



HOUSEVIEW

Global Economic Outlook

World

- Global economic activity continues to slow and the OECD Leading Economic Indicators show no signs of bottoming.
- The second half of 2008 and first half of 2009 is shaping as a period of widespread economic weakness.
- Growth worries are currently centred on OECD economies, but this will envelop emerging economies shortly as the demand for their exports from developed markets slows down.
- Concerns about the US financial system is undermining confidence generally, though the US Treasury bail-out (Troubled Asset Relief Plan) will help – but in due course.
- Central banks need to lower official interest rates – asset deflation is the problem now, not inflation.
- Further out, deleveraging of the household and financial sectors will be a key constraint on growth.

United States

- Numerically the US is not in recession – YoY real GDP was 2.1% at the end of Q2. However, the strong contributions by exports and inventories mask a plunge in domestic demand. Anecdotal evidence suggests strongly the US is in recession.
- As we have said constantly in recent months, the US consumer will turn from spender to saver and in those circumstances the US economy can only slow. This scenario is now unfolding. It will continue and intensify as consumer wealth continues to be eroded by falling house prices and stock markets.
- Policy focus is centred on addressing systemic risk facing the financial sector. Various fiscal measures have been implemented, the provision of liquidity has been a key objective and we expect that interest rates will be lowered significantly.
- With unemployment rising and commodity prices falling rapidly, inflation is no longer a priority for the Fed.

Europe

- Eurozone economic indicators have deteriorated sharply over the past two months and broad-based weakness is evident – German GDP contracted in Q2.
- Domestically a substantial involuntary build-up in inventories is being signalled and capital goods orders are weakening. Unemployment is rising slowly but only because it is early in the cycle.
- There has been a steep decline in export orders as a result of the strong Euro and weakening demand from foreign markets.
- This sombre picture should ensure that the ECB continues to cut rates.

Japan

- Further confirmation that the Japanese economy has moved into a recession was provided by the latest Tankan report - deteriorating domestic demand conditions and slowing global growth being the key reasons.
- With interest rates already close to zero, economic policy responses to the current environment are restricted to two macro alternatives – increasing liquidity, which is being implemented, though slowly, and increased fiscal spending, a strategy which has growing political support. A supplementary budget has been framed.
- We expect a short recession as there are minimal capacity, labour and inventory excesses.

Equities

- Global equity markets will continue to be haunted by multiple fears and uncertainties – fears about the efficacy of the global financial system, a global credit crunch, slowing economic growth, elevated inflation and excessive earnings expectations.
- We expect economic growth to be low and slow. Corporate and consumer balance sheets will be under repair. These actions will put substantial strain on profit growth and margins.
- We note there is strong empirical evidence that buying cheap equity markets, despite poor earnings, has been a lucrative strategy.
- Falling earnings and stock prices have decoupled when valuations are cheap, inflation has begun to fall, interest rates have fallen significantly and once global lead indicators of economic growth have bottomed. Perhaps that is when economic expectations are most depressed.
- Our count at this point on these four criteria is that only one – attractive valuations – supports a decoupling right now.
- The fact is inflation has only recently plateaued, though is close to falling. Economic growth will be weak for an extended period of time, and will envelop emerging markets. And essentially, the aforementioned fears and uncertainties means the way is clear now for central banks around the globe to orchestrate continued coordinated cut in interest rates.
- We therefore recommend international equity exposures be underweight until further into the second half of 2008.

Who Said That?

“One thing we can be sure of about the credit crisis is that it will end. Markets hope for a return to business as usual. No such thing will happen. The post-credit crisis world will be a durably altered one compared to the twin decades of disinflation that preceded it.”

--- David Roche, President, Independent Strategy and co-author “New Monetarism”

Bonds

- Fixed income markets – bonds, credit, money market and their accompanying derivatives – are in unprecedented territory on the back of fear of systemic failure of the global banking system.
- Systemic failure means there is no credit generation. Without credit generation the mechanics of the underlying economy stop functioning ... companies can no longer buy supplies without instant cash payment, students can no longer borrow to finance their education and cars and homes become impossible to buy for all but most of the population.
- It is crucial banks be supported and there is sufficient liquidity to ensure the credit mechanism continues to operate.
- Bonds have been the recipient of significant flight-to-quality flows over the past month making their valuations unattractive.
- Going forward the supply of bonds will become a factor adversely impacting yields as budget deficits (funding bail-outs) and as economic growth slows causing government's revenues to come under pressure.
- Inflation is no longer the issue anywhere – economic growth, or the lack of it, and systemic issues are what count now.
- We recommend an underweight exposure to international bonds and overweight cash and near-cash securities.

Returns

- An atrocious month for all stockmarkets, but the US (for the third month in a row) outperformed the benchmark. Emerging markets all performed poorly.
- Another good month for bonds, with many of the major markets achieving positive returns.

Equities Benchmark	September	Year-to-Date	12 Months
MSCI World (Local currency terms)	-10.78%	-22.75%	-25.09%
Bond Benchmark	September	Year-to-Date	12 Months
World Govt Bond Index (Local currency terms)	0.32%	2.85%	4.86%

Asia Pacific Economic Outlook

Overview

- Asian economic growth is already slowing and will decelerate further. Regional real GDP growth will fall from close to 9% in 2007 to near 7% in 2009.
- Asia is highly export sensitive. Rapidly weakening US and European economic growth will take its toll.
- Foreign direct investment flows into Asia will likely be affected.
- However there will be a partial offset in the shape of domestic demand.
- Asian central banks will move from tightening monetary settings to loosening them in response to the global economic and financial environment.
- Governments are generally in a comfortable position to be able to ramp up spending – consumption may be stimulated because consumers have suffered from high food and energy costs, and infrastructure projects will be favoured.

China

- The fear is that the most robust of the top four economies in the world, **China**, will also suffer a severe slowdown. And while 9% GDP growth for 2008, and around the same level for the following year, is the lowest for some years, it hardly represents a calamity.
- Beijing has been pro active in easing monetary policy and is also in a position to back this with stimulatory fiscal measures. Headline inflation has declined.

North Asia

- **Hong Kong** is a financial and property market hub and as such will suffer heavily from the global credit crisis. The wealth affect from falling stock and property markets will be substantial with the result consumer spending will slow significantly.
- The high leverage of the corporate and household sectors in **Korea** has caused a domestic credit, balance of payments and currency crisis.
- Sub-4% GDP growth in **Taiwan** likely for 2009 as domestic demand remains sluggish and exports decelerate. Government spending and fixed investment have contracted.

South Asia

- **India** has received a reality check – growth prospects have been pruned sharply, inflation is peaking at 12% plus and there are question marks over its public finances.
- **Malaysia's** economy is slowing and will weaken further as the synchronised developed world downturn takes its toll on what is a very open economy.
- Political uncertainties in **Thailand** will weigh on household spending and investment. But, unlike 2007, when exports soared putting a floor under growth, the going is likely to get tougher. With inflation falling, the Bank of Thailand can ease policy.
- Private consumption growth in **The Philippines** slowed sharply as households curtailed their spending in the face of soaring prices. Overseas remittances will decline with the global economy and provide less support for domestic demand.

Pacific

- Economic growth in **Australia** is slowing towards a sub-par 2.5% pace, a “soft landing” is in prospect. Consumer and business confidence has retreated. There remains scope for further cuts in interest rates even after 1% cut in October.
- **New Zealand** recorded its second consecutive quarter of negative GDP growth – it is in recession. A positive quarter of growth is unlikely before 2009. Interest rates will be cut further.

Asia Pacific Market Insights

Equities

- Asian capital markets are caught in a major ugly behavioral finance event. Both equity and credit markets have punched down through key index and historic valuation support levels. Investors confidence has collapsed with markets.
- Recent events illustrate that “globalisation” can have some nasty side-effects. But the hope is that policy makers act with sufficient force that this downward spiral is reversed.
- In the midst of this market turmoil though, investors can decipher some facts – valuations in Asia are becoming attractive, sentiment is poor, analysts have taken their earnings numbers lower though not as low as we had hoped, interest rates will fall and October-February is historically a good period for equity markets in Asia.
- Valuations based on earnings, overstate the attractiveness of equities. Those based on Price/Book Value, which remove this bias, are at 10 year average levels. No bull market has started at average valuation levels.
- Sentiment is reflected in foreign flows, which are negative now to the same extent as occurred during the SARS crisis.
- Earnings have been pruned back, though its debatable the latest forecasts reflect the most recent expectations for slower economic growth and its implications for margins and revenue.
- Inflation risks have receded and growth risks has accelerated – this signals a reversal of monetary policy.
- However, this is a bear market and rallies should be treated cautiously. Portfolios should be defensively structured.
- We believe an underweight exposure to Asian equities is appropriate in light of the above circumstances.

Bonds

- Amid the turmoil gripping global financial markets, it is easy to lose perspective on the longer term implications for Asia’s economies. Two issues stand out – firstly, since the demand for Asia’s products will remain sluggish for some time, a reorientation of the region’s economies will be required so that they become more self-reliant and growth is generated from domestic sources, and secondly, most countries in the region enjoy excess savings and so are in a good position to generate investment funds locally. In the shorter term, inflation, which has been the major focus for central bankers and policy makers, can now be consigned to a monitoring brief. The availability of credit and sustainability of banking systems takes over centre stage.
- Criticism that the region’s monetary policy has been more accommodative than it ought to have been at this point in the business cycle, has now proved to be a blessing in disguise.
- However political upheavals in Korea, Malaysia and Thailand have only exacerbated the impact of global problems.
- Sovereign bonds are lower risk than other asset classes and afford a degree of security in that respect.
- We recommend being neutral this asset class and being overweight cash.

Returns

- Another poor month for Asian stockmarkets with negative returns occurring in every market. The Pacific region performed no better. The best performing markets were Korea and the Philippines.
- Sovereign bond markets also had a bad month with no market escaping the carnage.

Equities Benchmark	September	Year-to-Date	12 Months
MSCI Asia Pacific Ex Japan (Local currency terms)	-13.20%	-34.45%	-34.13%

Bond Benchmark	September	Year-to-Date	12 Months
JACI Composite Index (USD terms)	-4.92%	-4.35%	-2.63%

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

	Key Drivers	Key Risks	Risk Rating
World Economy	<ul style="list-style-type: none"> Globally co-ordinated monetary and fiscal policies to support banking systems and promote availability of credit. 	<ul style="list-style-type: none"> World economy falls into recession. US slowdown is longer than expected. Credit crunch and sub-prime crisis impacts the world's real economy. 	<p>Low</p> <p>High</p> <p>High</p>
Global Equities	<ul style="list-style-type: none"> Depth and spread of world economic slowdown. Size of earnings revisions. Extent to which financial sector is impacted by credit crisis. 	<ul style="list-style-type: none"> Break-down of the global financial system. Earnings downgrades surprise on the downside. 	<p>Low</p> <p>High</p>
Global Bonds	<ul style="list-style-type: none"> Policy response to the global credit crunch and efficacy of the banking system. Size and speed of new issuance. 	<ul style="list-style-type: none"> Break-down of the global financial system. 	<p>Low</p>
Asian Equities	<ul style="list-style-type: none"> Degree to which exports slow. Extent to which governments can expand fiscal policy. Rapidity of cuts in interest rates. 	<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"> Policy response to the global credit crunch and efficacy of the banking system. 	<ul style="list-style-type: none"> Break-down of the global financial system. 	<p>Low</p>

Key Forecasts

	Real GDP				Inflation				90 Day Interest Rates*		10 Year Bond Yields	
	2008E#	ING	2009E#	ING	2008E#	ING	2009E#	ING	Actual 30-Sep-08	ING Forecast For Next 3 Mths	Actual 30-Sep-08	ING Forecast For Next 3 Mths
The World	2.9	0	2.5	0	5.1	+	3.7	0				
USA	1.8	0	1.4	0	4.5	0	2.9	0	0.74%	Lower	3.82%	Rising
Europe	1.6	0	1.1	0	3.6	0	2.7	0	5.27%	Lower	4.02%	Rising
Japan	0.9	0	0.9	0	1.6	0	1.2	0	0.87%	Steady	1.46%	Steady
Australia	2.6	0	2.6	0	4.4	+	3.3	0	7.32%	Lower	5.40%	Lower
China	9.9	-	9.1	-	6.8	+	4.6	+	7.20%	Lower	7.74%	Steady
Hong Kong	4.4	0	4.2	-	4.9	0	4.7	0	3.66%	Lower	2.89%	Lower
India	7.5	+	7.6	0	8.0	+	6.5	0	8.80%	Lower	8.64%	Lower
Indonesia	5.9	+	5.6	0	10.5	+	8.5	0	8.10%	Lower	13.20%	Lower
Malaysia	5.5	-	5.1	0	5.7	0	4.5	0	3.69%	Lower	4.57%	Lower
Philippines	4.7	-	4.8	0	9.7	0	6.8	0	4.13%	Lower	8.14%	Lower
Singapore	4.2	0	4.6	0	6.3	0	3.2	0	3.90%	Lower	3.20%	Lower
South Korea	4.4	0	4.3	0	4.9	+	3.8	0	5.83%	Lower	5.88%	Lower
Taiwan	4.3	0	4.4	+	3.8	+	2.9	-	2.22%	Lower	2.17%	Lower
Thailand	4.8	0	4.6	+	7.0	+	4.6	+	3.95%	Lower	4.40%	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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