

Fixed Income Perspectives

ING MARKET
PERSPECTIVES



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ING Investment Management's fixed income strategies cover a broad range of maturities, sectors and instruments, giving investors wide latitude to create a new portfolio structure or complement an existing one. We offer investment strategies across the yield curve and credit spectrum, as well as in specialized disciplines that focus on individual market sectors. We build portfolios one bond at a time, with a critical review of each security by experienced fixed income managers. As of December 31, 2011, ING Investment Management managed \$126.8 billion in fixed income strategies in the U.S.

Bond Market Outlook

Global Interest Rates: Rates will remain range-bound, with additional EM easing expected.

Global Currencies: We continue to favor the U.S. dollar relative to the euro, pound sterling and certain Eastern European currencies.

Corporates: Positive developments in the European sovereign debt crisis could propel spreads tighter.

High Yield: Fundamentals remain strong, with leverage stable to declining and liquidity near record lows.

Mortgages: A massive increase in prepayment speeds with HARP 2 is unlikely, though pockets within MBS may be exposed.

Emerging Markets: Despite strong underlying fundamentals, volatility will persist in first half 2012.

Macro Overview

- "Should old acquaintance be forgot, and never brought to mind?" Traditional New Year's rhetoric may elicit a nontraditional response this year as market participants reflect on a tumultuous 2011. Given the grim year for the euro zone, a nuclear panic jarring an already shaky Japanese economy and the downgrade of U.S. sovereign debt, who could be faulted for wanting to forget the past and start anew?
- The volatile and uncertain path markets took in 2011 has etched the way forward at the onset of 2012. Our old friend the euro zone remains shrouded in uncertainty and will continue to dominate headlines until European leadership can find a credible solution to the region's fiscal imbalances.
- Despite the European Central Bank's reluctance to give Europe the silver bullet (such as a substantial bond-purchase program) to once and for all eliminate its sovereign debt woes, it did lend direct support to the ailing euro zone this December in the form of a guaranteed three-year loan program. It remains to be seen, however, if banks will be enticed to use the ECB's low-rate loans to load up on higher-yielding sovereign debt to the extent necessary to bring yield spreads down to more tolerable levels.
- The U.S. fiscal picture is not much rosier than Europe's at the start of this crucial election year, but a festive round of positive economic indicators in December and early January — including lower jobless claims, stronger payrolls and more robust manufacturing data — continues to support the theme of a U.S. economy that will muddle along in 2012.
- Let it not be forgotten at the start of a new year that significant downside risks to the global economy remain. We expect global growth to be modestly positive, led by emerging markets, with the greatest drag on growth coming from the highly indebted developed economies. Rates shall remain low and spreads contained within a reasonable range. We resolve that the dominant share of total and excess returns in 2012 will be a product of finding attractive yields in higher-quality spread sector assets.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%)	
			December 2011	Full-Year 2011
Barclays U.S. Aggregate	100.0	87	1.1	7.8
Treasury	35.2	0	1.0	9.8
Investment Grade Corporates	19.9	234	2.1	8.1
Fixed-Rate MBS	31.8	77	0.7	6.3
Other				
High Yield		699	2.7	5.0
Global Aggregate		104	0.7	5.6
Emerging Markets		453	1.4	7.0

Country	Yield on Ten-Year Bonds (%)	Currency	Returns (%)	
			December 2011	Full-Year 2011
U.S.	1.88	EUR/USD 1.27	(3.7)	(3.0)
Europe	1.83	USD/JPY 76.91	1.0	6.3
Japan	0.99	USD/BRL 1.87	(3.4)	(11.6)
Brazil	12.42			

Note: All spreads are to Treasuries and option adjusted except for Emerging Markets, which is nominal. All returns are total returns including dividends expressed as percentages. All returns in U.S. dollars.

Source: Barclays Capital, JPMorgan, Standard & Poor's.

Sector Overviews

Global Interest Rates

- Given muted expectations for global growth, we believe interest rates for core developed sovereigns will remain range-bound. With rates low — and without a significant catalyst for them to rise — many investors are focusing their purchases in maturities with the most attractive yield and roll down for a given amount of interest rate risk. In the U.S., this favors the five- to seven-year segment of the yield curve.
- While there still appears to be some bright spots in Latin America and Asia, our range-bound case still applies. This is accentuated by expectations for further easing by various central banks to provide stimulus and balance sheet support in an effort to offset the pressures of debt-burdened economies. Further, we see additional interest rate easing by a number of emerging market central banks this year as inflation considerations continue to abate.

Global Currencies

- Given the headwinds out of Europe, we continue to favor the U.S. dollar relative to the euro and pound sterling. We maintain a negative bias toward Eastern European currencies such as the Czech koruna and Hungarian forint given their high correlations to the euro zone.
- While emerging market currencies remain volatile, growth dynamics for these regimes are particularly attractive relative to the G-3 countries. We favor the more fundamentally sound emerging market currencies in Latin America and Asia — including the Brazilian real, Korean won, Colombian peso and Indonesia rupiah — that exhibit lower dependencies to Europe.

Investment Grade Corporates

- Corporate fundamentals remain healthy, but macro headlines are likely to drive market direction again in 2012. Positive U.S. economic data and favorable seasonal factors bode well for near-term corporate market performance; over the last two years, excess returns have generally been positive during earnings release periods.
- Negative developments in the European sovereign debt crisis remain a key risk to the market, though positive news could propel spreads tighter. Investment grade corporate valuations are attractive, and new issuance, while generally highest early in the year, has historically not hindered spread performance.

High Yield Corporates

- Despite such macro concerns as the pace of the U.S. economic recovery and European sovereign stress, credit fundamentals for high yield remain strong, with leverage stable to declining and liquidity near record lows. Though issuer commentary and

earnings guidance have become more cautious, most issuers are well positioned to sustain several additional quarters of below-trend growth after refinancing the majority of maturities into 2013.

- The default outlook among issuers with more moderately leveraged balance sheets is still quite favorable versus historical levels, and spreads continue to offer attractive compensation for default risk in the longer term. The U.S. high yield story is attractive relative to Europe's.

Mortgages

- Agency mortgage-backed securities performed well in late December and are off to a very positive start in 2012. Performance was shared across the coupon stack and issues. Spreads have consistently dropped and are now at their tightest levels. The first week of 2012 saw originations hold steady at around 1.5 billion per day. Fed buying is mostly offsetting increased supply. We do not expect a massive increase in aggregate prepayment speeds with HARP 2, but there may be pockets within MBS that are exposed.
- Non-agency residential mortgage-backed securities (RMBS) have re-evolved into an intriguing asset class, following the supply driven re-pricing over the course of 2011. Yields look attractive, despite fundamental uncertainties; however, the prospect of forced sales from deleveraging European banks will continue to warrant caution, especially for certain segments of the non-agency RMBS universe.
- Commercial mortgage-backed securities (CMBS) have experienced a sustained rally to end 2011 and start 2012, diminishing relative value versus other risk sectors. However, the underpinnings of the rally — light supply and strong demand — remain. A relatively heavy new-issue calendar for the first quarter will dilute this imbalance, but we expect it to clear without issue. Accordingly, our tactical and strategic view on the sector is bullish, but we are mindful of the impact of maturing weaker 2007-originated loans on CMBS trusts and investor confidence as we invest in the sector.

Emerging Markets

- The fundamental picture in most emerging market countries continues to be supportive of hard currency and local currency sovereign debt. We remain constructive on the prospects for both asset classes given accommodative monetary conditions and improving growth momentum globally.
- We believe emerging market corporates are well positioned in 2012 as well, given the very attractive spreads and yields for the emerging market corporate bond universe, which is anchored by strong underlying fundamentals. However, we expect uncertainty and volatility to persist over the next six months in light of continued economic, financial and political pressures in Europe.

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