

Asset Allocation Views



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Recent data suggest that the pace of U.S. and global economic activity has slowed since May, and there has been a modest increase in some measures of financial strain. We continue to expect that the U.S. economy will make a successful transition from initial recovery to sustained expansion, but now recognize that this shift will prove longer than we had believed. We have modestly reduced our U.S. GDP forecast for 2010 and early 2011 as a result, but believe that the United States will avoid a second recession.

We continue to believe that cyclically sensitive assets are attractive in this economic context. In particular, we believe that high yield bonds offer the most attractive balance between reward and risk among major asset classes at present, and have therefore moderately increased exposure to them in our model portfolio.

Economic Outlook:

We have reduced our forecast for U.S. GDP growth to a 3.0% rate for the second half of 2010 and to 3.3% for 2011. This reflects our belief that growth in employment, and therefore income and household spending, is likely to be slow for the remainder of this year. We now expect the U.S. unemployment rate to remain at 9.0% or above through early 2011. Nevertheless, we do not expect a renewed period of economic contraction in the U.S. because we do expect businesses to expand employment in order to take advantage of growing global opportunities. Robust corporate profits and cash positions should enable larger firms to hire and to expand easily, even if smaller companies still face some credit constraints.

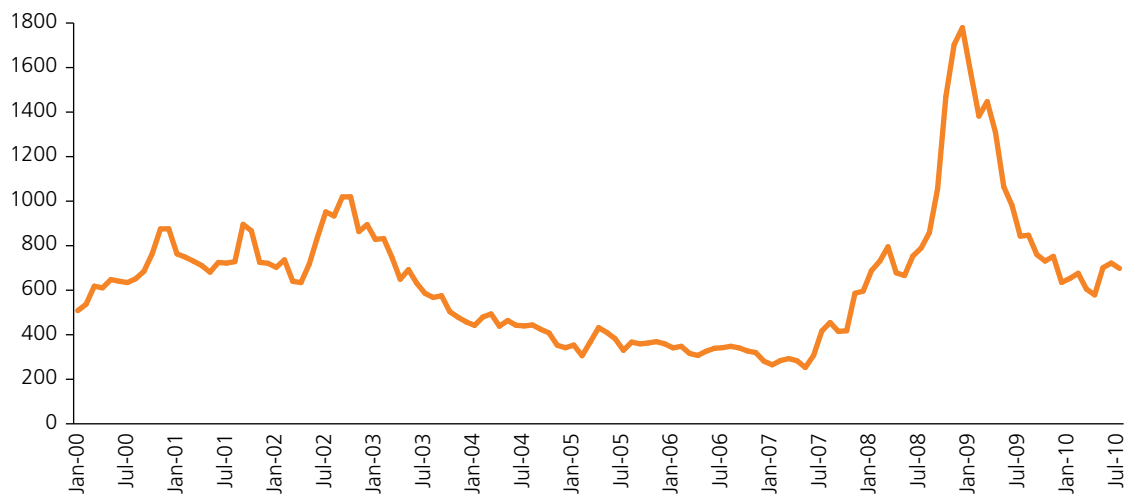
The chief risk to this still-optimistic outlook comes from a reemergence of severe financial strains. Since the European sovereign debt crisis grew more acute earlier this year, measures of financial stress such as interbank lending spreads and spreads on credit default swaps for European and U.S. banks have increased modestly. We believe, however, that the aggressive policy actions European governments and the European Central Bank took in response to the crisis in early May have greatly reduced the possibility of a new financial crisis such as occurred in Fall 2008. We are encouraged that measures of financial strain in Europe and the U.S. have declined in recent weeks, and expect this to continue.

High Yield Bonds:

In the economic environment we anticipate, high yield bonds remain extremely attractive. With a spread of just under 700 basis points this month, high yield bonds offer an income return substantially greater than the 2.0% dividend yield on the S&P 500 index. Yet high yield bonds are much less volatile than equities, with a standard deviation of 9% vs. 15% for the S&P 500 measured over the period from 1988 to 2010.

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High Yield Spread (basis points)



Source: Citigroup

Fundamentals for high yield debt issuers have clearly improved with the business cycle recovery and the broad improvement in corporate cash flow. Bond rating upgrades in the U.S. exceeded downgrades in the second quarter of this year for the first time since 2007. For example, Standard & Poor's upgraded 122 high yield companies in the second quarter and downgraded 80, while Moody's upgraded 88 high yield issuers and downgraded 51. Meanwhile, the annualized default rate on high yield debt fell below 1% in the first quarter, with no defaults at all in the month of March. We expect that high yield spreads should continue to narrow in coming quarters as economic activity and corporate cash flows continue to revive. The combination of an increasingly favorable cyclical environment with still-wide spreads and lower volatility compared with equities means in our view that high yield bonds offer a compelling investment opportunity at present.

Reflecting increase in high yield overweight, 7/14/2010

Current Tactical Asset Allocation					
	Benchmark (%)	Previous Allocation (%)	Recommended Allocation (%)		Change from Last Move
Stocks	65.0	65.0	65.0	Neutral	Unchanged
Alternative Asset Classes	10.0	10.0	10.0	Neutral	Unchanged
Bonds	25.0	25.0	25.0	Neutral	Unchanged
Cash	0.0	0.0	0.0	Neutral	Unchanged
Allocation within asset classes					
Domestic stocks	40.0	40.0	40.0	Neutral	Unchanged
Large Cap stocks	32.0	32.0	32.0	Neutral	Unchanged
<i>Large-cap growth stocks</i>	16.0	16.0	16.0	Neutral	Unchanged
<i>Large-cap value stocks</i>	16.0	16.0	16.0	Neutral	Unchanged
Mid-cap stocks	5.0	5.0	5.0	Neutral	Unchanged
Small-cap stocks	3.0	3.0	3.0	Neutral	Unchanged
International Stocks	25.0	25.0	25.0	Neutral	Unchanged
EAFE stocks	20.0	18.0	18.0	Underweight	Unchanged
<i>EAFE growth</i>	10.0	9.0	9.0	Neutral	Unchanged
<i>EAFE value</i>	10.0	9.0	9.0	Neutral	Unchanged
Emerging market stocks	5.0	7.0	7.0	Overweight	Unchanged
Alternative Asset Classes	10.0	10.0	10.0	Neutral	Unchanged
Domestic REITS	2.0	2.0	2.0	Neutral	Unchanged
International REITS	2.0	2.0	2.0	Neutral	Unchanged
Commodities	2.0	2.0	2.0	Neutral	Unchanged
Hedge Fund Beta	4.0	4.0	4.0	Neutral	Unchanged
Bonds	25.0	25.0	25.0	Neutral	Unchanged
Core U.S. Bonds	14.0	13.0	11.0	Underweight	Reduced
Global Bonds	4.0	4.0	4.0	Neutral	Unchanged
High Yield	3.0	4.0	6.0	Overweight	Increased
TIPS	4.0	4.0	4.0	Neutral	Unchanged
T-bills	0.0	0.0	0.0	Neutral	Unchanged

The Model Portfolio reflects the research and opinions of the Multi-Asset Strategies and Solutions group at ING Investment Management. Incorporating our assessment of macroeconomic conditions and the relative attractiveness of global capital markets, the Model Portfolio expresses both our long-term benchmark asset allocation as well as recommended tactical allocations intended to capture shorter-term opportunities.

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