JUNE 2009

ING ORANGE VIEW

FEATURES

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Global Economic Outlook

World

- The gradual healing of the global economy that began in March is continuing. The improvement is broad based across developed and emerging markets and across regions. Asia Pacific is at the forefront of the revival with China and India leading.
- The improvement in the economies has been reflected across asset markets with equities and more recently credit markets marking rapid gains. Currency markets are signalling increasing preference with a weakening bias for the USD.
- With improvements in the economy commodity prices have witnessed massive gains with oil and copper as two of the more closely watched commodities gaining more than 50% YTD.
- However, inflation remains subdued universally with high unemployment, low capacity utilisation and a still shrinking global economy. While commodity prices have improved they are largely well below prices last year.

United States

- A decline in jobless claims below 610,000 in each of the two most recent weeks from an average of 658,000 in March is the most reassuring signal so far from the US.
- There exists a plethora of indicators for the future health of the global economy. Amongst all, US treasuries being one of the most liquid and widely followed have historically been one of the few which have been consistent and prescient. Recently, the US yield curve has steepened dramatically with the 10 yr yield close to 4% and the 30 yr yield close to 5%. Indicating one or a combination of the following (i) a strongly reviving US/global economy, (ii) surging inflation in the future arising from aggressive monetary and fiscal initiatives from the US government and the federal reserve, (iii) a weakening confidence in the USD or (iv) a declining confidence in the US government's ability to successfully negotiate its future obligations.
- Yet (i) looks doubtful, (ii) appears unlikely in the near term with rising unemployment and a large output gap, (iii) presents a difficult dilemma as there are no other viable alternatives for a reserve currency and (iv) is outright alarming. The message is sobering!

Europe

- The Euro area is showing signs of stabilization with Private Mortgage Insurance (PMI) Rising to 40.7 in May from 36.8 in the previous month with the output component highlighting that the pace of contraction in industry is slowing.
- UK house prices rebounded in May in a sign that the property market slump is easing. Consumer confidence also matched the highest level in 11 months in May as people became more optimistic that they can weather the recession.

Japan

- The Japanese economy has been one of the worst hit in the current downturn with real GDP declining 4.3% and 8.8% YoY in 4Q08 and 1Q09.
- A weak domestic demand environment coupled with plunging exports, declining around 40% YoY has had a severe impact on the economy.
- Japan remains an economy most exposed and therefore most sensitive to a global economic recovery. A strong outperformance from the Japanese stock market should provide the strongest sign that the global recovery is sustainable and for real. Such signs are not apparent yet.

Global Market Insights

Equities

- Aggressive policy support leading to improving credit conditions have resulted in increasing consumer and business confidence which has been adequately reflected in asset markets. Recent investment considerations are, however, shifting from growing confidence about the economy to the recovery's sustainability.
- Emerging markets have seen larger inflows than developed markets since March as investors have been chasing 'higher beta' cyclicals with the Greater China region being a prime beneficiary. Of late this trend is reversing with global equity funds finding favour over emerging markets as laggard plays.
- While the global economy appears better than few months back the future trend in unemployment remains a big uncertainty, wealth destruction has taken place on a massive scale, developed world savings rate is on the rise, G7 consumption (>80% of global consumption) is expected to remain weak and banks will be less willing to supply credit as they repair their balance sheets. Under these conditions any recovery will be weak. Equity markets are pricing in a robust 'V' shaped recovery with a P/E ratio 15.9x 2009 and 12.7x 2010 with EPS growth (-13%, 2009) and (+25% 2010). These valuations represent a strong recovery beginning very soon – a scenario which is burdened with risk of disappointment.

Bonds

- US Treasuries once again weakened over the month, with improving macro sentiment, fiscally-induced supply and the diminished safe-haven appeal all contributing to the upwards pressure on yields. The yield curve steepened, with 10-year yields ending the month 34bps higher at 3.46%.
- Although the outlook for the global economy has brightened in recent months, we continue to believe that the lack of sustainable sources of private sector demand growth due to ongoing deleveraging and weakening income growth make it unlikely that economic equilibrium or a return to potential growth will be reached 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. However, further QE action cannot be excluded if financial conditions do not ease over the coming months. We expect the Fed to keep interest rates in the 0-0.25% range until Q3'10, and to modestly rise thereafter. We expect the ECB to continue to ease, bringing the refinance rate to 0.75% by Q3'09.

Returns

- Since the lows in early March, equity markets have rallied strongly for three months in a row.
- Global bonds had a strong month in May. Contribution from bonds were negative, with yields rising in most markets. However, sharp USD weakness resulted in very strong contribution from FX (in USD terms), leading to the strong performance of the index over the month.

Equities Benchmark	May	Year-to-Date	12 Months
MSCI World (USD terms)	9.06%	6.83%	-34.83%

Bond Benchmark	May	Year-to-Date	12 Months
World Govt Bond Index (USD terms, unhedged)	3.33%	-1.61%	4.35%

Source: Bloomberg

Asia Pacific Economic Outlook

Overview

- Despite improvements in activity, exports remain negative on a year-on-year basis.
- 1QGDP reports were mixed with most posting worse than expected numbers as exports collasped.
- Continuing to witness sequential improvements in economic indicators as the global economic climate stablises.
- Asian currencies continues to appreciate amidst further bouts of US dollar weakness.
- Strong liquidity is driving markets higher and further foreign capital inflows are expected.

China

- China's PMI stood at 53.1 in May declining from 53.5 in April though still signalling expansion.
- Exports decline accelerated to 22.6% in the month of April.
- Domestic consumption remained firm with retail sales growing 14.8% in April.

North Asia

- Hong Kong's GDP fell sharper than expected, down 7.8% in first quarter of 2009.
- Industrial production fell 8.8% in April and improved 2.6% from March in Korea.
- Taiwan's first quarter GDP fell 10.2%, which was worse than expectations.

South Asia

- Despite a dramatic slowdown, Indonesia's GDP nevertheless grew 4.4% in the first quarter.
- Malaysia's GDP fell by 6.2% in the first quarter as exports collasped.
- Philippines' OFW remittance remained robust growing 3.1% in the month of March.
- Due to increased government spending, India's first quarter GDP grew at a better than expected 5.8%.

Pacific

- As an indication of Australia's sluggish real estate sector, new building approvals fell 16.1% compared to year ago although improved 5.1% on a month on month basis.

Asia Pacific Market Insights

Equities

- Economic indicators point to stablising economic conditions though exports remain deeply negative on yearly basis.
- Liquidity remains abundant with investors willing to venture back into illiquid small and mid cap stocks.
- Asian currency strength is being further driven by US dollar weakness.
- There have been some earnings upgrades with positive momentum developing in earnings revisions.
- Market volume has picked up significantly unlike the rally in January where price gains were not matched with volume gains.
- Asia Pacific's 2009 estimated PE stands at 16.8X with an estimated earnings growth of -4.7% and 3 months earnings revision of +1.6%.
- This is a full valuation reflecting a strong recovery. We expect that the market is done some correction.

Bonds

- Asian local rates markets returned a positive performance during the month, with the strong performance of Asian FX being somewhat muted by the accompanying weakness in local bonds.
- Yield curves steepened across most of the regional markets, as improving macro fundamentals, upcoming supply and some inflationary concerns caused the longer end yields to back-up, while the short end remained well-anchored. Indonesia was the best performer, while Thailand's bond market was the worst impacted.
- We have moved to a neutral outlook on Asian bond markets (from overweight earlier), as heavy government bond supply, the end of the rate cutting cycle in most markets and some recovery in underlying growth data result in re-pricing of various yield curves in Asia. Upward momentum in US Treasury yields is also likely to negatively impact Asian bond markets.
- The near term environment remains favourable for risk appetite and is likely to keep the USD under pressure. We expect Asian currencies to continue strengthening, as strong current accounts supported by capital inflows into the regions' equity markets provide a favorable backdrop.

Returns

- Asia Pacific equity markets have outperformed developed markets. The Indian stock markets led with a gain of 36.68% in May as the results of the national elections were viewed positively.
- Asian local currency debt performed well in May. Strong performance by Asian currencies was somewhat muted by flat performance by bond markets.

Equities Benchmark	May	Year-to-Date	12 Months
MSCI Asia Pacific Ex Japan (USD terms)	14.42%	31.80%	-30.89%

Bond Benchmark	May	Year-to-Date	12 Months
HSBC Asia Local Bond Index (USD terms)	1.65%	0.76%	1.91%

Source: Bloomberg

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

Indian Economic Outlook

India

- Current ruling coalition United Progressive Alliance (UPA) won 262 out of 543 seats in the 2009 General Election. One can look forward to the formation of a stable government for the next 5 years given the strong mandate.
- In 4QFY09, India's GDP grew 5.8%, slightly above the market estimates. The 3QFY09 growth number has been revised upwards to 5.8% from 5.3%. Compared with the 2.2% decline reported in 3Q (now revised to a 0.8% decline), agricultural grew 2.7% in 4Q.
- Industrial Production (IP) data for the month of March did not provide any respite with Index declining 2.3% compared to decline of 0.7% (revised) in February.
- Wholesale Price Index based inflation for the week-ended May 16, 2009 came in at 0.61% yoy, broadly in line with expectations. We expect inflation to move to negative zone in next few weeks.
- Corporate India continued with its full year FY09 results. While the pressure on revenue and margins are clearly visible, broadly the results have been slightly better than expectations.

Source: www..rbi.gov.in

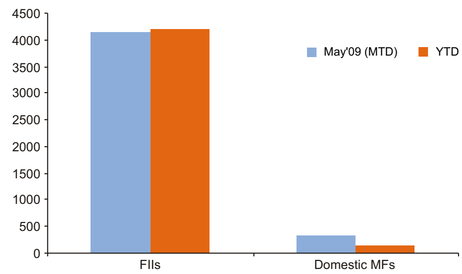
Indian Equity Market Insights

India

- May turned out to be a great month for emerging market equities with most emerging market indices registering double digit growth.
- Indian markets rallied significantly on back of ruling United Progressive Alliance's (UPA) victory in general election. BSE Sensex registered positive returns of 28.3% during May.
- FIIs continued to invest heavily in Indian market and pumped in more than US$4bn in the equity markets. MFs also turned buyer in the month of May buying ~US$300m worth of equities.
- Realty was the top performing sector during May registering the highest gain (up 79%). Metals, Consumer Durables and Capital goods sector also delivered returns in excess of 50%.

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

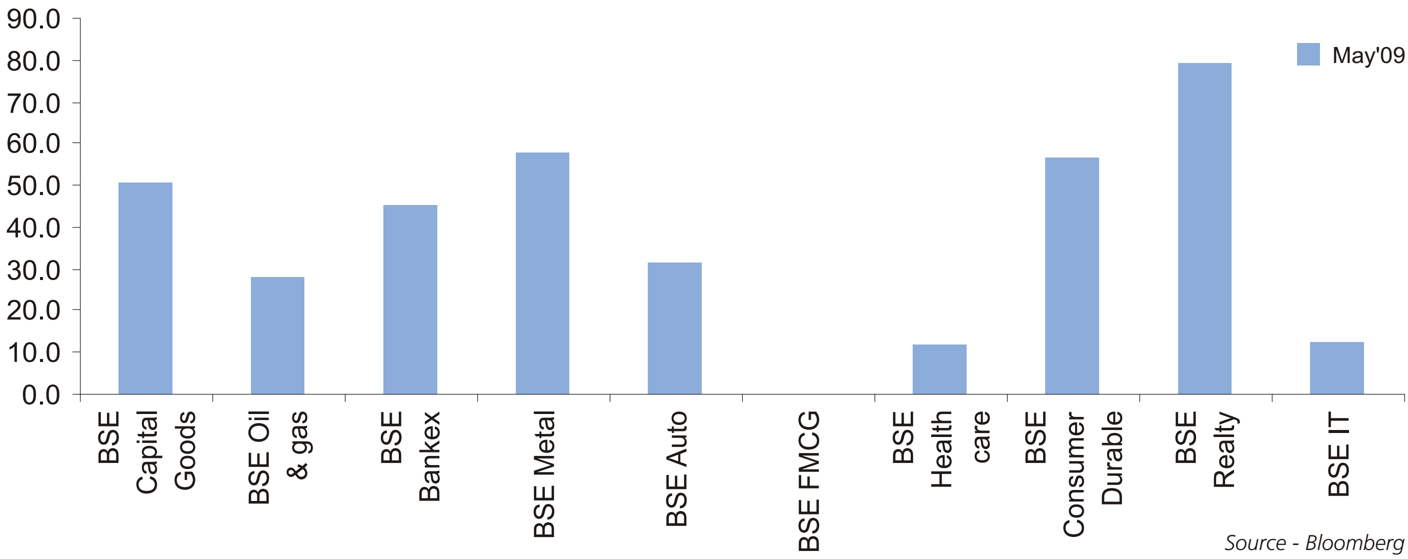
FII and MF Trend (Inflows)



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

- There has not been any sign of recovery in the sector so far with IIP data continuing in negative zone. However, strong victory for UPA government opens up the path for reforms. We expect spending by government to continue providing only silver lining in otherwise challenging environment for the sector. Valuations have run up significantly and are at a substantial premium to overall market. We maintain a cautious outlook on the sector.

Information Technology

- While the economic situation in US seems to be improving, there has not been any uptake on IT spending. Due to the ongoing recession, corporates are very sceptical on committing huge budgets on any transformational deal. Due to the poor demand, pricing remains under pressure impacting margins. Adverse movement of currency is also impacting the profitability of IT services companies. We continue to maintain a cautious view on IT sector.

Steel

- Global demand remains sluggish with world steel production down 23% for the month of April and the Jan-Apr period. India is notably an outlier in the group with 8% YoY production growth for April as current year's domestic consumption is expected to remain positive over last year's. Globally, supply side discipline gives an early sign of price stabilization, however, any strong recovery in the prices remains elusive owing to the ongoing de-stocking and excess unutilized capacity in buffer. Meanwhile, industry remains vulnerable to dumping threats till Government takes some action to protect the domestic producers from low cost imports.

Media

- Ad outlook remains poor with most companies cutting down on their marketing budgets. Poor overall outlook is not helping in pricing even and none of the broadcasting company has been able to get the ad rate hikes normally taken in the beginning of financial year. The ad growth outlook for the next year also looks challenging with difficult overall environment. In print space also he advertisement is likely to witness zero or negative growth rate in the coming year. However, reduction in raw material prices provide relief on margins. We maintain our bearish stance on the media sector.

Telecom

- Mobile Number Portability (MNP) is becoming a reality with Government aiming to launch the same by September in key circles. We expect the competition in wireless space to intesify with entry of new players and MNP. We maintain our cautious stance on the sector. Large integrated players with huge operating leverage would be better placed in a competitive market.

Bank

- Banking sector in India will benefit from the revival in capital markets, any financial sector reforms and a pick-up in loan demand driven by higher GDP growth. Sharply lower interest rates would see a return of the retail loan demand in the second half of FY10E. Lower rates scenario will also lead to lower delinquencies. Export oriented industries, commodities and over leveraged companies are expected to benefit and non performing assets from these sectors may not be very high.

Pharmaceuticals

- US FDA concerns continue to weigh heavily on the sector. Most of the top brass including Sun Pharma, Ranbaxy, Lupin and now Cipla too have small to major issues to be sorted with US FDA. Resolving these is the top priority for most as was clearly visible in Ranbaxy board changes. In the domestic and emerging markets growth continues though somewhat subdued due to restructuring sales forces or cautious approach to avoid riskier sales. Large MTM losses on hedges have been the trouble point for most of the companies in view of rupee depreciation. The earnings estimates for most of the companies in the sector are not prone to recessionary concerns. We are watching the quarterly results to determine the Contract Research & Manufacturing Services revival and sorting of issues in emerging markets. Overall the outlook and the valuations for the sector are good, with some company specific risks.

FMCG

- The Jan-Mar quarter has been quite encouraging for the FMCG sector as strong consumption trend shows no signs of slowdown. All companies have grown by double digits with growth being volume led for most of the players. However, there are instances of significant downtrading in few categories like soaps, detergent and edible oil, resulting into erosion of market share for the leaders. Companies with strong rural product portfolio are expected to continue doing well in the current scenario.

Cement

- Cement demand in India in the past 5 months has been strong on account of the government stimulus programme as well as rural demand. A substantial portion of this demand increase may not be sustainable and we could see cement demand growth returning to 7-8%. It is estimated that another 80 million tonnes of cement capacity will come on stream over the next 2 years. The delay in starting green field projects due to capital and execution constraints has postponed the excess supply situation from the 4th quarter of FY2009 to the 2nd half of FY2010. As a result of slowing demand and over supply, cement prices are likely to come under pressure from the 2nd half of FY2010 and utilization rates should drop below 80%.

Auto

- The sales volumes for auto companies continue to improve, getting a boost from government stimulus package as well as demand from the rural market and government employees. Total aggregate volumes for the month of April grew by 6.2% on year-on-year basis, aided by new product launches. However, the medium and heavy commercial vehicles segment continued to show significant year-on-year fall in volumes. Most auto companies should report improved margins in FY10 due to lower raw material costs on account of the sharp fall in commodity prices since the 1st half of 2009. This coupled with the lower cost of ownership and Pay Commission benefits to government employees should result in improved sector performance.

Source: ING IM Internal Research Team

Indian Debt Market Overview

- Rising Government debt and higher market borrowing coupled with better economic numbers leading to expectations of faster economic recovery has bought a significant change in all the market variables this month
- Interest rates have significantly backed up across major markets in the world. US 10 year has moved from 3% to 3.60%. INR rates have also gone up from 6.23% on 10 yr last month to close at 6.70%. Curves have also steepened with US 2*10 rising from 207 bps to 263 bps. In India 2*5 OIS has risen from 102 to 154 bps while 5*10 government curve has risen from 17 to 40 bps
- Better risk appetite has led to weakening of USD with EURO rising from 1.32763 to 1.4095, GBP rising from 1.4784 to 1.6133. USD/Asia has also rallied with INR closing at 47.12 vs 50.04 last month. Off course, locally, emergence of stable government, expectations of strong cross border flows has had a far stronger effect on INR apart from general weakening of the USD
- Base metals continued to show stronger performance on faster economic recovery theme. Gold rallied to USD 973.60 vs USD 896.45 per ounce last month on weak USD. Oil prices jumped to USD 66.04 vs 50.84 per barrel last month.
- INR Swap curve backed up on offshore paying as well as balance sheet and hedging by traders against rising Bond yields. 5 year swap moved up from 5.27% to 6.21%. Swap curve has continued to steepen signifying much higher rates going forward on forward to forward bps
- Front end of the corporate curve rose marginally after dipping during the first half of the month with 1 yr bank CD closing at 5.75%. Liquidity though remained fairly comfortable and is expected to remain easy
- Corporate bond yields also went up with 5 yr corporate bond closing at 8.12% as compared 7.60% last month. 5 yr Bond-Gsec spreads increased to 173 bps as compared to 146 bps last month on account of outflows from Income funds and rising corporate bonds supply concerns. Tata motors, REC, PFC, SAIL amongst others were few corporates who raised money during the 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

Fund Recommendations

- **Short Term Funds:** With credit spreads ruling around levels of 175 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 continues to be positive. Hence given that the risks are managed appropriately the returns in these funds could be on the higher end of fixed income category.
- **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.

Going Forward

- We had spoken about retracement of Bond yields last month on account of sharp fall in yields, given that the environment was shifting to more riskier asset class and increased risk appetite in the global markets as seen in weakening of the US dollar, rising equity and commodity prices based on better then expected economic numbers
- Huge momentum play and short covering seems to have been a bit overdone and we would like to believe that: a) Consensus view is that we have seen the bottom in various asset markets b) After a huge reversal in equity/bond/commodity/currency markets, all asset classes can be expected to retrace and consolidate and then we have to wait for fresh economic data to confirm that trend has turned bullish in favor of riskier asset classes c) Steep yield curves seem to be an indication for a large rise in interest rates going forward on a forward to forward basis. We would like to argue against that as markets are sometimes running ahead of the actual event and even in the event of an economic recovery theme plays out then interest/redraft markets would stabilize or otherwise we can again see a sharp fall in yields.
- Major economists have not drastically changed their forecasts of world growth rates and expected inflationary environment going forward, further strengthens our belief that markets are running much ahead.

Key Global Forecasts

	Key Drivers	Key Risks	Risk Rating
World Economy	• Deleveraging of consumer, financial and corporate sectors	• Emerging markets decline into recession	High
	• Continued co-ordinated approach to the financial and economic crises	• Protectionism emerges	Low
Global Equities	• Prospects for economic growth	• Earnings downgrades surprise on the downside	High
	• Earnings growth and the extent of revisions	• Availability of credit diminishes	Medium
Global Bonds	• Accomodative monetary stance	• Return of risk appettite/ demand for risky assets	Medium
	• Deficit spending & bond supply		Low
	• Weak growth, despite recent green shoots	• Inflation worries escalating	Low
	• Increased G-20 & IMF support to EM economies	• Increasing fiscal deficits, rising public debt	
Asian Equities	• Extent Asia is impacted by the global economic slowdown	• Earnings revisions surprise to the downside	High
	• International investors appetite for risk	• Valuations fail to halt market slide	High
Asian Bonds	• Bond supply and deteriorating fiscal dynamics	• Increased bond supply	Low
	• Accomodative monetary stance	• Higher G3 bond yields	Low
	• Weak growth, despite recent green shoots	• Increased inflation (due to higher commodity prices)	Low
	• Increased G-20 and IMF support to EM economies		
Indian Equities	• Improvement in liquidity scenario since October and stimulus packages announced by GoI and RBI may support revival in industry growth in the long term.	• Key economic data continued to show weaker trends (IIP down by 2.3% in March '09, 33% decline in exports in April '09). Several industrial units continue to report production cuts. Further, job cuts across sectors have severely affected consumer and business confidence.	Medium
	• While the fiscal situation remains precarious in India, adequate foreign exchange reserves and an anticipated improvement in the current account on the back of a fall in crude imports from FY10 onwards hold up hope.	• Central government's projected gross fiscal deficit (5.5% of GDP) is likely to overshoot significantly to over 8% of GDP in FY10.	High
	• Reduction of political risks and possibly better policies may not only induce corporates to undertake more projects but also incite investors globally to invest much more money.	• Budget in the first week of July '09 is the key event risk.	Medium
Indian Bonds	• Cut in key interest rates	• Credit markets to remain strained	High
	• Inflation declining	• High issuances at the longer end of the curve	High
	• Weak economic growth	• Weak corporate earnings	High
	• Credit spreads at attractive levels	• Large investors in fixed income mutual funds can exit in one day notice	High

Source: ING IM Internal Research Team

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