

Market Review

January 2010: Little Fury Things

Politics took center stage in January, as both major parties in the U.S. sought to tap into the groundswell of populist furor. While it's unclear whether the bluster from either side of the aisle ultimately will result in anything more than increased billings for Washington lobbyists, one thing is certain: uncertainty was no friend of the markets. After a good start to the month, equities traded down sharply worldwide in the latter part of January, battered not only by the swirling political winds in the U.S., but also growing sovereign risk concerns in the euro zone and China's efforts to rein in its vigorous economy. Treasury yields declined on the month, as investors took refuge in government paper.

U.S. GDP Surprises, but Uncertainty Prevails

In Massachusetts, Republican Scott Brown won the Senate seat held for 47 years by the late liberal stalwart Ted Kennedy, surprising many observers. Regardless of how the result is parsed — as a Tea Party-driven victory of a Republican everyman over an elitist liberal agenda or the inevitable result of a lackluster campaign by a Democrat — the Republican win represents a major blow to President Obama's legislative plans. Having lost their 60-seat, filibuster-proof supermajority in the Senate, Democrats will need to work more collaboratively with Republicans in order to get anything done. While this may not represent the death knell for health care reform, it probably means that only watered-down legislation is likely to be approved, to the great relief of companies in the health care space.

Perhaps not coincidentally, two days after the Democratic debacle in Massachusetts President Obama continued his own appeal to populism, taking another swipe at the "fat cats" on Wall Street. The so-called "Volcker Rule" seeks to restrict the size and scope of the nation's largest banks; as proposed, it bans these institutions from engaging in proprietary trading and sponsoring hedge funds and private equity vehicles. This announcement came about a week after the president announced a \$90 billion, ten-year "financial crisis responsibility fee" to be levied on about 50 financial institutions in order to recoup all losses from the Troubled Asset Relief Program. Although the ultimate scope and impact of these proposals will take some time to ascertain, banks may continue to be an attractive target of stumping politicians with mid-term elections coming up in November.

Looking abroad, Greece continues to bow under the weight of its massive debt, and there is growing concern that Europe may be the next global financial tinderbox. Although Greece garners the bulk of the headlines, other members of the currency bloc — including Portugal and Spain — are in similarly difficult financial straits, and this weakness has driven prices on credit-default swaps higher across the Continent. While politicians in the euro zone have been active in refuting the possibility of a coordinated bailout of their struggling brethren, it's difficult to imagine the stronger countries will allow a Greek (or Portuguese or Spanish) default given the impact it would have on the rest of Europe and worldwide financial markets.

China, on the other hand, has taken steps to cool off its surging economy, engaging in some "soft" monetary tightening as it posted GDP growth of 10.7% for the fourth quarter. Of late, policymakers have increased the reserve ratio requirements, raised certain interest rates and placed restrictions on bank lending and equity fundraising. These actions have stoked fears among investors that Chinese authorities would need to act more aggressively in the coming months to forestall bubbles from developing in the commodity, real estate and equity markets.

Despite these headwinds, there was some good news on the U.S. economic front. At 5.7%, U.S. GDP grew faster than expected in the fourth quarter and at the fastest rate in six years; the mean estimate had been for 4.7% growth. The single largest contributor to growth came from inventories, as businesses dramatically slowed their rate of inventory liquidation. Although the pace of inventory reduction is an important part of economic growth early in a recovery, this benefit declines as businesses approach more-normal levels of stock. Inflation data remain benign, but employment numbers continue to trouble; although the January report from the Bureau of Labor Statistics indicated an ease in the unemployment rate — to 9.7% from 10.0% in December — total nonfarm payrolls fell slightly more than expected. That said, there are indications that unemployment in the U.S. has peaked.

Equities Start 2010 on the Wrong Foot

The year began strong, with the S&P 500 Index reaching 15-month highs on January 19. By the time the month ended, however, the index was off about 3.6%. Other major indices in the U.S. exhibited similar trading patterns, with the Dow Jones Industrial Average and tech-heavy Nasdaq dropping around 3.4% and 5.4%, respectively. In terms of S&P 500 sectors, there was little relief to be found, with health care the only group of stocks able to post a (very slightly) positive return. Meanwhile, materials, information technology and telecom services all sold off sharply. Performance across capitalizations was uniformly poor, though investors showed a clear preference (or, at least, less distaste) for value stocks regardless of size.

Internationally, the MSCI EAFE Index was down more than 4.4%, and the loss on the euro zone component eclipsed 8%. In the

Continued >>>

emerging markets, the handful of countries that were able to post gains on the month were not enough to keep the category as a whole above water, as the MSCI Emerging Markets Index was down more than 5.6%. In contrast to the performance of European developed markets, emerging European markets fared relatively well on the month.

Despite this rocky start, we're still expecting a decent year for equities. The themes that were in place at the beginning of January — an improving macroeconomic picture, accommodative monetary and fiscal policy, strong corporate earnings momentum — haven't gone away. Further, the pullback over the month has presented an attractive opportunity to move into the higher-capitalization, higher-quality names that we think are going to lead the market for 2010.

Fixed Income Performance Is Mixed

Yields on U.S. Treasuries declined across the curve during the month. Performance among risk-based bonds was mixed relative to comparable-duration Treasuries; however, the widely watched Barclays Capital U.S. Aggregate Index posted a total return of about 1.5% in January, recouping most of its December losses. Corporate bonds as a whole were down, but utilities were able to eke out a slight excess return. Overall, intermediate corporate bonds outperformed longer-dated issues across sectors, while the same was true of BBB-rated issues relative to higher-rated paper. Securitized assets were strong across the board; commercial mortgage-backed securities posted the largest excess returns, as investors were seemingly unfazed by the 17% (a 15-year high) national office vacancy rate.

January saw a high volume of new issuance, particularly during the first couple of weeks. Data provider Dealogic reported that companies and foreign governments sold around \$95 billion of investment-grade debt in the month, with financial companies — many from outside the U.S. — responsible for more than \$70 billion of that. As we progress through earnings season, an increasing number of domestic non-financial issuers are expected to enter the fray. Municipalities, too, were active; the nearly \$32 billion of new debt set a record for January muni issuance.

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.

C10-0128-037 (2/09)