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Summer Rally Defies Pessimism as Bulls Stampede into Labor Day

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Equity markets were positive in August for the first time in three years, capping a three-month run of success and laying waste to the notion that investors should "sell in May and go away". Notably small-cap stocks surged nearly 4%, a sure sign of a new appetite for risk. Those who tried this timing strategy not only missed out on the summer's positive returns but were also penalized with a bill for transaction costs and a now-higher price to get back into the market.

The problem for investors is that it is much easier to sell in the face of global risks than it is to reinvest. Today, the highest-profile risks include:

- The "fiscal cliff", the draconian tax increases and spending cuts that in the absence of other action by Congress will be automatically implemented on January 1, 2013
- The European crisis and the potential for default or exit by Greece, Spain or Italy
- China's hard landing, or for that matter the risk of any of the BRICs slamming on the brakes of growth
- The Iranian nuclear threat and the potential that Israel may unilaterally launch a pre-emptive military strike.

Risks can be assigned to one of two categories: "Armageddon risks" and "normal volatility"; an Armageddon scenario would suggest that investors avoid the market, while normal volatility means they should continue to pursue a broad, globally diversified portfolio. Throughout the bull market that began over three years ago, all risks seemingly have been slapped with an unreasonable and unwarranted Armageddon label; our view is that the risks that have dominated investor psychology over the past few years — all of which can be seen, described and discussed

Executive Summary

- **August capped off a strong summer for equities, disputing the notion of "sell in May and go away".**
- **Risks that have dominated investor psychology are characteristic of normal volatility, not looming Armageddon.**
- **Global risks make headlines, but fundamentals and "tectonic shifts" are the pillars of growth that support markets.**

Returns for a globally diversified strategy over the last ten years refute the notion of a "lost decade"

Index	Wgt	Aug-12	YTD	2011	2010	2009	2008	2007	1 Year	3 Years	5 Years	10 Years
Equity												
S&P 500	10%	2.3	13.5	2.1	15.1	26.5	(37.0)	5.5	18.0	13.6	1.3	6.5
S&P MidCap 400	10%	3.5	11.6	(1.7)	26.6	37.4	(36.2)	8.0	12.7	15.7	4.0	9.6
S&P SmallCap 600	10%	3.8	11.2	1.0	26.3	25.6	(31.1)	(0.3)	16.9	16.2	3.1	9.8
Global REITs	10%	0.3	19.5	(8.1)	20.0	41.3	(48.9)	(4.7)	11.0	13.1	(1.7)	8.0
EAFE	10%	2.7	7.4	(11.7)	8.2	32.5	(43.1)	11.6	0.5	2.9	(4.3)	7.1
Emerging Markets	10%	(0.9)	1.1	(22.7)	9.8	93.5	(59.3)	59.1	(11.9)	1.6	(2.9)	18.6
Average		1.9	10.7	(6.9)	17.7	42.8	(42.6)	13.2	7.9	10.5	(0.1)	9.9
Fixed Income												
Corporate	10%	0.2	7.9	8.1	9.0	18.7	(4.9)	4.6	10.3	9.5	8.1	6.7
U.S. Treasury 20+	10%	(1.3)	6.8	33.8	9.4	(21.4)	33.7	10.2	22.2	14.0	11.9	8.6
Global Aggregate	10%	0.9	3.6	5.6	5.5	6.9	4.8	9.5	1.4	5.4	6.4	6.4
High Yield	10%	1.2	10.6	5.0	15.1	58.2	(26.2)	1.9	13.9	14.5	9.6	10.7
Average		0.2	7.2	13.2	9.8	15.6	1.9	6.5	11.9	10.8	9.0	8.1
60/40 Porfolio		**1.3**	**9.3**	**1.1**	**14.5**	**31.9**	**(24.8)**	**10.5**	**9.5**	**10.6**	**3.5**	**9.2**

Source: ING U.S. Investment Management/Global Perspectives, FactSet, FTSE NAREIT Index

No "Lost Decade"

— are simply normal volatility. The market is coming to this realization and will likely continue to do so.

We live in a risky world, and the current risks, while serious, are much less severe than they were during the 2008 Credit Crisis. The market seems physically but not psychologically cured; however, over the years it has bounced back from other crises including the September 11 terrorist attacks, the bursting of the "dot-com" bubble, the 1990 Persian Gulf War and Black Monday in 1987.

Historically our market, using the S&P 500 as a yardstick, has been priced at a price-to-earnings ratio of 15.5. Currently, it is at a low 13.5, reflecting excessive pessimism. If global risks were priced at the historical multiple, the S&P 500 could be 15% higher. But there are unrelenting arguments that Armageddon is around the corner and we must take off our rose-colored glasses and look at the reality.

We always prefer to separate fact from fiction, and we do that by examining the fundamentals. If world markets were in fact heading toward Armageddon, it would certainly be reflected in a breakdown of private economic activity among both businesses and consumers. Yet the cornerstone of our analysis for the past three years has been that the fundamentals continue to march on despite the global risks. This fact should have kept investors strong and disciplined enough to stay fully invested in the market because fundamentals could not be this good — and they are good — if times were as bad as the bears contend.

Fundamentals Press on Despite Global Risks

Let's examine the latest readings on the fundamentals.

Advancing corporate earnings. Our number-one fundamental indicator continues to advance. Growth expectations of 2% or less in the second quarter were shattered, and earnings grew 6.5% year-over-year, tripling expectations.

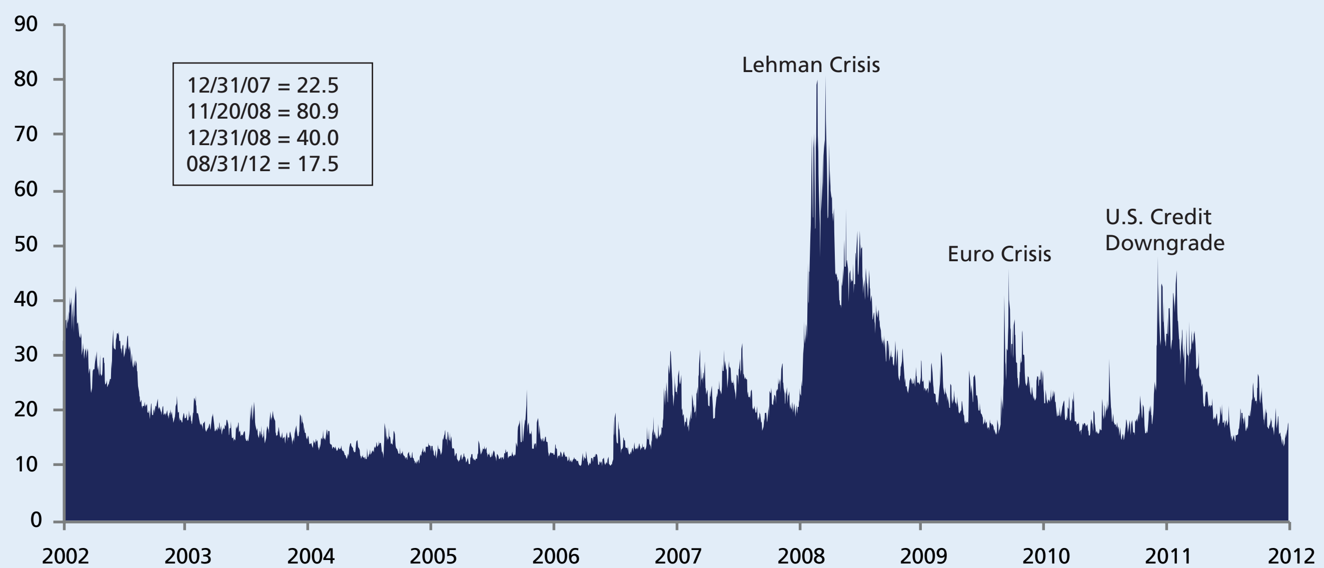
Broadening manufacturing. The U.S. ISM manufacturing index fell to 49.6 in August from 49.8 in July, the third consecutive sub-50 reading (indicating contraction) and below consensus expectations. Both production and new orders dropped from highs in April-May, fueling speculation of more Fed stimulus.

Consumer as a game changer. The consumer shook off the pervasive pessimism and went shopping in July. Retails sales climbed 0.8% for the month after a few months of declines. Consumer incomes and personal consumption spending were also higher. Moderating mid-summer gas prices and consistently positive housing news have been fueling the consumer resurgence.

In fact, housing has been the surprise economic bright spot this year. The rumblings of a sustainable recovery began in the first quarter, when sales were 5% higher than in 2011 and "healthy" sales (not counting foreclosures and short sales) improved 17% compared to a year ago. The increases in volume provided much needed support for prices. Now, housing numbers are shaping up across the board:

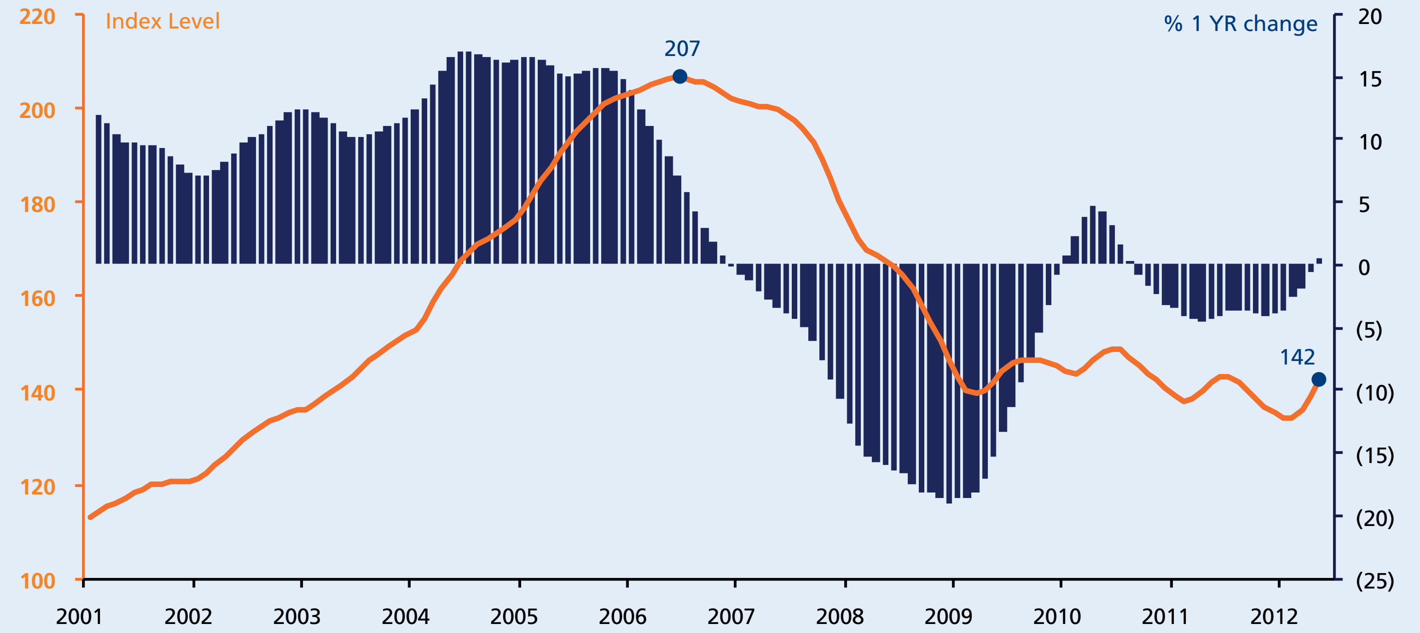
- Pending home sales rose to their highest level in more than two years in July, increasing 2.4% over June and 12.4% over a year ago, putting the index at its highest level since April 2010.
- New-home sales jumped to an annual rate of 372,000, a 3.6% gain compared with the 360,000 sold in June and a 25.3% year-over-year increase. And existing home purchases increased 2.3% to a 4.47 million annual rate.
- Although prices are 31% off their peak, the market experienced a positive annual growth rate for the first time since summer 2010. The national composite of the S&P/ Case Shiller Index was up 1.2% in second quarter 2012 compared to second quarter 2011 and was up 6.9% over first quarter 2012. The government homebuyers

Projected market volatility spikes in times of crisis then drops into the normal range as fear, uncertainty and doubt subside — apparently the prevailing sentiment today



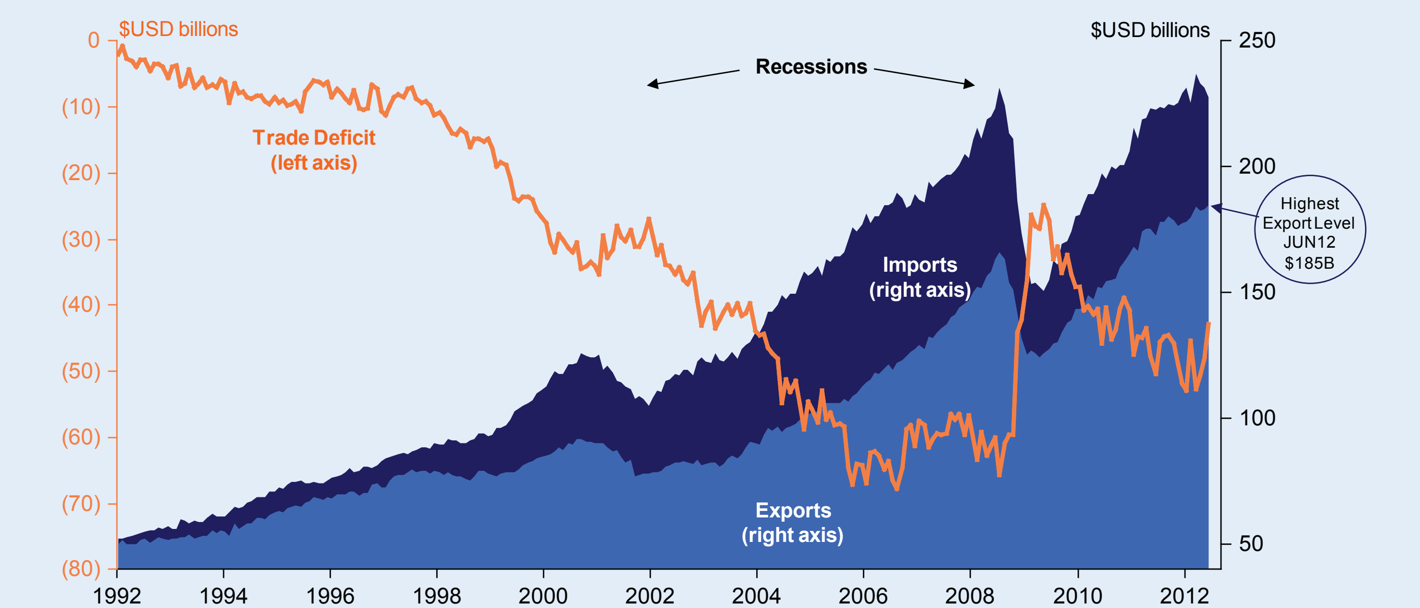
Source: ING U.S. Investment Management/Global Perspectives, Standard & Poor's, Chicago Board Option Exchange, FactSet

Home values are still 31% below 2006 levels, but the Case-Shiller national composite has shown signs of a sustainable recovery with its first year-over-year price increase in two years



Source: ING U.S. Investment Management/Global Perspectives, Factset, S&P Case-Shiller, Bloomberg

A growing economy fuels demand for imports; the trade deficit hit a ten-year low in the Great Recession as demand dwindled. Exports recently reached their highest level ever, at $185 billion



Source: ING U.S. Investment Management/Global Perspectives, FactSet tax credit muddied the waters by providing temporary, artificial buoyancy to the housing market in 2010; excluding the artificial price inflation, this is the first true year-over-year increase since December 2006.

Developing economies. Emerging market and BRIC darling Brazil has stumbled lately, but government stimulus has been able to offset some of the resulting global drag. Brazilian GDP expanded 0.4% in the second quarter from the previous three months, the fastest pace in a year, and Brazilian officials are predicting a strong reacceleration in the third quarter. Across other BRIC nations, Russia's GDP expanded 4.4% (annual rate) in the first half of 2012, GDP in India rose 5.5% in the second quarter from a year ago, and China continues to grapple with a GDP growth slowdown into the 7.6% level.

Tectonic Shifts — Global Trade

Beyond the fundamentals mentioned above, there are other catalysts for growth (which we call "tectonic shifts"). One of these ("global trade") continues to surge despite the fictitious view that emerging economies are rolling over; the fact is that global trade is accelerating.

Global trade continues to develop and support the global economy by opening more doors to advancement and prosperity. As the world's largest economy, the U.S. has much to gain.

After two decades of negotiations, Russia on August 29 became the 156th full member of the World Trade Organization. The World Bank estimates that although It may not see the typical immediate GDP boost of 1–3%, Russia's $1.86 trillion economy will increase 11% above and beyond its normal trajectory in the long run.

India, another BRIC country, recently announced that the government is aiming to double exports to $500 billion per year by 2015. How? By focusing on "South-South" trade, which is trade between developing countries in the globe's southern hemisphere. According to India's Commerce Secretary, "South-South trade has multiplied more than 10 times in the last two decades compared to global trade, which grew four-fold in this period." New trade routes between Asian and Latin American countries — the intra-emerging market trade — are indeed shaping the economic landscape.

Amid all the doom and gloom few seemed to notice that the latest trade numbers revealed that the U.S. reached an all-time high in exports. Yes, China and Europe are certainly slowing, but opportunities do exist. Just last week Washington's top trade official declared he saw "explosive" growth opportunities within Southeast Asia, as the U.S. pushed on with a drive to deepen ties with the dynamic and growing region.

Back-to-School Catalyst for the Markets

As the markets plowed through the summer, "sell in May" was a losing strategy. While investors embracing the Armageddon scenarios continue to wait for the sky to fall, those who remained focused on the fundamentals while seeing the global risks for what they truly are — incidents of normal volatility — have reaped the benefits of a surging equity market.

Global risks make headlines, but fundamentals and tectonic shifts such as global trade are the pillars of economic growth that support market resilience and — so far — a tireless bull market. The fundamentals continue to march on, exemplified by positive signs in retail sales and same-store sales reports. It looks like the 2012 back-to-school season will be a blockbuster for U.S. retailers. A lot can go wrong, but the market will take heart if the consumer — at 70% of the economy — is strong.

Armageddon will have to wait. In our view, the best approach is to equate today's global risks with normal volatility and stay fully invested.