SEPTEMBER 2009

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Global Economic Outlook

World

- Recent data releases point to global economic stabilization with selected emerging market countries, such as China and India, showing accelerated growth while the G7 economies appearing to have stabilized.
- The longevity of the current economic revival however remains uncertain as the improvement in industrial production is grounded upon an inventory restocking cycle and on massive government stimulus measures which are more of a one off in nature.
- The deleveraging of household balance sheets by debt reduction in developed economies will necessarily continue in the years to come though consumer confidence can rebound in the near term as asset prices have appreciated significantly in recent months.
- With greater risk appetite and abundant liquidity, the US dollar continues to weaken against major currencies and commodities.

United States

- Second quarter GDP growth in the US fell 1% QoQ, performing better than market expectations with personal consumption holding up better than forecast. The ISM Manufacturing Index in August pushed through the 50 level to 52.9 signalling expansion for the first time since January 2008.
- After witnessing a moderate improvement in the unemployment rate during the month of July at 9.4%, the August figure of 9.7% reminded market participants that the unemployment situation in the county continues to worsen and will likely breach the 10% mark before this recession is over.
- Encouragingly, the fragile housing market continues to see signs of improvement with new home sales and pending home sales climbing 9.6% and 3.2% MoM, respectively.

Europe

- Euro-Zone industrial production continued to struggle in the month of July, falling 0.3% MoM and 15.9% over 12 months.
- The Euro-Zone economy fell 0.1% QoQ in the second quarter of 2009 which was a substantial improvement over the 2.5% fall in the previous quarter. The economy nevertheless contracted 4.7% YoY during the quarter.

Japan

- In a sea changing event, the opposition Democratic Party of Japan won a majority in the House of Representatives, ending the Liberal Democratic Party's almost continuous reign since 1955. The party aims to reduce the bureaucracy of the Japanese government, improve efficiency and introduce transparent and decentralized government agencies.
- While improving 1.9% MoM in July, industrial production in Japan remains 23% below previous year level signalling economic improvements are currently tentative at best.
- The unemployment rate hit 5.7% in the month of July, which is the highest rate since the series began in 1953. The prospects of a quick recovery in employment appear elusive as the jobs to applicant ratio fell to a record 0.42 reflecting the current scarcity of job openings.

Global Market Insights

Equities

- Global equity markets continue to push higher with the prevailing consensus view that the global economy has bottomed and will begin to improve in the second half 2009 and start growing again in 2010. Amidst this seemingly bullish backdrop, it remains uncertain what the impact on the global economy will be when governments begin to reverse monetary policy and remove fiscal stimuli.
- Asia Pacific economies are expected to perform better going forward as modest leverage within the economies and strong domestic consumption should ensure that the region outpaces its developed nation counterparts in terms of economic growth. However, valuations reflect this with the region trading at 16.9X 2010 PE, a premium to the US and European markets.
- Asian economies have rebounded faster than developed economies and as such Asian equity market performances have far outpaced developed market peers. However, further evidence of G7 countries recovery will likely trigger a reversal in relative performance.

Bonds

- Global macro data confirm a strong cyclical rebound. The improving data flow, particularly in manufacturing, is likely to lead to increased focus on policy tightening and exit strategies, thereby exerting upward pressure on bond yields
- Global bond markets have been resilient so far however, as output gaps in developed markets are to sustain well into 2010 and more likely 2011. Financial sector deleveraging, high unemployment and limited consumer spending are likely to make the recovery relatively shallow.
- Near-term G3 policy tightening is highly unlikely. We 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.
- 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 n ear-term problem.

Returns

- Equity markets continued to climb in August, buoyant by continued optimism that the global economy has bottomed and potentially returning to growth in 2010.
- Global government bonds had another good month on the back of lower yields, in spite of an improved macro backdrop.

Equities Benchmark	August	Year-to-Date	12 Months
MSCI World (USD terms)	4.13%	20.12%	-17.21%

Bond Benchmark	August	Year-to-Date	12 Months
World Govt Bond Index (USD terms, unhedged)	1.98%	2.23%	9.86%

Source - Bloomberg

Asia Pacific Economic Outlook

Overview

- Second quarter GDP growth rates were generally better than expectation across the region.
- The absolute level and rate of increase in unemployment is also much lower than beginning of the year forecasts.
- Second quarter earnings surprised positively with aggressive cost cutting helping to sustain profitability.
- Potential policy tightening by the Chinese government appears to be the key concern among investors with the local A share market particularly vulnerable to rumours regarding policy.

China

- China's PMI stood at 54 in August, retaining the path of expansion.
- Industrial production was up 10.8% in July bring the year-to-date total to up 7.5%.
- As evidence of domestic consumption strength, retail sales grew 15.2% in July.

North Asia

- Hong Kong's second quarter GDP improved on a sequential basis up 3.3% QoQ and down 3.8% YoY.
- Korea's umeployment rate improved to 3.8% in July from the 4% reached in June.
- While second quarter GDP growth fell 7.5% YoY in Taiwan, it was nonetheless an improvement over the 10.2% fall witnessed in the first quarter.

South Asia

- Second quarter GDP grew a respectable 2.3% QoQ in Indonesia, registering a 4% growth YoY.
- Malaysia's economy remained sluggish with industrial production dropping 9.6% in June. However, Singapore saw a substantial rebound in industrial production, jumping 12.4% YoY.
- Philippines' OFW remittance remained robust, growing 3.3% in the month of June.
- India's total rainfall this monsoon season was 22.7% below normal, pointing towards a drop in farming incomes for the year.

Pacific

- Australia's private sector credit grew a mere 3% in the month of July, indicating the cautious stance of both private borrowers and bank lenders.

Asia Pacific Market Insights

Equities

- While it is now market consensus that the global economy is on the mend, the key concern for investors is the potential policy tightening by China.
- Nevertheless, second quarter earnings showed higher than expected profitability due to aggressive cost cutting and generally more positive business outlook.
- Earnings revisions maintain an upward bias with analysts factoring in a better economic environment for the remainder of 2009 and 2010.
- Second quarter GDP growth data showed sequential improvements in Asian economies, with the rate of unemployment increase slowing.
- Asia Pacific's 2009 estimated PE stands at 17.9X with an estimated earnings growth of +9.4% and 3 months earnings revision of +10.8%.
- While markets continue to move higher, any renewed fears over China policy tightening could have a negative effect on markets. Liquidity continues to triumph over fundamentals currently.

Bonds

- Headline inflation across Asia will rise from Q4 onward on the back of base effects and higher commodity prices. With a more synchronized global cyclical upturn and output gaps closing in several Asian countries in 2010, this will probably lead regional central banks to hike policy rates next year, ahead of the FED and ECB.
- We however expect the amount of rate hikes to be modest, and believe 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.
- Ample liquidity will continue to support most bond markets, whereas valuations are unchallenging given expected growth and inflation trajectories across the region.
- We remain fundamentally bullish on Asian currencies medium term.

Returns

- The Asian equity market took pause in the month of August as China tightening concern took its toll on the markets.
- Asian local currency bonds had a flat month performance wise. Somewhat weaker Asian currencies led to a modest negative monthly return.

Equities Benchmark	August	Year-to-Date	12 Months
MSCI Asia Pacific Ex Japan (USD terms)	-0.25%	48.95%	-4.60%

Bond Benchmark	August	Year-to-Date	12 Months
HSBC Asia Local Bond Index (USD terms)	-0.61%	1.32%	3.85%

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

Indian Economic Outlook

India

- India's real GDP growth during Q1FY10 came in at 6.1% yoy, mostly in line with expectations. This stands a tad higher than the 5.8% growth recorded during the previous two quarters.
- While industrial growth at 5% is still on lower side, the signs of recovery over the past two quarters are visible. Services growth at 7.8%, however, was the lowest since 4QFY04.
- The Index of Industrial Production (IIP), during June 2009 surprised positively, rising 7.8% yoy. Capital Goods (25.6% M-o-M, seasonally adjusted) and Basic Goods (4.6% M-o-M, seasonally adjusted) contributed heavily to the jump in the overall index.
- Wholesale Price Index (WPI) inflation has started inching upwards and was at -0.21%, with expectations that in very near future, it might reach the positive territory.
- CPI inflation (Consumer Price Index for industrial workers) shot up due to higher prices of food articles at 11.9% yoy for July 2009 as against 9.3% in June 2009. This is its highest level in a decade.

Source: www..rbi.gov.in

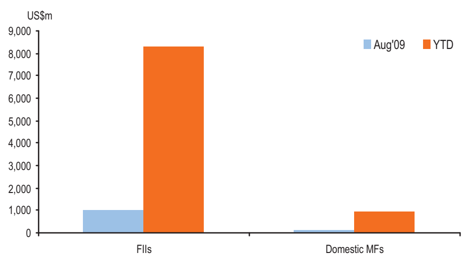
Indian Equity Market Insights

India

- August turned out to be another good month for global equity markets with most developed and emerging markets, registering a gain of 4-6%.
- Indian markets remained flat during the month. The large cap Indices Sensex and Mid cap indices ended the month with gains of 0% and 2.8%, respectively.
- FIIs continued to invest heavily in the Indian market in spite of monsoon fears. FIIs invested US$1bn in the month of August. Domestic MFs also were net buyers in the markets, investing US$132m in the equity markets.
- Realty and IT were the top performing sectors with gains of 12.9% and 5.3% respectively. FMCG and Banking sectors performed poorly.

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

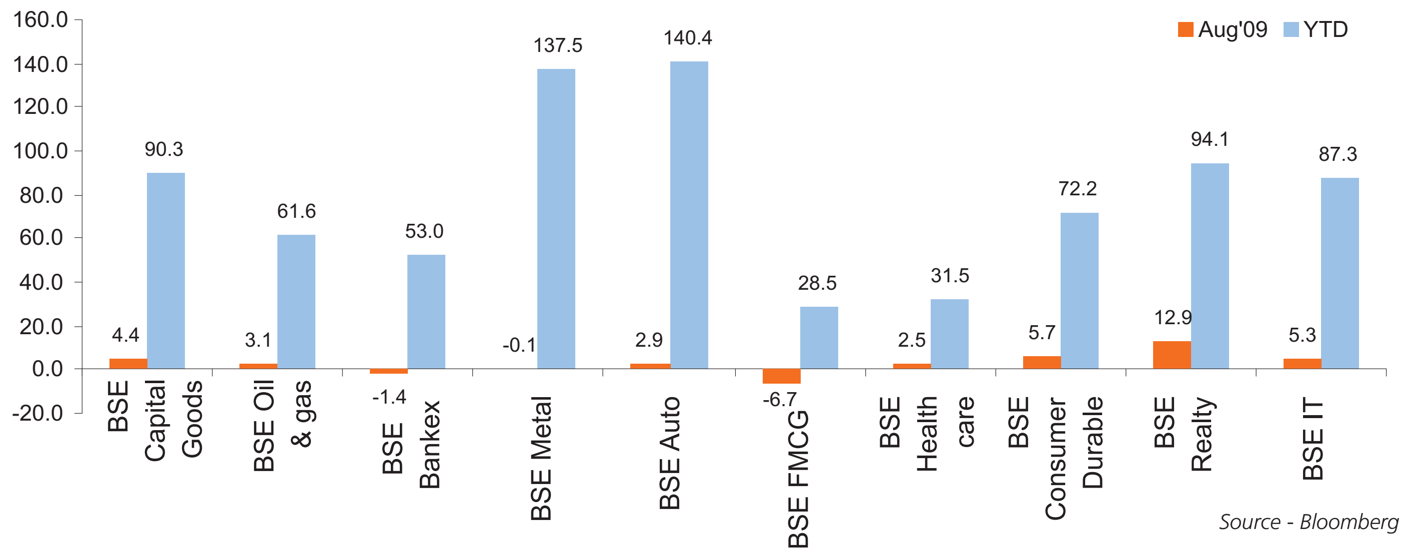
FII and MF Trend (Inflows)



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

- Index of Industrial Production (IIP), during June 2009 surprised positively with growth of 7.8%. However, there are still major concerns for the sector given lack of private spending. Construction activity has not really picked up in spite of all the positive sentiments. Valuation remains high and is at significant premium to the market. We maintain our cautious view on the sector.

Information Technology

- The last couple of months saw signs of recovery in the US market. However, the recovery has not yet translated to revival in IT spending as yet. Environment still remains challenging with most companies facing pricing pressures. Though, extension of Software Technology Parks of India benefit by another year will help most companies in near term, valuations are quite rich at the moment. We maintain a cautious view on the IT sector in the near term.

Steel

- Steel prices in Europe and the USA have continued to gain strength over the past few weeks. However, spot steel prices in China continued to weaken, highlighting that restocking in China has been somewhat faster than underlying demand growth. Weak end-user demand is still preventing a sustainable recovery in most regions. Capacity utilization globally is showing an improving trend, as few idle units re-start operations. With demand for Hot Rolled Coil safeguard duty being dismissed and prices correcting in China, fear of cheap imports will keep a check on the domestic prices.

Media

- Ad growth seems to have picked up from the lows of previous six months. A few broadcasters and print companies have also taken small hike in the ad rates indicating confidence in the growth. Valuations have also moved up, though in the last 3 months, but, still seem to provide further upside. We are positive on the sector.

Telecom

- Government finally came out with its long awaited decision on 3G spectrum pricing. Government has announced reserve price of Rs. 35.4 bn for Pan India 3G spectrum. Excluding one block reserved for MTNL/BSNL, the Government will auction upto four 3G spectrum blocks to the private telcos. We believe an aggressive bidding for 3G spectrum can hurt the telcos interest in the long term. The business environment remains challenging in an extremely competitive market. We maintain our negative view on the sector.

Auto

- As economic activity continues to improve and banks ease lending, auto volumes should continue to grow. Commercial vehicles sales are expected to register YoY growth towards the second half of the financial year on account of a low base effect and a pick up in industrial growth. Over the past year, demand for 2 wheelers have benefited from a strong rural economy. However below average monsoons are likely to have a negative impact on rural demand. Currently, while growth in 2 wheeler volumes is being driven by the rural segment, as the economy recovers, growth could revive in the urban segment, thus reducing dependence on the former.

FMCG

- The significant shortfall in the monsoon for the year so far is a concern for the FMCG sector sales and a risk to earnings. However, higher crop prices and National Rural Employment Guarantee Act should help cushion any big dent in incomes of rural India, and limit the impact on rural consumption. Rising input prices of staples and other concerned crops may impact the margins of few companies. FMCG sector has been on a robust growth traction for the past few quarters, however, post the recent run up, the sector is trading at fairly rich valuations of ~20x on FY11E earnings.

Cement

- Cement demand and pricing was strong in Q1FY10 and cement companies reported better quarterly results. As we had expected, significant capacity addition has begun to result in lower cement prices in south and west India and other regions should follow suit. The oversupply impact compounded by possible demand weakness due to below average monsoons could result in sustained downward pressure on cement prices. This should lead to a fall in operating profit margins for cement companies.

Bank

- Banking sector has reported a moderate loan growth of 15% YTD in Aug '09. Deposit growth has however remained strong at 22%. Due to lower demand for credit, bank investments in government securities have grown by 35% during the same period. Given the relatively higher proportion of investments in the SLR coupled with rising bond yields, the banks will have higher investment related MTM provisions, especially state owned banks, in Q2FY10E. Asset quality concerns still linger due to uncertain macro conditions and higher restructured advances.

Source: ING IM Internal Research Team

Indian Debt Market Overview

Market Impact

- Continuous supply, coupled with waning demand of government securities from the public sector banks due to exhausted limits in their HTM portfolio, resulted in a sharp rise in yields across maturities. Q1FY10 GDP numbers clocked a decent 6.1% growth, and at the same time, headline WPI inflation numbers have been coming worse than expectation for the past few weeks, while CPI inflation for industrial workers has hit 10 years high at 11.90% for the month of July 2009. The main culprit of this surge in inflation has been food prices especially of rice, pulses, sugar etc. due to a weak monsoon. This has added to the worry of an already anxious market as far as inflationary expectation in the coming months is concerned. RBI has also been making statements about its discomfort with the monetary policy and that at some point of time, it may have to be reversed. While it could be in form of reduction liquidity through an increase in Cash Reserve Ratio (CRR) / issuance of MSS bonds, or through an increase in Reverse Repo / Repo rate; we believe that RBI might take the former route in the next quarter, while a hike in Reverse Repo rate may come by Q4 FY10. However, if incremental inflation in the next couple of months rises sharply, we could see RBI taking some form of reversal steps in the October policy itself.
- Yield on the 10 year benchmark G-sec shot up from 7.00% at the end of July 2009 to 7.44% at the end of August 2009. Similarly yield on the 5 yr benchmark security rose from 6.72% at the end of July 2009 to 7.17% at the end of August 2009
- Corporate yields have also moved up, however, to a lower extent as that market does not face as high a supply problem as the G-sec market. 10yr corporate bond yield rose from 8.68% to 8.85%, while 5 year bond yield increased from 8.15% to 8.50%.
- Short end of the corporate bond curve i.e. 2-3 year papers have been the worst performes, with 2 year bond yields rising sharply from 6.55% to 7.05% and 3 year bond yields rising from 7.25% to 7.70% during the month of August. This has resulted in a flatter yield curve and we believe it could flatten more in the coming months due to expectation of higher inflation and a resultant reversal of a highly accommodative monetary stance by the RBI.
- INR Swap curve has been moving within a very narrow range with 5 year swap moving in range of 6.32% to 6.47%. 2 year swap rates moved up on inflation concerns from 5.10% at end of July 2009 to 5.26% at the end of August 2009. 5 year G Sec – Swap spread increased from 37 bps to 76 bps during the month as G-sec yields rose on supply concerns.

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 supply side pressures in September, however, with government borrowing for second half of FY10 being almost half of the first half borrowing amount, we expect a pullback in bond yields and rates stabilizing at lower level by end of this month.
- Markets are expected to remain volatile as inflation numbers will start inching up towards positive numbers territory and market builds in expectation of a possible reduction in liquidity through an increase in CRR or supply of MSS bonds.
- The corporate bond curve is expected to flatten further, with the short end of the corporate curve expected to underperform the longer end as any form of reversal would impact the shorter term yields more.

Our Portfolio Strategy

- In the long bond funds and the gilt funds, we would look to increase duration incrementally as we expect that during the month, there could be a pull back in G-sec yields due to completion of the borrowing calendar for the first half of the fiscal year and the lower supply of G-sec in the second half. As markets are expected to be volatile, we would actively manage duration to take advantage of any mispricing or spread widening or contraction.
- In the short term fund we would continue to have a mix of accrual assets and mark to market assets to get a descent accrual income and to take advantage of a pull back in bond yields by end of the month.
- In Liquid funds, we have been maintaining a judicious mix of cash and very short term instruments. We expect rates of 1-3 months CDs and CPs to remain stable and hence would like to remain invested in up to 3 months CD's and good quality corporate Cp's.

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 growth and the extent of revisions	• Earnings downgrades surprise on the downside	High
		• Availability of credit diminishes	Medium
Global Bonds	• Accomodative monetary stance • Deficit spending & bond supply	• Return of risk appettite/ demand for risky assets	Medium
	• Weak growth, despite recent green shoots	• Exit of accomodative monetary policies	Low
	• Increased G-20 & IMF support to EM economies	• Inflation worries escalating	Low
		• Increasing fiscal deficits, rising public debt	Low
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 fiscal stance	• Increased G3 bond supply	Low
	• Accommodative monetary policy & excess liquidity	• Increased inflation and higher commodity prices	Medium
	• Extent of growth rebound	• Increasing fiscal deficits, rising public debt	Low
Indian Equity	• Gradual decline in share of monsoon crop, 50% increase in key crop prices in last 4-5 years and the fact that 34% of agri GDP comes from non farm incomes would limit the impact on agri GDP growth.	• India is facing drought with cumulative rainfall on an all-India area weighted basis being 25% below normal, making the current monsoon season potentially one of the worst since 1973.	Medium
	• Credit growth is expected to improve in 2HFY09 with increase in loan demand from corporates.	• Credit growth was lower than deposit growth for the seventh month in a row.	Medium
	• India is expected to outperform due to its superior growth and possibility of strong policy action.	• Slower pace of global recovery.	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 25.09.2009

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