



HOUSEVIEW

Global Economic Outlook

World

- Industrial production, business confidence and real estate markets continue to show sequential improvements. Year-on-year comparison will look better going forward due to the base effect as third quarter 2008 onwards saw the economic fallout due to the collapse of Lehman Brothers.
- As the year draws to a close, trading volume and market liquidity is likely to further diminish and perhaps there will be greater volatility in the market place.
- The return of the carry trade is further pressuring the US dollar and boosting prices of risk assets.
- The outlook for 2010 remains a year of economic recovery though the timing of monetary tightening and withdrawal of fiscal stimulus could introduce volatility into the market place.

United States

- October's ISM manufacturing index rose to 55.7, signalling that manufacturing activity is growing again and at an accelerating rate.
- The unemployment rate continued to inch up registering 10.2% in the month of October, breaching the psychological 10% level. The US lost another 190,000 jobs in the month and continues to point towards a bleak outlook for the employment market.
- The FOMC kept interest rates unchanged at 0-0.25%. Interest rates are expected to remain low for the foreseeable future, given the fragile status of the US economy.

Europe

- The ECB kept interest rates unchanged at 1% and their expectations of a rate hike in the near future are low.
- While Euro-zone industrial production improved 0.3% MoM in September, which was the fifth consecutive month of sequential improvement, it remains 12.9% lower than the previous year's level.
- Euro-zone consumer confidence improved to -18 in the month of October, though the figure remains deeply negative.

Japan

- Industrial production improved 1.6% sequentially in the month of August though the figure was still down 19% from year ago levels. Machine tool orders highlight the difficulty in the Japanese economy, down 62.1% from year ago levels.
- Retail activity in Japan remained weak with total retail trade down 1.4% YoY. Supermarket sales and nationwide department store sales were particularly weak falling 2.4% and 7.8% respectively.
- The jobless rate in Japan continued to show a positive trend with the latest figure at 5.3% improving from 5.5% in the previous month.

Global Market Insights

Equities

- Global equity markets retreated moderately in the month of October though buyers stepped in quickly at market pullbacks.
- The third quarter earnings season was generally better than expectations. Investor focus has shifted away from companies that are cost cutting to maintain profitability to companies showing signs of revenue growth.
- The unemployment trends remain difficult and we would expect the eventual turnaround in the labour market to be slow and incremental.
- While secondary market volumes have declined, the primary issue pipeline remains very robust, especially in Asia ex-Japan.
- The substantial outperformance of developing markets vs. developed markets could reverse as economic recoveries in G7 countries continue to gain traction.

Bonds

- Global macro data remains broadly supportive, but unemployment is still rising and ample slack remains. Hence, in the absence of demand-pull inflation, inflation is a medium- rather than a short-term concern. We expect the Fed to keep interest rates in the 0-0.25% range until Q3 2010 and to only modestly increase them thereafter. Aggressive tightening from other G7 central banks is also unlikely.
- Asset markets are being driven by the “liquidity-trade”, as excess liquidity supports any asset class that provides a yield that is in excess of cash. This includes bonds, and particularly spread products.
- Poor fiscal dynamics will at one point take their toll on developed market bonds, but for now the demand for bonds continues to exceed supply by a comfortable margin.
- A sharp sell off in bond markets is unlikely. Beyond the sharp stimulus and inventory driven rebound, we expect bonds to perform relatively well as financial markets transition into a slower, broader recovery, where demand-pull inflation is not a near-term problem.

Returns

- Global equity markets corrected moderately in October though buyers quickly stepped in at market pullbacks.
- Global government bonds had an uneventful month, with bond yields modestly higher, and the USD flat vs JPY and a tad weaker vs EUR.

Equities Benchmark	October	Year-to-Date	12 Months
MSCI World (USD terms)	-1.78%	22.70%	18.42%

Bond Benchmark	October	Year-to-Date	12 Months
World Govt Bond Index (USD terms, unhedged)	0.10%	5.65%	16.56%

Asia Pacific Economic Outlook

Overview

- India was the second Asian economy to tighten monetary policy in response to an improving economic outlook.
- Asia is expected to reverse the current extremely relaxed monetary policy and fiscal stimulus measures earlier than G7 countries.
- Third quarter earnings have generally tracked or beaten consensus expectations. Markets continue to move higher on capital inflows and buoyant liquidity.
- After a brief pause, the IPO market is heating up once again in Asia as companies capitalise on the strong interest for Asian equities.

China

- China's PMI was 55.2 in the month of October, again coming in better than expected.
- Industrial production was up 13.9% in September bringing the year-to-date total to up 8.7%.
- Third quarter GDP growth was very strong, up 8.9% vs year ago levels.

North Asia

- Hong Kong's unemployment rate encouragingly fell 0.1% to 5.3% in the month of September.
- Korea posted stronger than expected third quarter GDP growth, up 2.9% sequentially and 0.6% compared to the previous year.
- Taiwan's industrial production posted a 1% increase in September, the first positive number since August of last year.

South Asia

- With inflation at only 2.57%, Indonesia continued to keep benchmark rates unchanged at 6.5%.
- Malaysia's industrial production fell less than expected, contracting by 5.7% in August.
- Philippines' OFW remittance rose to US\$1.37 billion, up 2.8% from year ago levels.
- India's central bank also began to tighten monetary policy with a hike of SLR to 25% and by increasing banks' provisioning requirement of commercial real estate to 1% from 0.4%.

Pacific

- After being the first Asian economy to tighten interest rates, the Reserve Bank of Australia kept interest rates unchanged this month at 3.5%.

Asia Pacific Market Insights

Equities

- Third quarter earnings have generally tracked or beaten consensus estimates with management comments being somewhat cautiously optimistic towards 2010.
- Market corrections appear to be short and shallow with buying interest returning quickly after small market adjustments.
- Liquidity remains buoyant with the IPO market heating up once again after a brief pause.
- Asian economies will likely see monetary policy and fiscal policy tightening before G7 economies. However, we expect the pace of tightening to be measured as central banks deem economic recoveries to be fragile.
- Asia Pacific's 2010 estimated PE stands at 14.4X with an estimated earnings growth of 21.4% and three months earnings revision of +5.2%.
- Markets continue to grind higher on momentum and buoyant liquidity and with the third quarter earnings season progressing well, markets can continue to rally heading into year-end.

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 is exaggerated as the longer term growth outlook and final demand from the developed world remains uncertain.
- Strong capital inflows complicate the situation, as higher Asian interest rates will attract more capital coming in, necessitating even more aggressive FX intervention, hence more liquidity to be mopped up.
- This excess liquidity, and diminished bond supply concerns, are likely to cap upside in Asian bond yields.
- We remain fundamentally bullish on Asian currencies, and expect China to move back to a crawling peg sometime in 2010.

Returns

- Asia Pacific ex-Japan fell slightly in the month of October with investors using market dips as an opportunity to acquire stock.
- Asian local currency bonds traded in a range in October, with Asian currencies weakening towards the end of the month after a strong start.

Equities Benchmark	October	Year-to-Date	12 Months
MSCI Asia Pacific Ex Japan (USD terms)	-0.35%	62.71%	65.84%
Bond Benchmark	October	Year-to-Date	12 Months
HSBC Asia Local Bond Index (USD terms)	0.29%	5.70%	12.55%

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

	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 	<p>High</p> <p>Low</p>
Global Equities	<ul style="list-style-type: none"> Prospects for economic growth Earnings growth and the extent of revision 	<ul style="list-style-type: none"> Earnings downgrades surprise on the downside Availability of credit diminishes 	<p>High</p> <p>Medium</p>
Global Bonds	<ul style="list-style-type: none"> Accommodative monetary stance Deficit spending and bond supply Muted core inflation and weak consumer demand 	<ul style="list-style-type: none"> Return of risk appetite/ demand for risky assets Exit of accommodative monetary policies Inflation worries escalating Increasing fiscal deficits, rising public debt 	<p>Medium</p> <p>Low</p> <p>Low</p> <p>Low</p>
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 	<p>High</p> <p>High</p>
Asian Bonds	<ul style="list-style-type: none"> Bond supply and fiscal stance Excess liquidity Extent of growth rebound 	<ul style="list-style-type: none"> Higher G3 bond yields Increased inflation and higher commodity prices Premature and excessive monetary policy tightening 	<p>Low</p> <p>Medium</p> <p>Low</p>

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