

# Market Review

## February 2010: Feeling Gravity's Pull

Global equity markets were mixed in February. The U.S. and Asia-Pacific returned to growth after a difficult start to 2010, while Europe extended its decline as the EU continued to nurse its various sovereign headaches. However, one would be forgiven in being a bit surprised at the degree of success of the U.S. market for the period; the tenor of economic news flow for the month was notably, if not dramatically, downbeat — a series of body blows absorbed by the global recovery as it continues to resist being pulled back down to the canvas.

### Economic Headlines a Source of Frustration

While not unusual in a recovery, particularly given the magnitude of the recession from which we have emerged, the stubborn unevenness of the economy's growth trajectory has left many exasperated. Consumer confidence, as reflected in surveys conducted by both the University of Michigan and the Conference Board, fell more than forecast in February. This spike in pessimism comes as no surprise in light of the Bureau of Labor Statistics' second report on fourth quarter GDP, which showed that personal income in both the third and fourth quarters of 2009 was lower than originally stated. Weekly employment data flow throughout the month inspired little optimism that this ongoing stagnation in personal income would soon reverse itself. (However, the early-March release of non-farm payrolls for February showed a smaller than expected decline, inspiring hope that job growth finally will turn positive in the coming months.) Housing data, in terms of both existing and new home sales, was disappointing, as the home buyer tax credit pulled more demand forward into 2009 than was initially expected.

Despite the less-than-inspiring data, the Federal Reserve apparently has seen enough good to begin unwinding some of its extraordinary accommodation. Mid-month, the central bank raised the discount rate (the rate it charges banks for short-term loans) 25 basis points, though it left the fed funds rate, and its messaging around it, unchanged. Though Chairman Bernanke was emphatic in stating that normalization of the discount rate did not represent monetary tightening, this announcement — which also included reducing the maximum maturity for discount window loans and an increase in the minimum bid rate for term auction facility (TAF) funds — is indicative of a larger policy reversal that should involve rate increases and other explicit monetary tightening steps before too long.

In Europe, attention continues to be centered on the Hellenic horror show that is Greece's economic situation. As widely anticipated but only recently articulated, EU officials declared in mid-February that the currency bloc would take "determined and coordinated action, if needed, to safeguard financial stability in the euro area as a whole". This support, however, comes at a cost. Athens was pressed to outline a concrete plan to reduce its budget deficit to 8.7% of GDP in 2010 and under the EU-mandated limit of 3% of GDP in 2012; it currently stands at 12.7% of GDP. A grab bag of

austerity measures put forth by the Socialist Greek government — including an increase in the value-added tax and a 30% reduction in the two-month bonuses paid to federal employees (the so-called "14th salary") — was met with acceptance by its European neighbors but vehement protests and strikes at home. Financial markets were enthusiastic, and an early-March offering of ten-year Greek debt was nearly three-times oversubscribed; however, it took a yield of 6.3% — more than 3% in excess of the rate of German bonds — to get there. Meanwhile, the rest of the PIIGS (Portugal, Ireland, Italy and Spain) continue to teeter on the brink of insolvency, and there has been talk that the U.K. may soon be facing a debt crisis of its own.

The Asia-Pacific region, on the other hand, has exhibited strong growth out of recession on the back of accelerating global trade and aggressive fiscal stimulus. Success has been exhibited not only by bellwethers like China and Korea, but also by smaller economies like Taiwan and Thailand (which attribute about 70% of their GDP to exports). Given attractive year-ago comparisons for first quarter 2010, these strong numbers are likely to continue for at least one more quarter before year-over-year growth becomes more of a challenge.

### Equities Surge as Earnings Continue to Impress

U.S. equities surged in February, shaking off their dismal start to 2010. The S&P 500 Index gained 2.9%, a monthly rate of increase not seen since November 2009, while the Dow Jones Industrial Average and tech-heavy Nasdaq posted returns of 2.5% and 2.9%, respectively. In terms of S&P 500 sectors, success was widespread, with only the defensive sectors of utilities and telecom services sectors finishing in negative territory. Consumer discretionary was the top performer, as personal spending increased for a fourth straight month and many retailers raised their expectations. Industrials and materials also performed well. Mid- and small-cap stocks were particularly strong on the month; large caps delivered a positive return but lagged the broader market. Growth outperformed value overall, though value stocks were favored in the small-cap space.

Corporate earnings in the U.S. continue to rebound. Of the nearly 95% of the S&P 500 that have reported fourth quarter earnings, 74% have delivered an upside surprise, according to Zacks Investment Research. While strong earnings have been *de rigueur* for several

Continued >>>

quarters now, they have largely been the result of aggressive cost cutting. Fourth quarter data, however, showed signs of top-line growth; 57% reported higher revenue on a year-over-year basis for the final quarter of 2009 while less than 30% did so for the third quarter.

Internationally, the MSCI EAFE Index was down about 0.9%, dragged down by the euro zone's 3.8% decline; the aforementioned PIIGS were all down sharply, ranging from 9.8% for Greece to 3.9% for Ireland. Asia-Pacific was up, led by strong performance in Hong Kong and Australia. The MSCI Emerging Markets Index was slightly positive for the month, at 0.25%, as strength in Latin America was almost completely offset by weakness in Europe and Asia.

From a thematic standpoint, the conditions that we expected to drive equity markets in 2010 — an improving macroeconomic picture, accommodative monetary and fiscal policy, strong corporate earnings momentum — remain intact. We continue to favor cyclical sectors, namely industrials (capital goods, in particular), consumer discretionary, technology and health care.

### Fixed Income Performance Is Mixed

Yields on U.S. Treasuries declined modestly across the belly of the curve during February, but were higher on the long and short ends. Performance among risk-based bonds was mixed relative to comparable-duration Treasuries, as the widely watched Barclays Capital U.S. Aggregate Index posted a total return of 0.37% for the month. Corporate bonds as a whole were down slightly relative to Treasuries; financials fared particularly poorly, as sovereign risk concerns and a Standard & Poor's report highlighting the potential of downgrades at major banks inspired investors to re-evaluate their risks, though industrials posted a slight excess return. Securitized assets were for the most part strong, with commercial mortgage-backed securities (CMBS) again leading the way. Fixed-rate agency residential mortgage-backed securities (RMBS) declined, as the end of the Federal Reserve's mortgage purchase program loomed. U.S. high yield was down on the month relative to Treasuries, while emerging market debt recovered from January's selloff to post a positive excess return.

This commentary has been prepared by ING Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change. Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) interest rate levels, (4) increasing levels of loan defaults (5) changes in laws and regulations and (6) changes in the policies of governments and/or regulatory authorities.

The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Fund holdings are fluid and are subject to daily change based on market conditions and other factors.

While macroeconomic data continues to improve at a fitful pace, prospects for a sustained recovery remain favorable; that said, major uncertainties — from high unemployment to significant economic slack — persist. As such, we expect the Federal Reserve to continue to be accommodative, maintaining the fed funds target rate at its current level until at least mid-2010 and potentially beyond. And although concerns about inflation may resurface intermittently, we don't expect it to be a problem in the near term. This environment should be supportive of fixed income investments in general, even after the asset class's strong 2009 performance.

The Standard & Poor's 500 Index is an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq is a computerized system that facilitates trading and provides price quotations on more than 5,000 of the more actively traded over the counter stock.

The Dow Jones Industrial Average is a price-weighted average computed from the stock prices of 30 of the largest and most widely held public companies in the United States, adjusted to reflect stock splits and stock dividends.

The MSCI EAFE Index is a free float-adjusted market capitalization weighted index designed to measure developed markets' equity performance, excluding the US & Canada, for 21 countries.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that measures emerging market equity performance of 22 countries.

The Barclays Capital U.S. Aggregate Bond Index is an unmanaged widely recognized, unmanaged index of publicly issued investment grade U.S. Government, mortgage-backed, asset-backed and corporate debt securities.

The indices do not reflect fees, brokerage commissions, taxes or other expenses of investing. Investors cannot invest directly in an index.

---

### Daniel P. Donnelly, Head of Investment Communications



Dan Donnelly is Head of Investment Communications at ING Investment Management. Prior to joining the firm in 2009, he held similar marketing and communications positions at BlackRock, Morgan Stanley, Columbia Management and JP Morgan. Dan received a B.A. in economics and English from the University of Connecticut and holds FINRA Series 7 and 63 licenses.