AUGUST 2009

ING ORANGE VIEW

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Global Economic Outlook

World

- Recent data releases continue to build the case for an upturn in global economic activity in 2H09. With 2Q GDP data mostly in, it is becoming clear that almost all G7 economies will have come out of technical recession by 3Q as will have countries in Asia.
- The improvement is, however, all based on a restocking cycle as inventories have been drawn down and production is expected to pick up for any rebuild. Any sustainable recovery will require a genuine pick up in consumption which is not yet in sight.
- With industrial production already recovering in Asia and anticipation of a recovery in the G7 economies in 2H2009 commodity prices have run up very hard. Commodity stocks Have run harder and are due for a correction.
- The major currencies have been rangebound for the past three months as relative prospects for real growth and inflation remain muted.

United States

- The unemployment rate dipped to 9.4% in July, the first decline in 15 months. The pace of job losses also slowed as payrolls fell by 247,000 after a 443,000 loss in June. While the worst in terms of job losses are behind us, the unemployment rate is sure to move higher in the coming months. The unemployment rate was also flattened by fewer people looking for jobs i.e. the labour participation rate also moved lower.
- If the employment news was upbeat, sales and income data were not so. Retail sales (ex autos) fell 0.6% in July against expectations of a small increase and nominal personal income fell by 1.3% MoM in June and is down 3.4% YoY – incidentally, the worst on record since the the monthly series began in 1959.
- More encouragingly, the various housing indicators have all been improving: new and existing home sales have picked up, housing starts are expanding and house price declines are moderating.

Europe

- France and Germany reported that their economies grew in the second quarter. The 16-nation Euro area however, shrank 0.1%, the best result in more than a year.
- In the UK, the Monetary Policy Committee surprised the market with its decision to extend asset purchases by GBP50bn to GBP175bn (12.6% of GDP).

Japan

- Japan's economy expanded 3.7% in 2Q (YoY) after declining 11.7% in the previous quarter. QoQ, the economy grew 0.9%, slightly below the 1% expected. Exports led the expansion contributing 1.6% to QoQ growth.
- Polls show that the ruling Liberal Democratic Party is likely to lose to the opposition Democratic Party of Japan, which has never held power before, in the lower house elections slated for the end of this month.
- The new government will have to tackle near record unemployment rates, currently at 5.4% and unprecedented wage cuts as monthly wages including overtime and Bonuses dropped 7.1% in June. Japan's recovery is therefore expected to be weak as consumer spending will remain muted.

Global Market Insights

Equities

- Equity markets anticipated the bottoming out of global economic activity with remarkable prescience. Asian markets were the first to bottom out in October 2008, followed by the rest of the world in March 2009. Since the bottom, in October, Asia Pacific markets have outperformed developed markets by a very wide margin, gaining 78%. Over the same time frame Europe gained 35% followed by a 19% gain in the S&P500 in the US.
- While economies in Asia Pacific have better prospects for growth and are operating in a far better macroeconomic setting this is reflected in market valuations. Thus, Asia Pacific is trading at 19x 2009 and 15x 2010 earnings, about 2 to 4 points higher than the developed markets.
- If the global economic healing continues we would expect the marginal news flow from developed markets to improve in 2H09 while Asia consolidates its recent gains. Within Equities we prefer developed markets over Asian markets in the near term.

Bonds

- The outlook for the global economy has brightened in recent months on the back of a massive inventory correction, policy stimulus and easier financial conditions. For now this exerts upward pressure on bond yields, even if the lack of sustainable sources of private sector demand growth make a return to potential growth unlikely over the next year or two.
- With US monetary policy makers already having taken a lot of action, the majority of policy stimulus is likely to come from the fiscal side. We however do not expect any near-term tightening either and expect the Fed to keep interest rates in the 0-0.25% range until at least Q3'10, and only to modestly increase the policy rate thereafter. We project the ECB to keep the refinance rate at 1% until late 2010, and Japan to keep overnight rates at 0.1% throughout 2009 and 2010.
- After a strong performance of government bonds in recent weeks, the rally is likely to slow, as risk appetite recovers on the back of better than expected Q2 results. We favour European over US bonds.

Returns

- Buoyed by expectations of G7 economies emerging from recession in 2H09 global equities rallied strongly in July.
- Global government bonds started the month poorly with a sharp sell off mid-June before rallying in the 2nd half of the month on the back of weaker risk appettite and green shoot concerns.

Equities Benchmark	July	Year-to-Date	12 Months
MSCI World (USD terms)	8.47%	15.36%	-21.61%
Bond Benchmark	**July**	**Year-to-Date**	**12 Months**
World Govt Bond Index (USD terms, unhedged)	1.78%	0.25%	5.62%

Source - Bloomberg

Asia Pacific Economic Outlook

Overview

- Greenshoots are manifesting themselves in better than expected economic data with the pace of decline slowing and in some cases moving into positive territory.
- So far, second quarter GDP growth for Asian economies are better than expectations.
- Second quarter earnings are also tracking better than expectations with aggressive cost cutting measures leading to margin expansion.
- Regional property markets continue to improve along with equity markets and sentiment. New property projects are being taken up quickly, indicating strong underlying demand.

China

- China's Private Mortgage Insurance (PMI) stood at 53.3 in July and points to continued expansion.
- Second quarter GDP grew 7.9% on a YoY basis, outpacing the 6.1% performance in first quarter.
- Year-to-date industrial production is up 7% , in stark contrast to the contraction witnessed globally.

North Asia

- Hong Kong's exports fell only 5.4% in the month of June pointing towards potential recovery by the end of the year.
- Korea's second quarter GDP fell 2.5% from year ago though improved 2.3% compared to the previous quarter.
- Export orders in Taiwan fell a moderate 10.9% in June, far outpacing expectations.

South Asia

- Providing signs that the economy has bottomed, Indonesia's consumer confidence index rose to 115.4.
- Malaysia's economy remained sluggish with industrial production dropping 11.1% in May though Singapore's economy rebounded sharply with advance GDP estimates up 20.4% on quarterly basis.
- Philippines' OFW remittance remained robust growing 3.7% in the month of May.
- India kept interest rate on hold and signalled that monetary tightening would eventually take place once the economy is on the mend.

Pacific

- Australia's house price index rose 4.2% QoQ signalling improvements in housing sector.

Asia Pacific Market Insights

Equities

- Anecdotal "green shoots" are manifesting in better than expected economic data showing signs of global economic recovery.
- Domestic property markets are fast improving with increases in both number of transactions and price.
- Second quarter results are tracking better than expectations with analysts upgrading their overly bearish earnings numbers for 2009 and 2010.
- Second quarter GDP data for the regional economies are also likely to be better than expectations and upgrades to GDP forecasts are likely.
- Asia Pacific's 2009 estimated PE stands at 18.9X with an estimated earnings growth of 4.3% and 3 months earnings revision of 8.8%. Earnings growth estimate for 2009 is no longer negative.
- Earnings momentum is turning more positive as the market begins to discount better earnings for 2009 and 2010. With strong liquidity equity markets have rallied hard, we expect some consolidation in the regional markets.

Bonds

- Inflation has bottomed in Asia, and is bound to rise to more normal levels on the back of base effects and the YTD rise in commodity prices. A sharp rebound in asset prices is a source of concern in several countries, particularly Korea.
- The monetary easing cycle is over, with only the occassional rate cuts in Indonesia and the Philippines likely. Rate hikes within 2009 for the rest of Asia are unlikely. For 2010 we expect Korea and India to be among the first to start tightening policy.
- Macro-indicators across Asia point to a budding economic recovery, but after the impact of fiscal stimulus has worned off & the restocking process is completed, the outlook for domestic and external demand for Asia remains uncertain. This sets the stage for short term upward pressure on bond yields, but a relatively bond friendly environment in the longer term.
- Asian bond yields are well off their mid-June peaks, when fiscal sustainability concerns, inflation fears, and noise about exit strategies from quant easing had an exaggerated impact on bond markets globally. At current levels we retain a more neutral outlook on Asian bond markets.
- We remain fundamentally bullish on Asian currencies medium term, but see near term risks as risk appettite consolidates.

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

Indian Economic Outlook

India

- The Index of Industrial Production (IIP), during May 2009, rose 2.7% yoy, marginally above expectations. This increase reflects a modest recovery from the prolonged sluggishness during H2FY09.
- In line with expectations, The Reserve Bank of India (RBI) did not make any change in the key policy interest rates and reserve requirements in its first quarter review of The Annual Policy Statement.
- GDP growth outlook for FY10 was maintained at 6%. RBI is turning positive on growth but maintains that an uptrend in the growth momentum is unlikely before the middle of 2009-10. Inflation projection for end-FY10 raised upwards to 5% (from 4% as projected in Apr-09).
- Wholesale Price Index based inflation for the week-ended July 18, 2009 came in at -1.54% yoy, compared to -1.14% in the previous week. However, CPI remains a concern and continues to be the focus of policy makers.

Source: www..rbi.gov.in

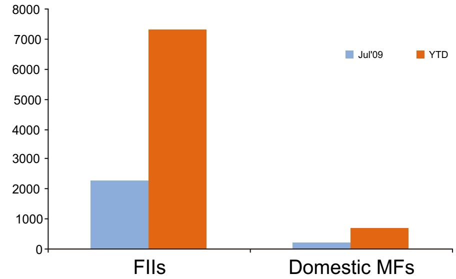
Indian Equity Market Insights

India

- After taking a breather in month of June, global markets again continued their upward surge in month of July with most developed market gaining 8-10%. Indian markets also went up broadly in line with global markets. The large cap Indices Sensex and Mid cap indices ended the month with gains of 8.1% and 9.6%, respectively.
- FIIs flow continued in the month of July. FIIs invested US$2.3bn in month of July. Domestic MFs also were net buyer of the markets, buying US$234 worth of equities.
- Auto and FMCG were the top performing sectors during July registering gains of 25% and 21% respectively. Capital Goods and Oil and Gas sectors, however, fared badly during last month.

Source: ING IM Internal Research Team & www.sebi.gov.in

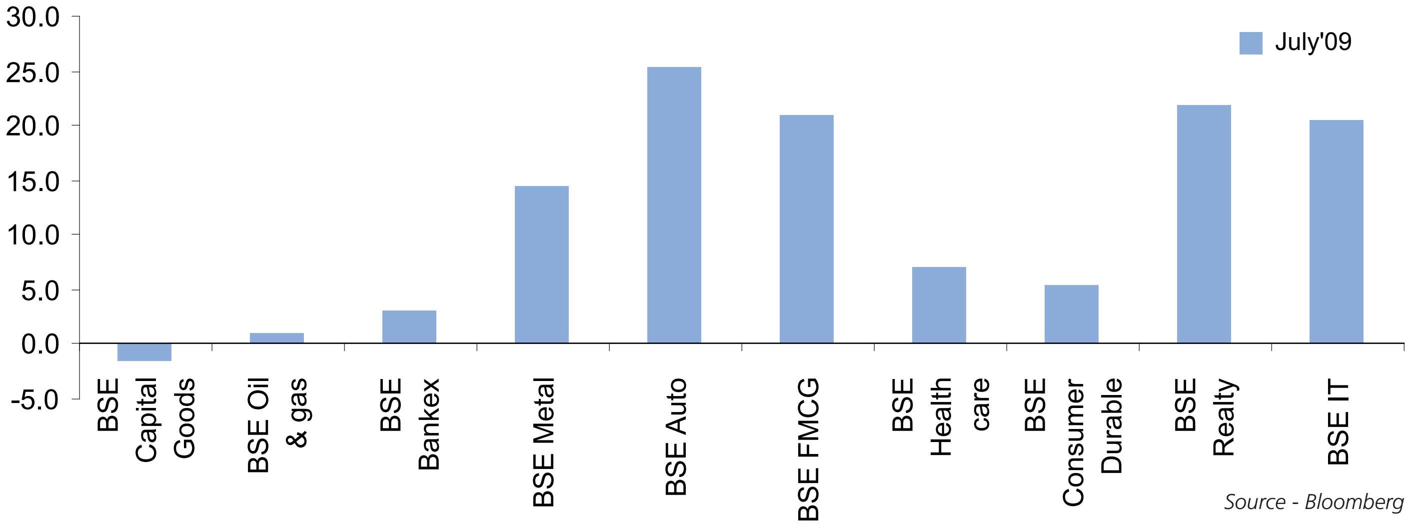
FII and MF Trend (Inflows)



Source: www.sebi.gov.in

Snapshot of Sectoral Trend

% change compared to previous month.



Source - Bloomberg

ING Overview of Sectoral Trend

Industrial Manufacturing and Construction

- The sector is still recovering from the shocks of last year and spending has not returned to normal as yet. While government spending continues, private spending is still under pressure. Construction activities has not really picked up in spite of positive sentiments all around. Valuations have run up significantly and are at a substantial premium to overall market. We maintain a cautious outlook on the sector.

Information Technology

- 1st quarter results for most IT companies were broadly in line with expectations. While the large companies were able to hold on to the margins due to careful cost control, smaller companies suffered due to significant reduction in topline. Pricing pressure remains high and profitability in the coming quarter will depend a lot on recovery in demand and movement of US$. We remain cautious on the sector at current valuations.

Steel

- Global steel production showed remarkable improvement in June 2009 witnessing de-growth of -16% yoy for the month as compared to de-growth of -23% for the aggregate of first 5 months of 2009. While re-stocking demand resulted in price up tick in the developed economies, Chinese economy witnessed a price rise on the back of strong demand and higher raw material prices. Even as the weakness in the demand persists, stable prices, lower costs and improving liquidity situation point towards the bottoming out of global steel industry.

Media

- Ad growth remains a challenge for most media companies as visible in first quarter results. Ad revenue fell by as much as 25% for many companies leading to severe margin pressures. While print media is gaining on cost front due to significant reduction in newsprint prices, broadcasting media is facing great difficulties due to high programming and fixed costs. While a modest recovery is expected in the current year, things are likely to normalise only by next year. We maintain our cautious view.

Telecom

- 1st quarter results were below par for most large companies with revenue growth slowing down significantly. The intense competition in market coupled with implementation of MNP is likely to lead to margin pressure for most players. We remain focused on large integrated player with better economies of scale.

Auto

- With improved quarter on quarter product mix supported by lower input costs and interest costs, most auto companies reported sharp improvement in profitability for the 1st quarter of FY2010. Going ahead, as economic activity improves and banks ease lending, auto volumes should continue their strong run for the rest of the year. Demand for commercial vehicles has also increased sequentially in line with the gradual improvement in economic activity and government stimuli. However, failure of the monsoons could affect two wheeler volumes which have been strong due to higher rural sales.

FMCG

- Consumer Goods sector stands to benefit from Government's continued focus on the upliftment and development of rural and social sectors by way of increased budgetary outlays for the rural schemes in the released budget. Increase in budget allocation to NREGA schemes by 44% to INR 311 bn, higher MSPs and higher farm sector credits stand positive for aggregate rural income. FMCG companies will also benefit from the abolishment of commodity tax transaction & fringe benefit tax, non-reversal of excise cuts and proposed introduction of GST.

Cement

- Cement demand has been strong in the 1st half of 2010 supported by increased government spending in social sector schemes and one off spending including pre-election spending by the government. However, demand revival has been skewed regionally with the northern and central regions being the key drivers, while the southern region slowed significantly. As we had expected most cement companies reported improved profitability in the 1st quarter of FY2010, reflecting the benefits of higher cement prices and lower input costs. Going forward, although demand growth is expected to remain steady, significant capacity addition would result in declines in capacity utilization putting pressure on cement prices.

Source: ING IM Internal Research Team

Indian Debt Market Overview

- Huge increase in borrowing by the government in the new budget led to a Bond market selloff but as the market realized that after accounting for the MSS issuances and already increased borrowing , the excess borrowing for rest of the financial year works out to INR 40k cr rather than 90k cr. Also lack of supply at the far end of the curve and a reasonable borrowing calendar for the rest of the first half led to market reviving to pre budget levels. However, lack of strong appetite for Bonds led to yields rising after each auction with 10 year G-Sec closing at 7.00% as compared to 6.90% last month.
- Interest rates hardened across major markets in the world with US 10 years Gilt closing at 3.61% vs 3.49% in the previous month. Similarly UK 10 year Gilt moved up from 3.64% last month to 3.81% this month, Aus 10 year Gilt from 5.50% to 5.59% and Korea 10 year Gilt from 5.18% to 5.33%
- Front end of the curve in corporate Bond market remained flat with a slight increase in 1 year CD levels from 5.20% previous month to 5.30% in this month. 10 year AAA corporate bond yield rose from 8.55% to 8.68% this month. Yields rose largely on account of increased corporate bond supply and any significant market appetite amongst mutual funds without any large flows in short term and duration funds. 5 year Bond G-sec spread however shrunk to a low of 128 against 135 last month and 10 year Bond G-sec spread remained flat at 155 bps.
- INR Swap curve backed up on offshore paying as well as Bond swap positions. 5 year Bond –swap rose from 20 bps to 45 basis. 5 year swap moved up from 6.30% to 6.36%. Swap curve however flattened with 2*5 OIS coming in from 139 bps to 123 bps.
- Currencies remained flat with EURO closing at 1.4137. USD/INR remained flat at 47.96 vs 47.91 in previous month end. USD JPY also remained flattish at 95.75 as compared to 95.97 previous month.
- Base metals continued to show stronger performance on faster economic recovery theme. Oil prices however came off from highs of USD 71.93 last month to close at USD 67.07. Gold also came off from 940.20 in previous month to 934.90 this month.

Macro Economic Matrix

FACTOR	Impact on Debt Market				
	Very Negative	Negative	Neutral	Positive	Very Positive
Economic Growth			✓		
Credit Deposit Trends				✓	
Fiscal Situation		✓			
Inflation				✓	
Liquidity Situation				✓	
External Sector			✓		
Monetary Policy Stance			✓		

Source: ING IM Internal Research Team

Going Forward

- Market continues to face heavy supply side pressures in August after which the borrowing starts tapering off, hence we can see yields stabilizing by middle of august as market starts building in lower borrowings in future.
- Market expected to remain volatile with central banks also giving mixed signals as to the monetary policy stance but most of the major central banks have by and large done with their rate cutting spree and are expected to be on wait for few months before taking any decision as to stay put or raise rates.
- Economic data will continue to move markets. Going by recent data, signs of economic recovery continues to be real though would be long drawn process then a V shaped recovery.
- Month on month commercial vehicle data points out to some real economic recovery in India.
- Inflation will continue to remain subdued for few months before base effect starts kicking in. CPI numbers however remain high.

Fund recommendation

- **Short Term Funds:** With credit spreads ruling around levels of 140 bps these funds would be able to generate decent accrual income along with duration plays. With credit spreads expected to stabilize going forward, we expect the short term funds to perform well going forward and maintain our positive outlook for an investment horizon exceeding 6-8 months.
- **Gilt Funds:** Given the current environment, medium to long term horizon for fixed income funds is neutral.
- **Liquid funds:** We expect liquid funds to generate steady returns going forward. These funds still remain the best avenue for risk-averse investors who do not wish to lock-in their investments.

Key Global Forecasts

	Key Drivers	Key Risks	Risk Rating
World Economy	• Deleveraging of consumer, financial and corporate sectors • Continued co-ordinated approach to the financial and economic crises	• Emerging markets decline into recession • Protectionism emerges	High Low
Global Equities	• Prospects for economic growth • Earnings growth and the extent of revisions	• Earnings downgrades surprise on the downside • Availability of credit diminishes	High Medium
Global Bonds	• Accomodative monetary stance • Deficit spending & bond supply • Weak growth, despite recent green shoots • Increased G-20 & IMF support to EM economies	• Return of risk appettite/ demand for risky assets • Inflation worries escalating • Increasing fiscal deficits, rising public debt	Medium Low Low
Asian Equities	• Asia is impacted by the global economic slowdown • International investors appetite for risk	• Earnings revisions surprise to the downside • Valuations fail to halt market slide	High High
Asian Bonds	• Bond supply and deteriorating fiscal dynamics • Accommodative monetary stance • Weak growth, despite recent green shoots • Increased G-20 and IMF support to EM economies	• Increased bond supply • Higher G3 bond yields • Increased inflation (due to higher commodity prices)	Low Low Low

	Key Drivers	Key Risk	Outlook
GILT OUTLOOK MATRIX Short Term	• Neutral monetary policy stance • Inflation declining/weak economic numbers. • Easy liquidity • SLR demand from banks	• Higher supply on account of government bond auctions • Recent rise in commodity prices • Inflationary expectations on better economic numbers	Neutral
Long Term	• Rise in central bank policy rates	• Expansionary fiscal policy measures resulting in huge government borrowing • Rebound in economic growth	Negative
CORPORATE BOND OUTLOOK MATRIX Short Term	• Attractive spreads. • Increase in FII limit	• High supply in terms of refinancing and re-issuances by banks and corporates.	Neutral
Long Term	• Rise in central bank policy rates	• Credit markets to remain strained • High issuances at the longer end of the curve • Weak corporate earnings • Large investors in fixed income mutual funds can exit in one day notice	Negative

Source: ING IM Internal Research Team

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As on 27.08.2009

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