

Asset Allocation Views

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- The advance report for 4Q08 U.S. GDP came out at a -3.8% annualized growth rate — less negative than expected by consensus. Much of this apparent moderation, however, was the result of lower than expected inventory reductions and of an increase in Federal government spending. All other parts of the economy contracted — personal consumption fell for the second consecutive quarter at a 3.5% rate and business fixed investment fell 20%.
- With global industrial activity in a sharp decline, we have revised GDP forecasts for 1Q09 downward, as have many other forecasters. We now expect the economy to further contract by an annualized 5% in 1Q09 and to start modest recovery by the second half of the year, spurred primarily by fiscal policy and initiatives to heal financial markets.
- Despite the gloom, in January tentative signs emerged of decelerating rates of decline in some macroeconomic indicators, such as purchasing management indices in the United States and several other countries. It remains to be seen whether or not these are early signs of the economy approaching a bottom, but we are monitoring them closely.
- The lack of detail in the Financial Stability Plan presented by Treasury Secretary Geithner on February 10 initially disappointed markets, and the S&P 500 fell 5%. U.S. equities have trended down since then.
- Earnings estimates for the S&P 500 continue to decline, as 4Q08 reports were broadly disappointing and as firms provided cautious forecasts for 2009. We believe that an estimate of \$60 for 2009 is reasonable and that the final 2008 number should come out at around \$55.
- Our asset allocation has not changed from the previous month. With a highly uncertain short term outlook, we remain neutral on equities and maintain a modest cash position for a tactical move if the opportunity arises.

Current Positions			
	Benchmark (%)	Recommended Allocation (%)	Change from Last Move
Stocks	65.0	65.0 Neutral	Unchanged
Bonds	35.0	32.0 Underweight	Unchanged
Cash	0.0	3.0 Overweight	Unchanged
Allocation among stocks			
Domestic stocks			
Large-cap core stocks	18.0	18.0 Neutral	Unchanged
Large-cap growth stocks	13.5	13.5 Neutral	Unchanged
Large-cap value stocks	13.5	13.5 Neutral	Unchanged
Mid-cap stocks	4.0	4.0 Neutral	Unchanged
Small-cap stocks	6.0	6.0 Neutral	Unchanged
International Stocks			
EAFE stocks	10.0	10.0 Neutral	Unchanged
Total stocks	65.0	65.0	

Investment Themes

Is a bottom anywhere in sight? Many investors are hawkishly monitoring economic and market indicators for the first signs that the pace of decline in those indicators is moderating — the so-called second derivative effect. A deceleration in the speed of decline of an indicator could imply that the trough may be close. There is empirical evidence that clustered troughs and peaks of select indicators during recessions could be predictive of the broad economic trough, i.e., the end of a recession. For example, the decline in the U.S. and the OECD leading indicators tend to be deepest five to six months prior to the end of recession. Since equity markets on average start pricing in recovery four months prior to the end of recession, it is tactically important to get those signs right.

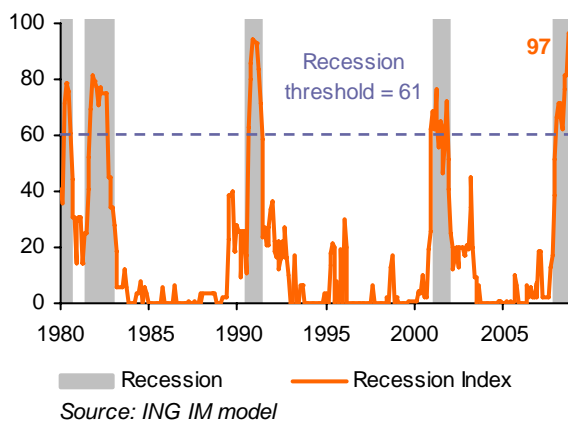
Although our in-house recession model remains deep in recession territory, there are tentative signs of stabilization in the rate of decline of some indicators. Last month for the first time since January 2008 more indicators have registered monthly improvements than deterioration: Eight out of 14 indicators have modestly improved relative to the previous month's reading (see table to right).

The signs of relative stabilization at the bottom are even broader and international in scope — international trade activity as measured by the Baltic Dry (freight) Index¹ showed signs of moderate improvement last month. China's leading economic indicators index and purchasing managers' survey index registered a monthly up-tick. The German IFO business confidence index, which has been in a steep decline since last May, seemed to start bottoming out in January.

Of course, these could prove to be early or even false signals. In the 16-month recession of 1981–82 the leading indicators index had the rate of decline reversed (a trough) 12 months before the end of recession but continued to decline, although at a slower rate. The equity market rallied only eight months after the trough in the leading indicators index. Such wavelike patterns are not unusual for long recessions when temporary relief happens halfway through followed by another wave of decline. Both the 1973–74 and 1981–82 recessions had a quarter of positive growth in the middle.

The equity market has trended down since February 10, disappointed by the lack of details on the administration's financial stability plan, and concerned over the effectiveness of fiscal policy. Given the uncertainty of the current outlook we remain neutral on equity and maintain a modest cash position for a tactical move should an opportunity arise.

Our Recession model remains squarely in the recession territory...

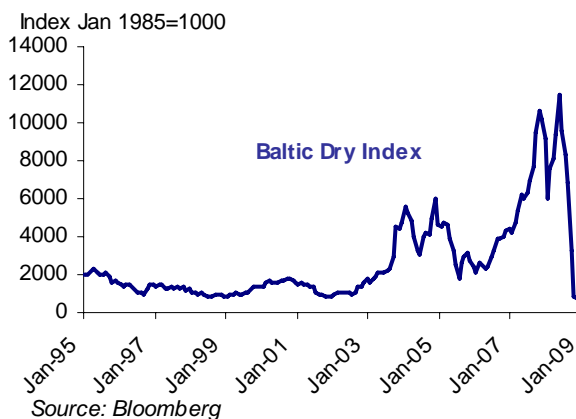


...However, the rate of decline in the indicators of the model started to moderate.

Indicator	Recession Signal	Change from the previous month
US LEI % change y/y	Yes	+
PMI	Yes	+
OECD LEI % change, 6 months	Yes	-
Housing Starts	Yes	-
High Yield Spread	Yes	+
Change in Payroll Employment	Yes	-
Consumer Sentiment	Yes	+
Initial Jobless Claims	Yes	-
PCE, % change y/y	Yes	-
ISM Net New Orders	Yes	+
S&P 500, return y/y	Yes	+
Real Retail Sales, % change y/y	Yes	-
Yield Curve	No	+
Oil Price, %change y/y	No	+

Source: Bloomberg, ING IM calculations

Collapse of international trade seems to have slightly reversed in the last two months.



Fear and Greed

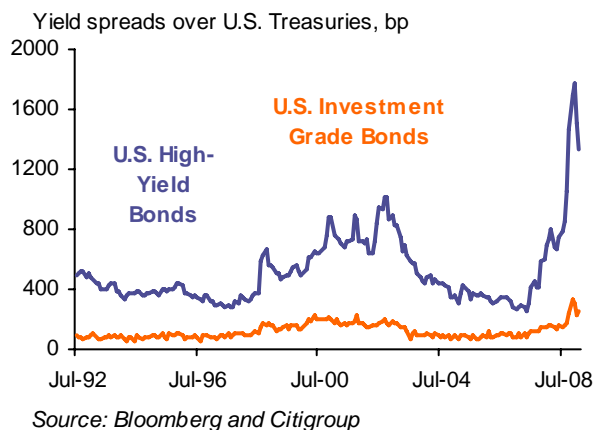
Signs of healing in corporate credit. The equity market's bear rally from November lows ended in early January as weak economic and earnings data curbed investors enthusiasm. Continued uncertainty about policy, the fiscal stimulus package, the financial stabilization plan, and a plan to address housing, has since then kept the equity market in a trading range. Credit instruments, however, continued to rally with high yield bond indices leading the way. High yield bonds' 5.3% monthly return in January outshone municipal bonds' 3.9% return and gold's 5.2% return. Bond spreads still remain near historically extreme levels and have a long way to go down before they even reach the highs seen in the last recession. Nevertheless, the stabilization in corporate bond spreads could mark a beginning of a healing process. Empirical evidence suggests that corporate spreads peak and equity prices trough at approximately the same time. Spread compression, however, tends to lead the actual recovery in equities. In the 2002 bear market, for example, spreads peaked and stock prices troughed at the same time (October 2002) but spreads continued to narrow for another six month before stocks finally began to rally in March 2003.

Volatility has peaked. Barring another unexpected incident in the financial system similar to Lehman Brothers' bankruptcy, it seems that volatility peaked in fixed income markets in October and in equity markets in November. Since then volatility in both markets, although still historically high, has been on a declining trend. This is another tentative sign of financial healing.

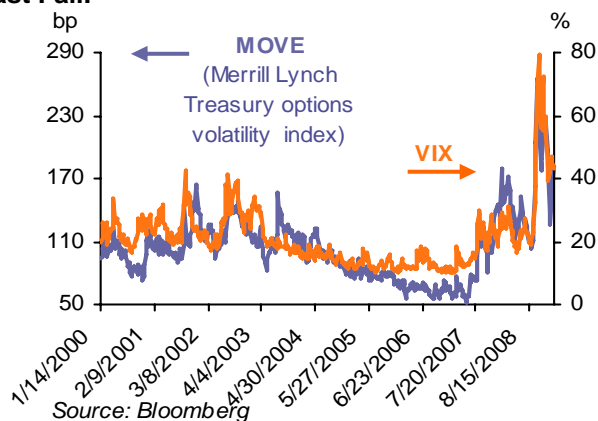
Oil prices – uneven impact on emerging markets. The precipitous collapse of oil prices since July has matched their earlier spectacular rise. It is not a coincidence that the broad global industrial production decline started in the same month as oil prices peaked. Lower oil prices should alleviate some recession pain in developed countries by reducing energy costs for struggling consumers. Its impact on developing economies, however, is not that straightforward.

Recent dollar strength has sent many emerging markets' currencies into a sharp decline. As oil is priced in U.S. dollars, the oil price decline had a smaller positive impact on oil-importing countries such as South Korea and Eastern European countries, where currencies fell by 20% to 30% versus the U.S. dollar. Oil-exporting countries whose currencies are not pegged to the U.S. dollar, such as Russia and Venezuela, are suffering the most. Not only has their oil revenue declined substantially, but prices for their essential imports have risen sharply.

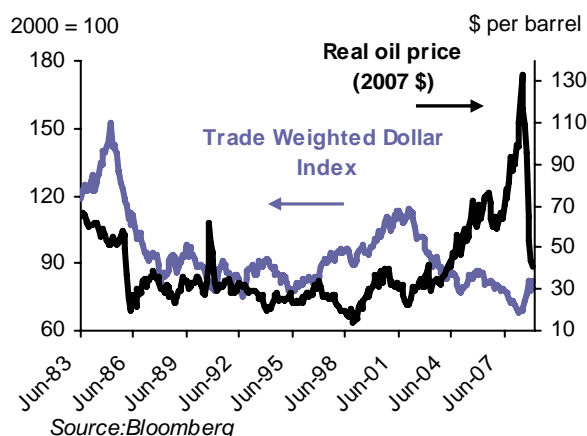
Corporate bond spreads are at historically high levels but have started compressing.



Volatility in both bond and equity markets peaked last Fall.



Oil prices are reverting to their long-term average.



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- Active asset allocation at the strategic and tactical levels
- A fully integrated program capable of managing all of an investor's assets or provide a complement to other managers' capabilities or styles
- A rebalancing discipline that keeps the client's portfolio in balance without incurring inordinate trading costs

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¹ The Baltic Dry Index (BDI) is a shipping and trade index created by the London-based Baltic Exchange that measures changes in the cost to transport raw materials such as metals, grains and fossil fuels by sea. The Baltic Exchange directly contacts shipping brokers to assess price levels for a given route, product to transport and time to delivery (speed). Changes in the BDI can give investors insight into global supply and demand trends. This change is often considered a leading indicator of future economic growth (if the index is rising) or contraction (index is falling) because the goods shipped are raw, pre-production material, which is typically an area with very low levels of speculation.