.1x with an estimated earnings growth of 8%. Arguably, earnings estimates are still too high and will likely come down further. However, trailing Price to Book of 1.3X and 5.3% trailing dividend yield appear to be attractive, especially in light of increasingly lower interest rates.
- In 2009, Asia is likely to be a region that would exhibit the fastest economic growth globally led by China and India. With macro finances generally healthy and financial system leverage low, we expect Asia to rebound faster than other economic regions post the current downturn.
- The last few months of 2008 has provided the answer to the question which has been uppermost in most investors' minds so far – whether the global economy will slip into a recession. And, the answer is an unambiguous 'yes'. As we approach 2009 and over the next several months we hope to be able to find the answer to how long the recession will last. As the rate of economic deterioration accelerates globally, asset markets remain skittish as various probabilities are priced in. Underweight Asian equities is recommended.

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 stabilize 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 investors appetite may negatively impact markets with higher foreign participation. such as Indonesia and Malaysia.
- With the USD benefiting from global deleveraging, we expect Asian currencies to continue their weakening trend versus the greenback for now.
- We recommend being neutral this asset class.

Returns

- Asian stock markets continued to decline in November with significant currency losses in many countries. China was the clear outperformer with a gain of 4.52%.
- While Asian bond returns are firmly positive in domestic currency terms, Asian FX depreciation has pushed returns in USD into negative territory. Over 12 months Asian bonds have clearly outperformed equities.

Equities Benchmark	November	Year-to-Date	12 Months
MSCI Asia Pacific Ex Japan USD terms, unhedged	-6.09%	-55.62%	-56.07%

Bond Benchmark	November	Year-to-Date	12 Months
HSBC Asia Local Bond Index USD terms, unhedged	-0.81%	-7.70%	-6.70%

Recommended Asset Exposures	
Global Equities	Neutral
Asian Equities	Underweight
Global Bonds	Neutral
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. 	<ul style="list-style-type: none"> Emerging markets decline into recession. 	High
	<ul style="list-style-type: none"> Continued co-ordinated approach to the financial and economic crises. 	<ul style="list-style-type: none"> Protectionism emerges. 	Low
Global Equities	<ul style="list-style-type: none"> Prospects for economic growth. 	<ul style="list-style-type: none"> Earnings downgrades surprise on the downside. 	High
	<ul style="list-style-type: none"> Earnings growth and the extent of revisions. 	<ul style="list-style-type: none"> Availability of credit diminishes. 	Medium
Global Bonds	<ul style="list-style-type: none"> Extent and pace of bond issuance. Interest rate cuts. 	<ul style="list-style-type: none"> Government guaranteed bonds (from all sources) will crowd out non-governemnt guaranteed paper. 	High
Asian Equities	<ul style="list-style-type: none"> Extent Asia is impacted by the global economic slowdown. 	<ul style="list-style-type: none"> Earnings revisions surprise to the downside. 	High
	<ul style="list-style-type: none"> International investors appetite for risk. 	<ul style="list-style-type: none"> Valuations fail to halt market slide. 	High
Asian Bonds	<ul style="list-style-type: none"> Foreign capital flows. Bond issuance to cover fiscal deficits. 	<ul style="list-style-type: none"> Currency weakness 	High

Key Forecasts

	Real GDP				Inflation				90 Day Interest Rates*		10 Year Bond Yields	
	2008E#	ING	2009E#	ING	2008E#	ING	2009E#	ING	Actual 29-Nov-08	ING Forecast For Next 3 Months	Actual 29-Nov-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	-	0.04	Steady	2.92	Lower
Europe	1.0	-	-0.2	-	3.5	-	2.6	-	2.13	Lower	3.26	Lower
Japan	0.6	-	0.1	-	1.4	-	1.0	-	0.51	Steady	1.40	Steady
Australia	2.5	-	2.5	-	4.2	0	3.2	-	4.71	Lower	4.60	Lower
China	9.5	-	8.1	-	7.0	-	4.8	-	1.77	Lower	3.02	Lower
Hong Kong	3.6	-	1.4	-	4.7	-	4.3	-	0.03	Steady	1.66	Steady
India	7.1	-	6.6	-	7.8	-	6.6	-	6.86	Lower	7.08	Lower
Indonesia	6.0	-	4.7	-	10.5	-	8.2	-	12.99	Lower	15.58	Lower
Malaysia	5.3	-	3.3	-	5.8	0	4.1	-	3.39	Lower	3.67	Lower
Philippines	4.2	-	3.6	-	9.9	-	7.1	-	6.46	Lower	9.45	Lower
Singapore	2.5	-	1.2	-	6.4	-	3.0	-	0.82	Lower	2.29	Lower
South Korea	4.2	-	2.8	-	4.8	-	3.6	-	5.43	Lower	5.75	Lower
Taiwan	3.7	-	2.5	-	3.8	-	2.5	-	1.71	Lower	1.49	Steady
Thailand	4.5	-	3.2	-	6.5	-	3.7	+	3.29	Lower	3.83	Lower

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

Asia Pacific Consensus Forecasts - Consensus Economics Inc.

INVESTMENT MANAGEMENT



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