Revue Hebdomadaire

11 Juillet 2012

Houseview

Global Strategy

Can't Always Get What You Want

Strategy Recommendations

	+	=	-
TAA	FI	EQ	COMM
	REIT		
EQUITY			
- Sectors	DISCRET	STPLS	INDUS
	HEALTH	FIN'L	
		UTIL	
		TELCO	
		MATS	
		ENERGY	
		IT	
- Regions	JPN	ASIA	US
	EURO	GEM	
- Size		LGE	
		SML	
- Style		GRWTH	
		VALUE	
FIXED			
- Markets	GOVT		IFL
	SPREAD		
- Markets	EMD HC	EPT	ABS
	HY/SBL	EM rates	
	IGC	EM FX	

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Economic Outlook

- ECB underwhelms, as the central bank remains reluctant to expand its balance sheet further
- China: waiting for the stimulus to filter through

ECB underwhelms

After last week's Euro summit all eyes were on the ECB to see whether or not Draghi would "reward" the progress made there by loosening monetary policy further. In the end, the ECB did deliver to some extent as it cut the target refi rate by 25 bp while the deposit rate was even cut to 0%. The latter now makes the euro more attractive as a funding currency in FX space relative to other G4 currencies which was immediately visible in a depreciation of the euro.

The interest rate cut was motivated by fact that some of the downside growth risks were now materialising (which is partly an acknowledgement of the fact that Germany is now also decelerating). Since we believe that external demand is the only factor that can give the Euro area some traction again and because global growth continues to decelerate, we now believe that a further 25 bp cut will be forthcoming.

The cut in the deposit rate implies that the immediate action was a little bit more than expected. Yet, the ECB still managed to disappoint the markets because it was made very clear that the central bank remains reluctant to engage in another LTRO or give the ESM access to its balance sheet. Draghi stated that the LTRO's are too blunt as an instrument because they do not discriminate between struggling (peripheral) banks which need more liquidity and healthy (core) banks which can use these as a free lunch so to speak. Hence, the preferred policy would then seem to be to loosen the collateral rules once again to ensure ongoing peripheral access to ECB funding. Nevertheless, this overlooks the main attraction of the LTRO which is that it gives banks a much needed degree of certainty about future funding conditions.

In our view the use of the ECB's balance sheet will be very crucial in providing liquidity to sovereigns until the fundamental problems are to a large extent solved (which they will not be for a long time to come). The reason is very simple: The ECB is the only institution with unlimited firing power.

For the struggling peripheral sovereigns (Spain and to a lesser extent Italy) there are currently only two options:

- They keep partial market access as yields are supported by ESM or ECB bond buying
- They are driven into a full scale Troika program

The big problem is that policymakers have done everything they can to make the bond buying option as ineffective as possible. ESM bond buying may well backfire because the markets know that its resources are limited. There is an analogy here with a central bank trying to prevent a devaluation of the currency: Because speculators know FX reserves are finite, FX interventions become completely self-defeating as they are an open invitation to what is ultimately known to be a one-sided bet.

Meanwhile, ECB bond buying could actually drive yields up as well because ECB holdings are perceived to be senior and because the ECB is not willing to go at it full force. For markets it is not sufficient to know that a central bank has the ability to end speculation, they need to be convinced that it is willing to do so as well!

China: real stimulus coming through

Chinese data continue to reflect the weak domestic demand growth picture. June Inflation was a bit lower than expected, at 2.2%, down from 3.0% in May. Much of the decline can be explained by base effects. Last year in June and July, pork prices rose sharply. This is the main reason why food price inflation on a year-on-year basis fell by more than two percentage points. But next to the favourable base effects and less inflation coming from food and energy, we see the weaker demand picture clearly reflected in the inflation data. The month-on-month CPI rate was -0.6%, the third negative number in a row, after the -0.1% and -0.3% in April and May. Producer price inflation fell to -2.1% year-on-year.

Import growth fell to 6%, down from 13% in May. The decline looks worse than it really was, as May had more working days than a year earlier. Compared with the 7% average for the first five months of the year, the 6% recorded in June does not represent a dramatic change.

Export growth was a bit better than expected and stopped falling. The 11% recorded in June was even higher than the 9% average of the January-May period. More good news came from the housing sector. Social housing investment has been accelerating in recent months, in line with statements and announcements by government officials recently. For the first half of the year, 4.7 million new housing units were started to be built, which equals 63% of the 2012 year target. Particularly June was a good month.

After two months of accelerated policy easing, we are slowly seeing the evidence coming through. The June activity data and the Q2 GDP number are likely to be weak still, but from July onwards we expect Chinese growth numbers to start improving. With the Eurozone crisis ongoing and deepening perhaps, and global trade growth likely to remain weak, we expect that the Chinese authorities will continue with their accelerated easing initiatives. The Chinese recovery should strengthen in the course of the second half of the year.

Willem Verhagen
Senior Economist

Maarten Jan Bakkum
Senior Emerging Market Strategist

Forecasts

Global macro

The global economy has reached a bifurcation point. One branch represents the negative state of the world where the EMU shock is large enough to induce a substantial global growth slowdown (and maybe a recession). Whether or not we are already on that path is very difficult to answer. We know that cyclical turning points are the result of the interplay between shocks, the degree of macro economic imbalances and the policy response. Because we are in unchartered territory as far as the imbalances are concerned and because the policy response is constrained by real or imaginary limits, it is impossible to tell whether the current shock will tip the balance towards a growth slowdown.

The other branch of the bifurcation represents the state of the world where global growth slows down somewhat in Q2 but then gradually regains strength in H2'12. This pattern is the result of a fading boost to global IP from the rebound following the Thai floods and a continued stable pace of underlying final demand growth. The most supportive factor for the latter is undoubtedly the declining global inflation which should produce a substantial boost to real wage and profit income growth.

Despite the uncertainty we can make two important observations. The EMU crisis is clearly corrosive for financial conditions and confidence in other parts of the world. The probability of a negative global growth outcome increases the longer this uncertainty persists. On the other hand, taking the past two and a half years as a guide, a (temporal) reduction in this uncertainty due to an EU/ECB policy response in combination with global policy easing and a declining inflation momentum certainly has the potential to cause a growth acceleration again later this year.

It is important to remark that, as far as the second point is concerned, the cards are certainly a lot better than last year. In Q2'11 global inflation momentum was increasing and many EM central banks were in the process of tightening policy. This time around it is almost exactly the reverse: The fall in inflation creates more opportunity for policy easing.

All in all, our base case remains that we will end up on the positive global growth outcome of the afore-mentioned bifurcation, possibly after a somewhat longer soft patch than anticipated. However, our confidence in this outcome has clearly decreased over the past months.

Valentijn van Nieuwenhuijzen
Head of Strategy

Willem Verhagen
Senior Economist

ING IM Global Economic Outlook

	Real GDP			Inflation			Policy Rates (%, YE)		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
World	3,6	3,0	3,5	4,2	3,1	3,0			
Developed	1,3	1,1	1,6	2,6	1,8	1,5	0,45	0,36	0,36
US	1,7	2,1	2,2	3,1	2,0	1,8	0,13	0,13	0,13
Euro	1,5	-0,5	0,8	2,6	2,2	1,6	1,00	0,75	0,75
Japan	-0,4	2,5	1,8	0,0	0,0	0,1	0,10	0,10	0,10
UK	0,8	0,3	1,5	4,4	2,7	1,8	0,50	0,50	0,50
Emerging	6,6	5,4	6,0	6,3	4,7	5,0			
China	9,3	7,7	7,8	5,5	3,3	4,3			

	Unemployment rate			Budget balance			Current account		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
Developed	8,7	8,8	8,8	-7,3	-6,3	-5,3	-1,4	-1,3	-1,3
US	9,0	8,1	7,9	-8,6	-7,4	-5,9	-3,1	-3,0	-3,0
Euro	10,3	11,5	11,9	-4,5	-3,5	-2,5	-0,5	-0,3	-0,2
Japan	4,5	4,5	4,2	-9,3	-9,0	-9,5	2,3	1,9	1,5
UK	8,1	8,4	8,2	-8,2	-7,5	-6,2	-1,8	-1,0	-0,8
Emerging									
China	6,5	6,4	6,4	-1,7	-1,6	-2	4,3	3,9	3,5

Source: Forecasts from ING IM, historical data from IMF (GDP, inflation) and Economist Inteligence Unit (rest data)

Global markets

Bond yields (10y)

quarter end (%)	Q1 '12	Q2'12	Q3'12	Q4'12
Countries				
US	1.9%	1.7%	2.1%	2.5%
Eurozone (bunds)	1.8%	1.3%	1.7%	2.1%
Japan	1.0%	0.8%	1.0%	1.2%
UK	2.2%	1.8%	2.0%	2.4%

Corporate bond (IG) yields

quarter end (%)	Q1 '12	Q2'12	Q3'12	Q4'12
Countries				
US	3.4%	3.5%	3.7%	3.9%
Eurozone	3.2%	3.2%	3.5%	3.7%
Japan	0.7%	0.8%	0.8%	0.9%
UK	5.1%	5.1%	5.1%	5.3%

Equity

quarter end	Q1 '12	Q2'12	Q3'12	Q4'12
Countries				
S&P 500	1408	1400	1425	1450
Euro stoxx 600	263	270	275	290
TOPIX	854	870	900	920
FTSE 100	5768	5900	6100	6250
MSCI EM Free	1041	1100	1125	1150

Foreign exchange rates

quarter end	Q1 '12	Q2'12	Q3'12	Q4'12
Currencies				
EUR/USD	1.33	1.27	1.25	1.30
USD/JPY	83	83	85	85
GBP/USD	1.60	1.55	1.54	1.57
EUR/JPY	110	105	106	111
EUR/GBP	0.83	0.82	0.81	0.83

Source: ING IM (11/07/2012)

Fixed Income Strategy

- Treasuries remain well supported
- Keep spread product overweight in fixed income
- EMD HC and HY are preferred picks

Fixed Income Strategy

With respect to our fixed income allocation strategy it is important to point out that shifting regulatory rules are not (yet) counter balancing other ongoing supportive factors for treasury markets. Growth is still weak, inflationary trends are down, central banks are easing and return momentum remains supportive.

At the same time, a couple of developments have brightened the outlook for spread products in fixed income space recently. Most noteworthy was the better-than-expected outcome of the EU Summit at the end of June. Significant steps towards a genuine banking union, with Eurozone-wide banking governance and centralized recapitalisation capacity, was the most important progress in this respect. This provided the strongly desired transparency for markets on the details of the Spanish banking sector bail-out and marks an important first step towards debt mutualisation in the Eurozone (basically pooling contingent sovereign liabilities). Thereby, it is the first serious step at breaking the vicious bank-sovereign contagion cycle.

Next to this, the initiated "growth"-pact of Eur 130bn set another important precedent as it reflects the first acknowledgement that the collective austerity agenda is not working and needs to be complemented by stronger support for near-term growth.

Also, crucial important is that market dynamics for spreads remain more supportive than for other “risky” asset classes like commodities or equities. Momentum in spread product remains firm and funding conditions remain supportive of further positive excess returns over (equal duration) treasuries. The latter is a clear expression that some of the support mechanism, that have been put in place during the last 2 years, was successful in limiting damage to inter-bank and general fixed income market liquidity.

All this does not take away that many challenges remain as the firewall to fight-off contagion is still too small, the re-design of the Eurozone institutional structure is far from finished (much more political and fiscal union is still needed) and the growth agenda is still much too weak (ECB needs to do more, Eur130 bn not enough to make material impact).

Still, we feel the Summit outcome is certainly enough to support spread market for the next couple of months, especially since it comes against a backdrop of depressed sentiment and defensive positioning amongst investors. Also important for our allocation stance is that market momentum has become much more constructive in recent weeks. Therefore, we decided to move spread products from neutral to a medium overweight.

Within spreads Emerging Market Hard Currency (EMD HC) and Global High Yield remain our favourites as both benefit from relatively healthy balance sheets (EM sovereign and US corporates most notably) and ongoing inflows that are “searching” for yield. Next to that, we feel that the Summit outcomes are especially beneficial for European Investment Grade Credits (IGC) and therefore upgrade this asset class to a small overweight despite still cautious allocation signals on the back of the short-term relative return momentum and bottom-up analyst expectations for the asset class.

Also, we have decided to move EM FX from a small underweight within spread product to a neutral stance. The two key factors driving the move are improved relative return momentum as EM currencies have started to rebound from the middle of June onwards and firm conviction of our EMD analysts in future performance of the asset class. Most other spread product analysts have become more cautious recently. Also, the higher amount of policy ammunition and flexibility in EM compared to DM is becoming more obvious and more needed again as global cyclical momentum has weakened further. From here on that might start to benefit EM currencies as not only rates cuts, but also fiscal stimulus might be used more extensively in EM space.

European Aaa ABS remains a big underweight as relative return momentum is very weak and uncertainty surrounding the impact of new banking and insurance regulation continues to limit visibility on the future demand for this type of paper. Some hope of less harsh treatment of ABS has occurred in recent weeks, but clear facts are needed to really eliminate market concern.

Valentijn van Nieuwenhuijzen
Head of Strategy

Mary Pieterse-Bloem
Senior Investment Strategist

Equity Strategy

- Policy makers fail to convince investors
- Earnings estimates are too high. We have more confidence in dividend prospects.
- High dividend yields act as an attractive source of income

Dividends to the rescue

The short-term outlook for equities looks more and more like the summer weather in the Netherlands: many dark clouds, even more rain and occasionally a bit of sun to make people feel happy but overall it is a summer below par.

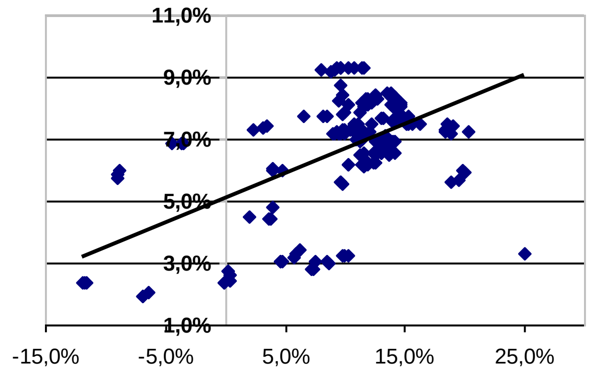
The positive effects of last weeks' summit didn't last long as despite some modest progress, the focus turned towards timing and execution risks related to the firing power of the ESM/EFSF and the creation of a single banking supervisor. In addition, further monetary easing by the ECB, the BoE, Denmark and China couldn't turn the tide either. The macro economic data continue to come in below expectations and investors expect more convincing measures both from a monetary as from a fiscal and political point of view. In the mean time, Spanish bond yields jumped back towards 7% and the spread with Germany rose beyond 550bp.

Contrary to the previous quarter we do not expect that earnings will come to the rescue. The momentum is firmly negative across all regions and sectors as companies are guiding down analysts estimates rapidly. We think that US Q2 earnings will show a 2%-decline relative to last year. Weaker global growth, a stronger dollar and lower energy prices will weigh on earnings. The latter may sound odd but given the importance of this sector in the S&P500 (11%) and due to the fact that - contrary to the negative impact of the oil price decline - the positive effects, through higher disposable income, are coming with a time lag this is a normal pattern.

In short, we expect a further decline in earnings estimates. These revisions will be even more important with regards to 2013. It is in our view difficult to conceive an increase in corporate margins in a period of sluggish economic growth, especially taking into account the current record-high net profit margins.

The following scatter diagram illustrates the relation between revenue growth and the level of net margins for US companies. For 2013 we expect 5%-6% revenue growth which would correspond with margins around 7-8%. This compares with the current 8.2% net margin. This is why we think the current bottom-up estimates for 2013, indicating a 12% earnings growth are much too high. In our view, 5% is a more realistic figure.

sales growth and margins



Source: Datastream, INGIM (July'12)

On the other hand we feel comfortable with the dividend payments over the next 2 years. Companies have strong balance sheets and are cash rich. It is not excluded that companies, especially the US ones will increase financial leverage by buying back their own equities. The room to do so is there, especially as this is an easy way to increase the return on equity and the EPS.

For investors, the dividends can act as a sort of 'waiting money'. In the Eurozone the trailing dividend yield is 4.3%. This even compares well to corporate bond yields which average 3.7%. In other words, while buying the equities of a company, the investor not only receives a higher immediate yield but also receives an option on future growth for free. Over the last 30 years, average dividend growth was 7.8% and has never fallen below 2% over a 10-yr period. A long-term investor can take advantage of the current weak market status (low valuations, high risk aversion, unloved) and nevertheless generate an income above bond yields.

10 year dividend growth (ann)

Source: Datastream, INGIM (July'12)

Patrick Moonen
Senior Equity Strategist

Real Estate

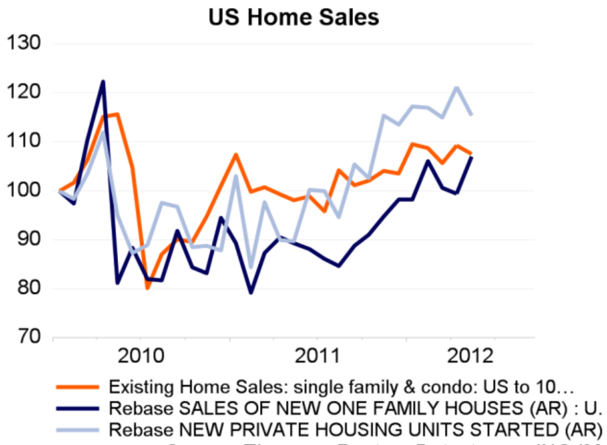
- US Housing bottoming

US Housing, out of a coma and wiggling the big toe

Have US house prices bottomed? In the first quarter of this year we wrote that US Macro fundamentals were showing encouraging signs and in relation to real estate indicated a bottom in property prices. Based on the end of 2011 inventory figures and pace of sales in existing and new home sales, the US shadow inventory was projected to be cleared by the summer of 2013. Now, a few months further on in the year we take another look at US housing dynamics.

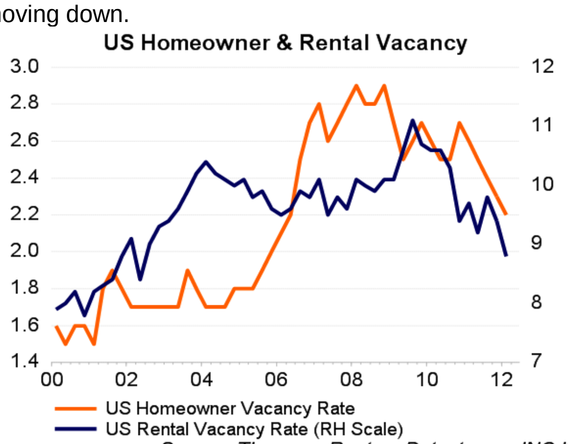
The good news

Sales in both existing and new homes have been encouraging, over the last two years the volumes have been increasing in both series. Also, the number of new starts in private housing have been increasing. Admittedly, this is an improvement from low levels.



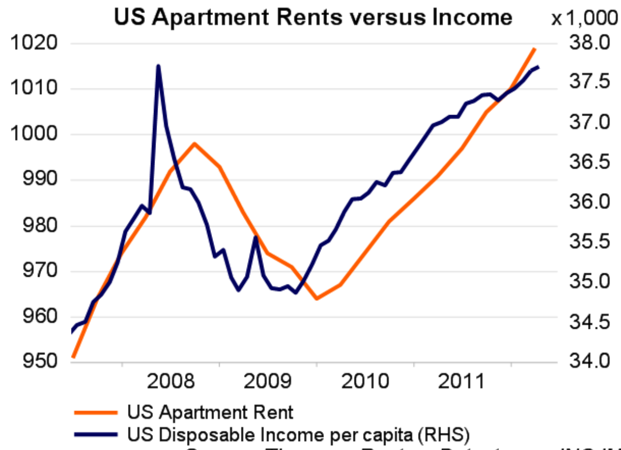
Source: Thomson Reuters Datastream, ING IM

When looking at vacancies outstanding we see a similar trend. In both the series of vacancies in homeowners and rentals, the general trend over the last two years has been moving down.



Source: Thomson Reuters Datastream, ING IM

The decrease in rental vacancies is noteworthy, as demand in the rental market in the apartment segment has been solid throughout the last few years as a replacement from owning a house. In this phase of the cycle, we see rents increasing at the same pace as disposable income per capita. This means that households have more money to spend and they are currently willing to spend it on higher rents (for the moment). These are slow cycles, however if this tendency continues the balance will tip over to switch from living in a rental apartment to becoming a homeowner. In particular, as current house prices are low and affordability remains at very supportive levels. It is important in this respect that employment statistics continue to improve.



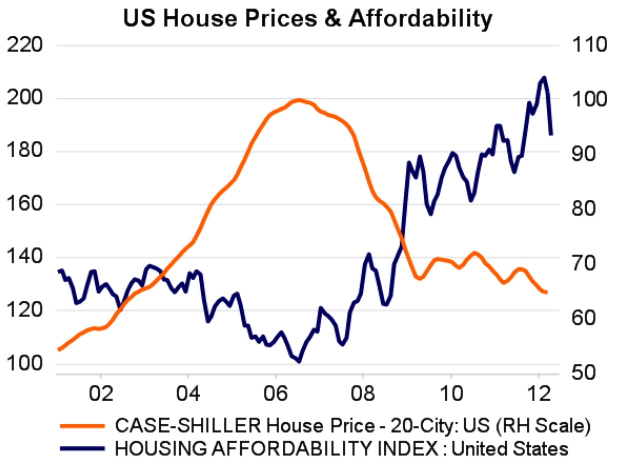
Source: Thomson Reuters Datastream, ING IM

One innovative way the Obama administration is trying to keep rents affordable is to turn about 250,000 home properties owned by Fannie Mae, Freddie Mac and the Federal Housing Administration to rental properties. The additional benefit is that this process speeds up the clearance of the shadow inventory, which has been at the core of the crisis in 2008. By approximation this is roughly a quarter of the total foreclosed properties included in the shadow inventory.

Based on the combined existing and new home sales pace of five million units against an available housing stock of 2.6 million units, the prediction made for the shadow housing inventory to be cleared by the summer of 2013 is still on track. As the shadow inventory has been typically the cause for official data to understate the actual number of inventory in the market and thus been the cause of uncertainty, the decrease or even prospect of removal of the foreclosure inventory will be a huge boost to confidence.

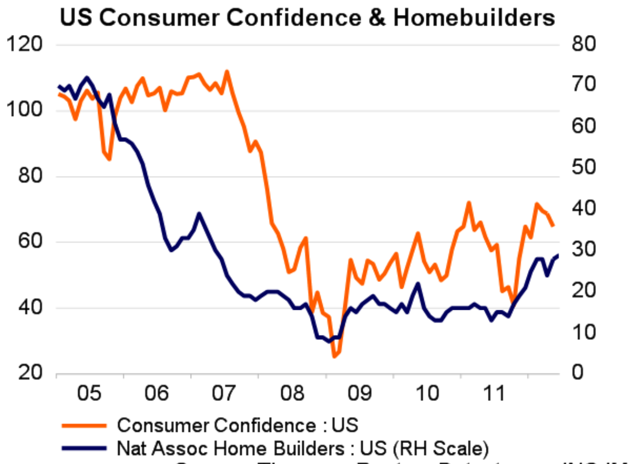
The bad news

Despite the good news of increasing sales volumes, improving income dynamics, supportive affordability and expectation for the shadow inventory to clear next year, house prices have not moved higher. The latest Case-Shiller house price index, a composite of property values of 20 cities, is showing a slowing pace of decline, but is still sloping down.



Source: Thomson Reuters Datastream, ING IM

It will take time for the above mentioned dynamics to feed through to higher house prices. Two points to mention in terms of somewhat negative news over the last weeks are first the latest tick down in consumer confidence and second the latest read in both the jobless claims and nonfarm payrolls, which have been disappointing.



Source: Thomson Reuters Datastream, ING IM

Conclusion

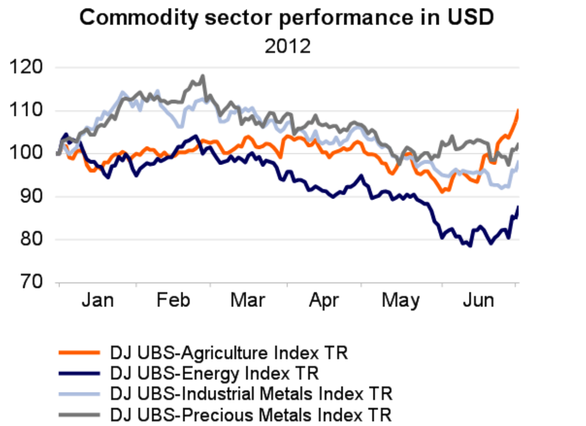
There are increasingly more signs of a nearing bottom. In particular, activity in sales and starts are optimistic indications of a turnaround. The other big positive is the prospect for the supply overhang in foreclosed property to be cleared next year. All seems to be on track. A necessary condition is, however, that confidence and employment dynamics continue to improve.

Siu-Kee Chan
Investment Manager STAAG

Commodities

- Commodities broadly up
- Oil dynamics fragile

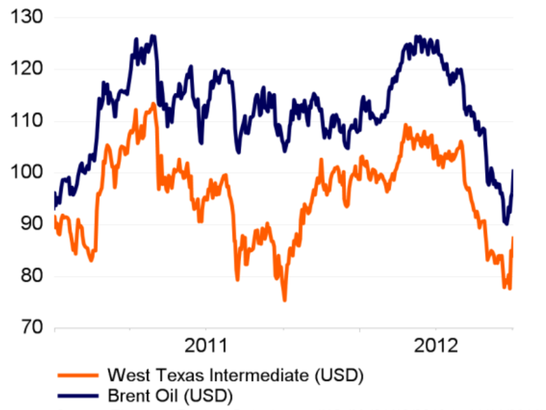
Commodity markets, as measured by DJ UBS Commodity Index, moved higher this week. All commodities sectors surged on the back of the positive outcome in the Euro zone. The interesting point to note is that agricultural commodities have been trading up since May driven by weather impact on grain prices.



Source: Thomson Reuters Datastream, ING IM

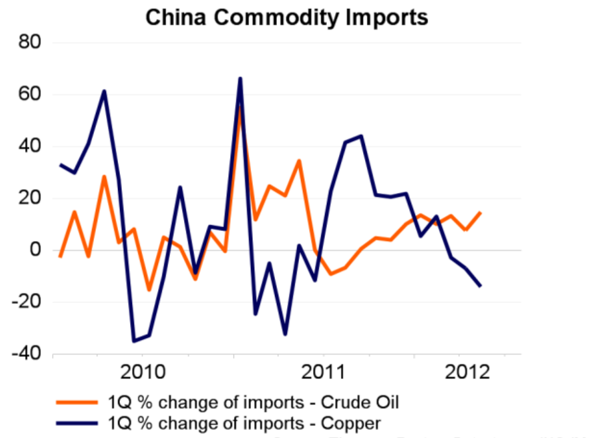
Oil markets

A lot of attention has been lately on the oil price after a substantial fall since the first quarter of this year. The Brent oil price has been peaking this year above the USD 120 and dropping to levels near USD 90 before the relief rally kicked in to current levels near the USD 100 mark.



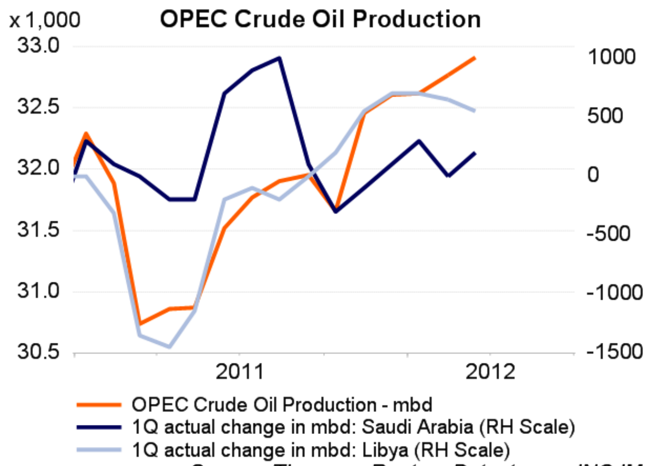
Source: Thomson Reuters Datastream, ING IM (31/12/2010 to 11/11/2011)

From the many indicators to highlight related to the oil price there are two drivers which stand out. First, growth in Chinese demand has been slowing since 2011. Clearly the effects have been even more apparent in the copper price, but the slowing demand in oil also had its effect on the overall demand side.



Source: Thomson Reuters Datastream, ING IM

The second point is that the production from Saudi Arabia and thus most likely for the OPEC countries are likely to remain high.



Source: Thomson Reuters Datastream, ING IM

Putting the slowing demand growth and high production output together, combined with disappointment following the Fed announcement (no QE yet) in June and silence in the Iran issue, it proved to be a good recipe for oil prices to fall.

The recent move from the 90 to 100 dollars was the result of the good outcome in the Euro zone. It remains the question if this is a sustained rally. As long as both supply as well as demand dynamics are fragile, the recent rally could proved be a short term bounce.

Siu Kee Chan
Investment Manager STAAG

FX

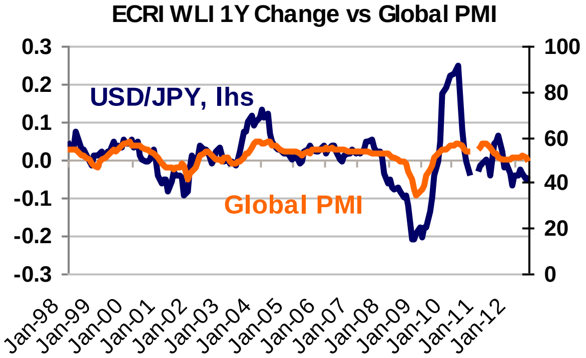
- The importance of risk sentiment has decreased but it remains an important FX driver
- The cyclical momentum is now more relevant
- Market participants have adapted to the new nature of macro-economic cycles

Has the importance of risk sentiment decreased?

There has been a lot of discussion at the beginning of the year on the decreasing importance of risk sentiment as a driver of currency returns, so this week we have a closer look at this statement. Moreover, we dig into the impact of the global cycle on currencies.

Our analysis is based on a sample of major G10 and EM currencies over the period of 2000 to 2012. We construct simple trading rules where we go long or short a currency depending on the signal given by the indicator. We measure the average return conditional on the signal and proxy the profitability of a trading style by the sum of the two. As an example, if the average weekly return of being long AUDUSD in a “risk-on” environment is 0.25% and the weekly return of being short AUDUSD in a “risk-off” mode is 0.15%, then the proxy for the strategy return is 0.40%.

We use the momentum in the ECRI weekly leading index (WLI) to define the cycle due to its close correlation to the global PMI and more timely release. To monitor the risk sentiment, we use a proprietary volatility-based indicator.



Source: Bloomberg, ECRI, JP Morgan

Indeed, but it remains an important FX driver

The first observation is that like in many other asset classes, over the last 12 years (full sample) the risk sentiment has been an important driver of FX markets. While this driver gained importance after the Great Financial Crisis (GFC), it was also a relevant source of alpha prior to the GFC.

More important, we got confirmation that indeed the role of “risk on – risk off” has decline lately. The table below shows that the trading based on risk sentiment has been delivering decreasing return since the GFC.

	Risk	Cycle
2000/2012	0.37%	0.12%
2000/2007	0.23%	0.10%
2007/2008	0.62%	0.47%
2009/2010	0.36%	-0.01%
2011/2012	0.19%	0.27%

Source: Bloomberg, ING IM

The cyclical momentum is now more relevant

The second interesting observation is that the importance of risk sentiment relative to other drivers like the global cycle has also changed. Over the full sample period, risk sentiment has been a more dominant factor than the global cycle in driving currency returns. This observation is also valid for EM currencies and other commodity currencies, which are traditionally stamped as more cyclical.

But over the last 18 month, this has reversed and the cycle has become a more prominent driver of FX return. This is also the case for currencies like the USDJY typically labelled as “risk off” currencies. So while the risk sentiment remains a key variable, it seems that trading the global cycle nowadays has become a more profitable strategy.

This might be explained by the fact the global economy has been drifting into a below potential, low growth environment as reflected by the drop in global PMIs since early 2011. In itself, this has made the macro dynamics more sensitive to shocks and more volatile. With lingering and rising tail risks (Europe, oil shock,…) in a world economy weakened by continued deleveraging, this has shifted investors’ focus to getting the cycle right given its influence on risk sentiment.

Also interesting is the observation that in the aftermath of the GFC (2009-2010) the cycle had no influence on FX returns while the risk sentiment was a dominating driver. Most currencies in the sample appreciated in up and downturns. One explanation might be that over those years, the cycle was more resilient as growth levels were at high levels and global PMI reached an all time high. Also, the support from monetary policy was strong, reducing the sensitivity of non-US currencies to a deterioration in the growth momentum as they were rallying on Fed QE announcements or expectations of additional monetary support.

Adaptive markets and the new nature of cycles

The third interesting observation is that trading the improvement or deterioration of economic activity based on short term signals has become more profitable and the opposite is true for lower frequency indicators. Clearly, trading the cycle is very much dependent on how the macro dynamics are measured. The below table shows the result of a cycle-based strategy for different momentum signals (3, 6 and 12 months change in ECRI WLI).

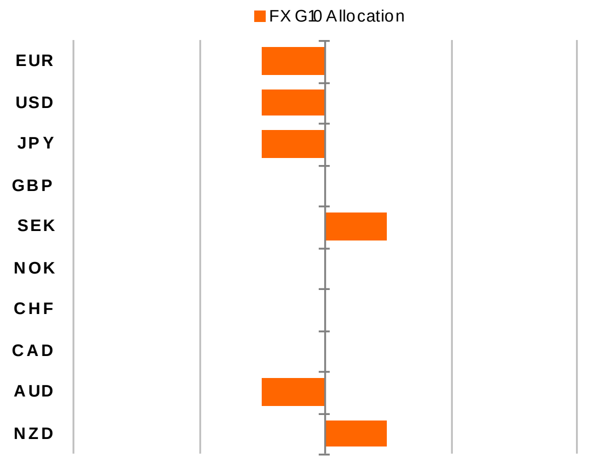
	Cycle 3M	Cycle 6M	Cycle 12M
2000/2012	0.12%	0.10%	0.12%
2000/2007	0.10%	0.02%	0.08%
2007/2008	0.47%	0.24%	0.50%
2009/2010	-0.01%	-0.09%	-0.20%
2011/2012	0.27%	-0.01%	-0.09%

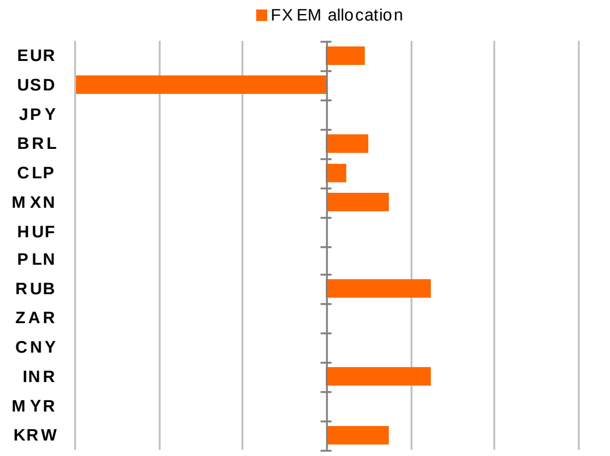
Source: Bloomberg, ING IM

This performance distinction has become more dominant over the last 18 months. While over the last 12 years, trading currencies conditional on a 1 year macro momentum indicator delivered similar returns to shorter term indicators, such strategies have become unprofitable over the last 18 months, leaving the more dynamic indicators as a better source of returns to trade the cycle.

It seems market participants have now acknowledged the new reality of shorter cycles and have adjusted their trading stance accordingly. Among the reasons often cited by economists why cycles are now shorter are their increased fragility, the increased sensitivity to commodity prices (automatic stabilizers) and the limitations of fiscal policies and of unconventional monetary policy tools.

Going forward, we expect the cycle to remain an important driver of currency returns. Its rising importance suggest we should monitor more closely the short term swings in the macro momentum





Source: ING IM (11/07/2012)

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Asset Allocation

- Poor post-Summit PR ends relief rally
- Equities moved back to neutral
- Commodities from neutral to underweight

You Can't Always Get What You Want

Three key factors are currently driving financial markets: the Euro crisis, the state of the global business cycle and the policy response to either of the previous two. Market direction and dispersion largely depends on the assessment of investors on how the balance of risks surrounding these three risk factors is shifting over time.

Over the last thee months, risks surrounding the Euro crisis and the direction of global growth have both shifted to the downside and thereby driven risky assets lower and (relatively) safe assets higher. Most noteworthy are probably the drop in commodity prices (oil prices still down 20% since March) and record low trading ranges for treasury yields in large and liquid markets of the US and Germany.

More recently, however, hope of a substantial policy response to either the Euro crisis or signs of a deteriorating growth outlook have started to support market sentiment. This caused signs of bottoming to emerge in equity, commodity and treasury markets.

Monetary policy action in the US and the UK and policy stimulus in China and Brazil are partially responsible for cautious hope that a policy rescue will materialize. More importantly than a more simulative policy mix outside of Europe is, however, the perceived effectiveness on how European policy makers are handling the crisis. Clearly, the latest Summit surprised positively on this for a change as especially signs of the formation of a genuine banking union supported a more positive stance towards risk of investors.

Obviously the latter was helped by successful expectations management and a history of disappointing outcomes at previous Summits. In combination with investor sentiment at relatively low levels and fairy defensive positioning by investors, the backdrop for a potential relief rally on the back of a more constructive outcome had been created recently.

Although the latter created a short post-Summit rally, doubts have increased again over the sustainability of this market sentiment. Poor post-Summit PR by European policy makers play a big role in that. For us this, once again, underscores that we need to remain dynamic and adapt quickly if needed to changing market conditions. With little new policy initiatives anticipated over the coming weeks and disappointment in the upcoming earnings season not excluded, we moved equities back to neutral and commodities back to an underweight. All in all, this leaves us with a fairly balanced allocation stance as real estate is still a small overweight (benefitting from relatively high rental yields and better US data) and treasuries are also overweight (expected to perform well in a stress scenario).

Fixed Income

We have moved spreads to an medium overweight position on the back of the progress with respect to European (banking sector) integration and strengthened return momentum. Within spread space, we hold on to an overweight in EMD HC as cyclical and flow momentum remain supportive. Also, EMD HC has proved to be more resilient in times of Euro crisis stress than the other asset classes. Also High Yield and Investment grade credit are small overweights, while Euro Aaa ABS is still our least favoured spread product.

Equities

Relative earnings momentum of cyclicals sectors versus defensive sectors has become less supportive. We have therefore moved our sector and regional stance to neutral. Also, we moved the policy-sensitive sectors (materials, financials and energy) to a balanced stance.

Real Estate

Real estate have been moved to overweight. The positive Summit outcome, low yields and market momentum are crucial. Also, positive US housing data provide support. Within real estate we prefer the Japanese market on attractive valuation and a more supportive domestic policy mix.

Commodities

Commodities are moved to an underweight again. Next to disappointing policy dynamics in Europe, we have also seen that Chinese data have continued to look soft. The latter might start to turn over the coming months on the back of (more aggressive) policy easing in China, but we prefer to wait from some prove of that before we want to override our negative allocation signal for commodities.

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