ING Global Perspectives

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February Leaps to a Multi-Decade Market Open

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After matching its stellar January performance in February, the S&P 500 Index is off to its best start since 1991. The Dow Jones Industrial Average crossed the psychologically important 13,000 mark, a level not seen since May 2008. Europe, Asia, South America and Africa also staged broad-based market rallies throughout February. And all of that happened before the heavy-hitting European Central Bank stepped to the plate with the second installment of its Long-Term Refinancing Operation (LTRO) on Leap Day. Those investors waiting for a meaningful pullback to provide an attractive entry point may be sorely disappointed by a market bound and determined to get into alignment with its strong underlying fundamentals.

However, it is never too late to make the right decision; in this case, that entails incorporating high-return, volatile, low-correlation assets into a well-diversified portfolio, which — in accordance with modern portfolio theory — both reduces risk and increases potential return. Among the asset classes that should be considered are small-cap stocks, which have been shunned despite surging more than 10% in the past three months to reach an all-time high in February; emerging market equities, which have the best ten-year track record of any asset class; and high yield bonds, which have beaten a cross-section of equity indices over the past five years while providing near double-digit income.

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Executive Summary

- **The markets' YTD success has been fueled by a dramatic reduction in global risk and upbeat economic data.**
- **The fence to contain the euro crisis has been definitively established.**
- **Oil prices are a concern, but the real economy has the wind in its sails.**
- **Though equity fund outflows continue, it's never too late for investors to do the right thing.**

Global Capital Market Returns: S&P 500 Has Its Best Start Since 1991

Index	Wgt	Feb-12	3-mos	YTD	2011	2010	2009	2008	2007	1 year	3 years	5 years	10 years
Equity													
S&P 500	10%	4.3	10.1	9.0	2.1	15.1	26.5	(37.0)	5.5	5.1	25.6	1.6	4.2
S&P Midcap	10%	4.5	11.0	11.4	(1.7)	26.6	37.4	(36.2)	8.0	2.6	31.5	4.7	8.2
S&P Smallcap	10%	2.1	10.2	8.8	1.0	26.3	25.6	(31.1)	(0.3)	5.1	31.4	3.4	8.1
U.S. REITs	10%	(1.4)	9.2	4.9	4.7	23.5	21.0	(41.5)	(20.2)	2.1	36.7	(6.2)	7.1
EAFE	10%	5.8	10.4	11.4	(11.7)	8.2	32.5	(43.1)	11.6	(7.0)	20.3	(2.5)	6.8
Emerging Mkts	10%	6.4	18.8	21.5	(22.7)	9.8	93.5	(59.3)	59.1	(3.8)	29.3	6.4	18.8
Average		3.6	11.6	11.2	(4.7)	18.3	39.4	(41.4)	10.6	0.7	29.1	1.2	8.9
Fixed Income													
Corporate	10%	0.8	5.3	3.1	8.1	9.0	18.7	(4.9)	4.6	10.4	13.6	7.0	6.5
U.S. Treasury 20+	10%	(2.3)	0.7	(2.6)	33.8	9.4	(21.4)	33.7	10.2	32.5	9.4	10.0	8.6
Global Aggregate	10%	(0.1)	2.3	1.6	5.6	5.5	6.9	4.8	9.5	6.5	8.6	6.6	7.4
High Yield	10%	2.4	8.3	5.5	5.0	15.1	58.2	(26.2)	1.9	6.9	25.2	8.2	9.5
Average		0.2	4.1	1.9	13.2	9.8	15.6	1.9	6.5	14.1	14.2	7.9	8.0
60/40 Portfolio		**2.3**	**8.6**	**7.5**	**2.4**	**14.9**	**29.9**	**(24.1)**	**9.0**	**6.0**	**23.2**	**3.9**	**8.5**

The Global Asset Allocation strategy is comprised of ten asset classes, equally weighted: S&P 500, S&P 400 Midcap, S&P 600 Smallcap, MSCI U.S. REIT, MSCI EAFE, MSCI BRIC, Barclays Capital U.S. Corporate Bonds, Barclays Capital U.S. Treasury Bonds, Barclays Capital Global Aggregate Bonds, Barclays Capital U.S. High Yield Bonds. Source: FactSet.

risk, mainly due to the improvements in Europe. But here at home, the world's largest economy has been surging forward despite rising oil prices that threaten to rain on our parade. In fact, fourth quarter GDP was just revised upward to an inflation-adjusted 3% (from 2.8% in the previous estimate). At this growth rate, our $15 trillion economy is adding as much to the world GDP pie as, say, a $5 trillion economy growing at 8.9% (cough, China).

Europe on the Mend

The foundation for an effective fence around the euro crisis has been definitively established. Liquidity has been ensured, key players are now coordinated and unified, a Greece debt deal has been reached and financial discipline will be monitored and enforced. Continued strong and specific policy will fortify this fence and allow the underlying global fundamentals to progress. While rules, regulations and enforcement are important first steps, financial markets are the ultimate enforcer of discipline. However, the recent fiscal unity pact is a symbol of coordinated action, and the market likes it.

We view the strong action and discipline from a "EURO" perspective.

E = ECB Action

- The ECB's two Long-Term Refinancing Operation installments removed the risk of an immediate liquidity crisis. Through the program, the ECB lends to banks at 1% in exchange for a wide range of collateral. Among the popular uses of this cheap cash is a carry trade in which the banks buy sovereign debt at higher yields and pocket the difference. This demand effectively puts in a bid for the highest-yielding and poorest-quality debt, mainly that of Italy and Spain.
- Since launched in late December, the LTRO has provided an injection of confidence into the banking system, and bond yields in Spain and Italy have fallen more than 150 basis points.
- The second LTRO tranche, released February 29, was even bigger than the first effort, nearing €530 billion and featuring more widespread participation.

U = Unity

- The recently established fiscal compact is a binding agreement that will promote fiscal unity and coordination among the 27 countries of the European Union.
- The compact mandates tighter control of tax and spending by governments that overstep the deficit limit of 3% of GDP and limits public debt to 60% of GDP.
- Currently 25 of 27 countries have agreed to the treaty, with only the U.K and the Czech Republic holding out.

R = Resolution

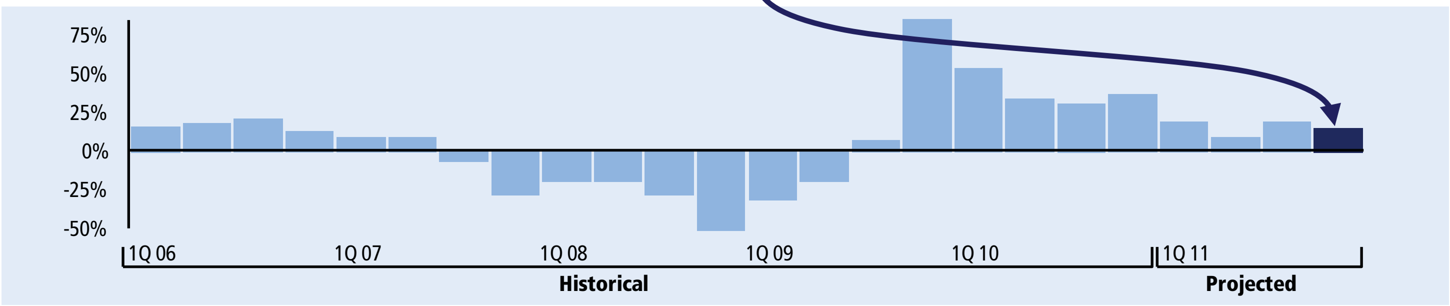
- Greece's debt default drama is nearing an end. Policymakers have agreed to force private investors to take a 53.5% haircut on the face value of Greek bonds, while also swapping their old Greek bonds for new bonds with lower interest rates and longer repayment schedules. If this agreement is successfully executed, Greece's debt-to-GDP is expected to decline to 120% by 2020, from 160% currently.

O = Oversight

- There will be strong ongoing oversight of taxation and budget policy.
- Enforcement mechanisms — including stiff mandatory fines for noncompliance — would be enacted.

S&P 500 Corporate Earnings Growth Once Again Significantly Exceeds Wall Street Expectations

Sector	Reported			Earnings Growth			Earnings Surprise		
	Actual	/	Total	Percent	Positive	Negative	Percent	Positive	Negative
Energy	42	/	42	7%	28	13	0%	24	18
Materials	29	/	31	-11%	15	11	3%	16	10
Industrials	60	/	61	13%	49	9	8%	43	13
Consumer Discretionary	74	/	80	6%	46	24	5%	53	18
Consumer Staples	40	/	42	2%	25	15	1%	22	10
Health Care	52	/	52	5%	37	15	2%	33	11
Financials	80	/	80	64%	43	31	2%	42	30
Information Technology	29	/	71	14%	39	32	10%	47	15
Telecommunication	8	/	8	-23%	4	3	-11%	2	5
Utilities	32	/	33	4%	19	12	1%	15	14
S&P 500	488	/	500	13%	305	165	4%	287	144



Note: "Earnings Growth" is the percentage change in the cumulative share-weighted EPS earnings from that of a year ago. "Earnings Surprise" is the share-weighted average of the ratio of actual company earnings versus the consensus estimate.
Source: Bloomberg, Standard & Poor's, Factset

The EURO is the strong policy that has been demanded by the markets, taking Europe off the front page and sending the CBOE Volatility Index to nine-month lows.

Will Oil Prices Derail the Markets?

With Europe relegated to page two, what has taken its place in the headlines? Well, oil prices are skyrocketing, gas prices are back to last year's highs, and investors are worried that an adversely impacted consumer could derail the markets and economy. But wait — isn't the U.S. producing more oil than ever, and isn't U.S. consumption at an 11-year low? While both of these statements are true, it is unfortunately geopolitics — not U.S. supply and demand dynamics — that is dominating oil prices. While increased U.S. oil production will eventually temper prices, we are for now beholden to global markets.

The U.S. economy has changed significantly over the past 30 years, marked by a broad migration toward a service economy despite the recent gains in manufacturing. Given this shift, as well as the increased efficiency of oil and the emergence of such alternative fuels as natural gas, our economy uses an impressive two-thirds less oil to produce a dollar of GDP (a metric called "oil intensity"). So even if oil keeps climbing — in spite of these demand and supply trends — its material impact on the economy is likely to be muted even if its psychological impact inspires volatility.

Fundamentals Remain the Key to Market Success

The real economy has the wind in its sails, fueled by a dramatic drop in inflation, a meaningful decline in unemployment, regular upside surprises in corporate profits and sustained across-the-board expansion in manufacturing. Meanwhile, the consumer — the economic game-changer at 70% of the economy — is setting records for consumer spending and retail sales, while the perpetually lagging indicator of consumer confidence has been surging off its lows.

Our "ABCDs" of fundamentals have continued to have a positive impact.

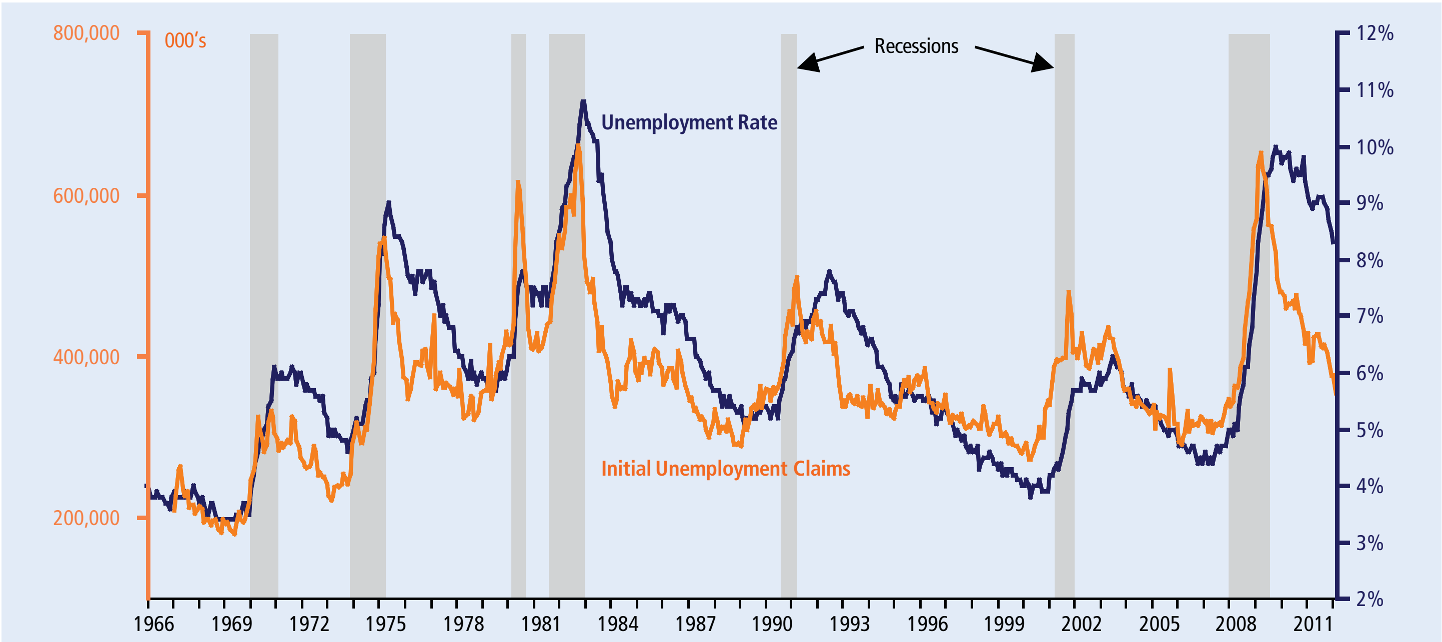
Advancing corporate profits. Fourth quarter earnings season started with a few significant misses and a lot of handwringing in the media. The consensus had earnings growth pegged at around 9% before strategists started dialing back their expectations to the low single digits. Boy, was that the wrong call — this season has been yet another blowout. With 94% of the S&P 500 having reported results, earnings growth is 13% over fourth quarter 2010 while top-line sales growth is up 8.3%. Corporate earnings reached an all-time high in 2011 and are on track to set new records in 2012.

Broadening manufacturing. U.S. manufacturing has reemerged as a powerhouse. The ISM manufacturing index has expanded for 30 consecutive months, while the Chicago PMI accelerated to an 11-month high in February. After 12 straight years of job losses, U.S. manufacturers added 109,000 workers to their payrolls in 2010 and another 237,000 in 2011, helping manufacturing output expand at a rate more than double that of the overall U.S. economy. Exports surged to an all-time high of $180 billion in September; although they ticked back in subsequent months, 2011 exports increased 14.5% over 2010.

Consumer strength underestimated. A variety of data points suggest the consumer is emerging as a game-changer. The unemployment rate, at 8.3%, is at its lowest level in three years, while initial unemployment claims are at 2008 lows. Personal Income and personal consumption expenditures have reached all-time highs. January retail sales surpassed the $400 billion mark to reach the highest monthly level ever, and auto sales grew 10.7% in 2011. Even housing has shown signs of life, with housing starts increasing 10% in 2011.

Developing economies are driving global growth. Emerging markets continue to be a key catalyst for U.S. corporate revenue. China — despite evidence of cracks in the sustainability of its state-supported growth engine — continues to fuel world demand. Meanwhile, smaller Asian, African and Latin

Initial Claims Have Plummeted, Boding Well for Continued Upside Surprises in Employment



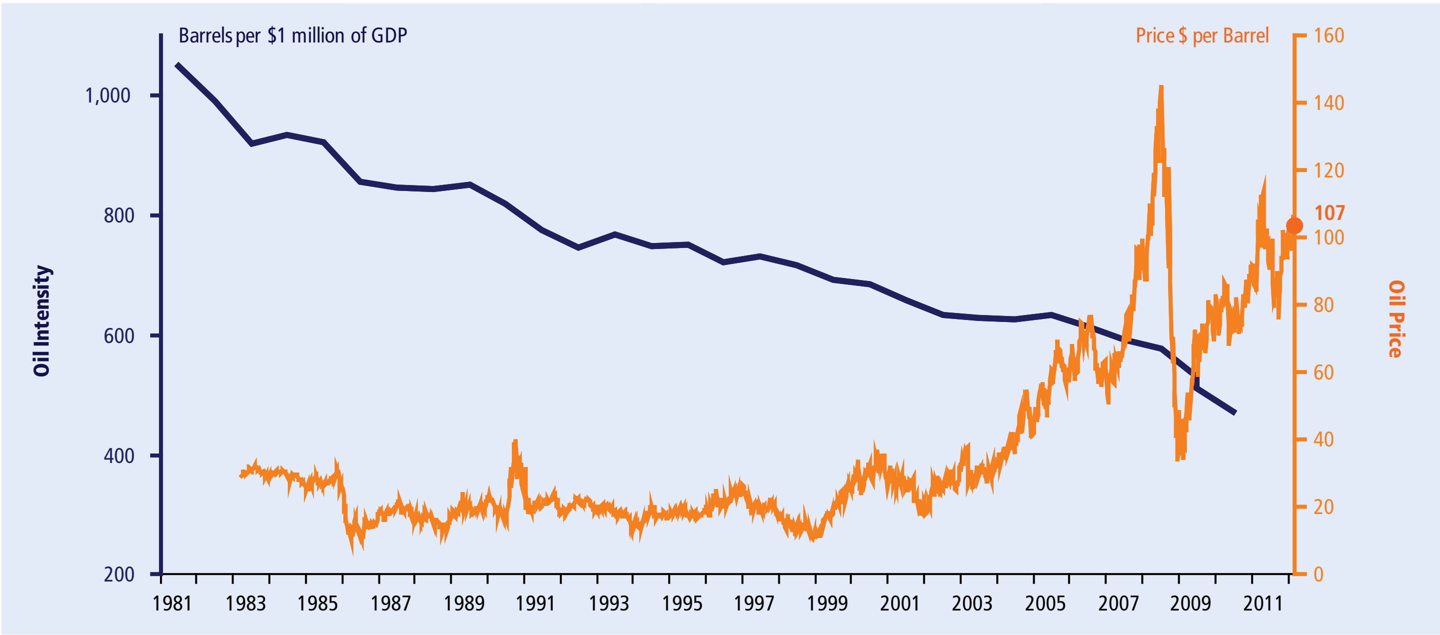
Source: Bureau of Labor Statistics, FactSet

American countries are stepping up for their chance to emerge into the middle class. Thailand, for example, is the world's top rice and rubber exporter and is one of the fastest-growing economies in Southeast Asia. It is responsible for 40% of all computer hard disks and produces more light trucks than Japan. After last year's severe flooding, the country is expected to bounce back with growth of 5% in 2012.

The Madness of Crowds and Investing (or "Gaming Diversification")

Given an equity market that is finally recognizing the solid economic fundamentals, investors must be feeling pretty content, right? Wrong — domestic equity mutual funds saw $94 billion in outflows in 2010, another $134 billion in outflows in 2011 and $6 billion in outflows through the first six weeks of 2012. This is the madness of crowds; just when investors should have been piling into equities, they have been heading for the exits. Most likely, the market turmoil of recent years has frightened investors into trying to sidestep risk by gaming diversification, with predictably poor timing. Risky assets should be viewed from a portfolio perspective, not as standalone investments; when combined appropriately, risky assets help build wealth with lower volatility. Fortunately, it is never too late to make the right decision. ■

It Now Takes Two-Thirds Less Oil to Produce a Dollar of Economic Growth Than It Did 30 Years Ago



Note: Oil Prices are West Texas Intermediate light crude spot prices (NYMEX).
Source: US Dept of Energy, FactSet

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