



**Paul Zemsky**  
Chief Investment  
Officer, Multi-Asset  
Strategies

## A Look at 2012

Our central case for 2012 is for modest economic growth in the face of a risky global environment. The U.S. should avoid recession in 2012 and post moderate growth as consumer exuberance will be tempered by continued household balance sheet repair as well as sluggish housing and jobs markets; our current full-year 2012 forecast is for GDP growth of 2.5%, though we may revise this figure upward given recent positive trends in consumption and housing. Inflation should remain contained despite a highly accommodative Federal Reserve.

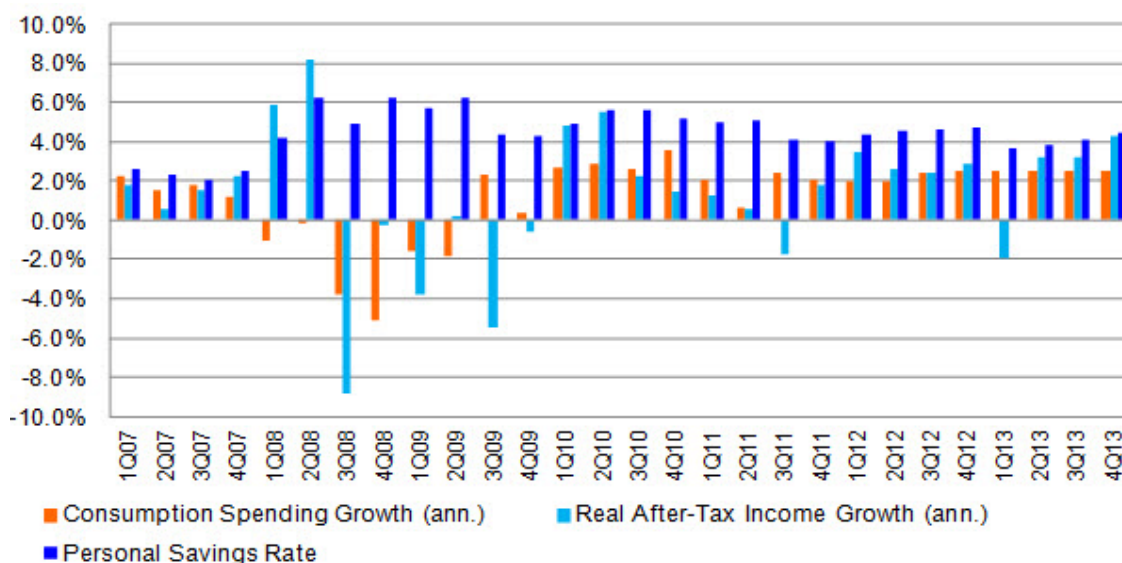
Of course, our forecast for the U.S. is dependent upon the avoidance of any sort of financial calamity as a result of the European debt crisis. We believe that some combination of government and European Central Bank actions will ultimately contain the European crisis and help to avoid a financial accident, primarily because we believe the key European political actors have the determination to solve these problems. A modest contraction in Europe is unlikely to jeopardize U.S. growth in 2012, though a protracted slowdown on the Continent could threaten the economies of major trading partners like the U.S.

Below, we take a look at some of the components of our forecast.

**Consumption.** With income stagnant, household balance sheet repair should continue to hold back consumption growth in the U.S. To reduce debt, households have continued to save at a higher rate than before the recession; we expect this trend to persist over the next few years, with consumer spending growing at only a moderate rate of 2.0–2.5%. (See Figure 1.)

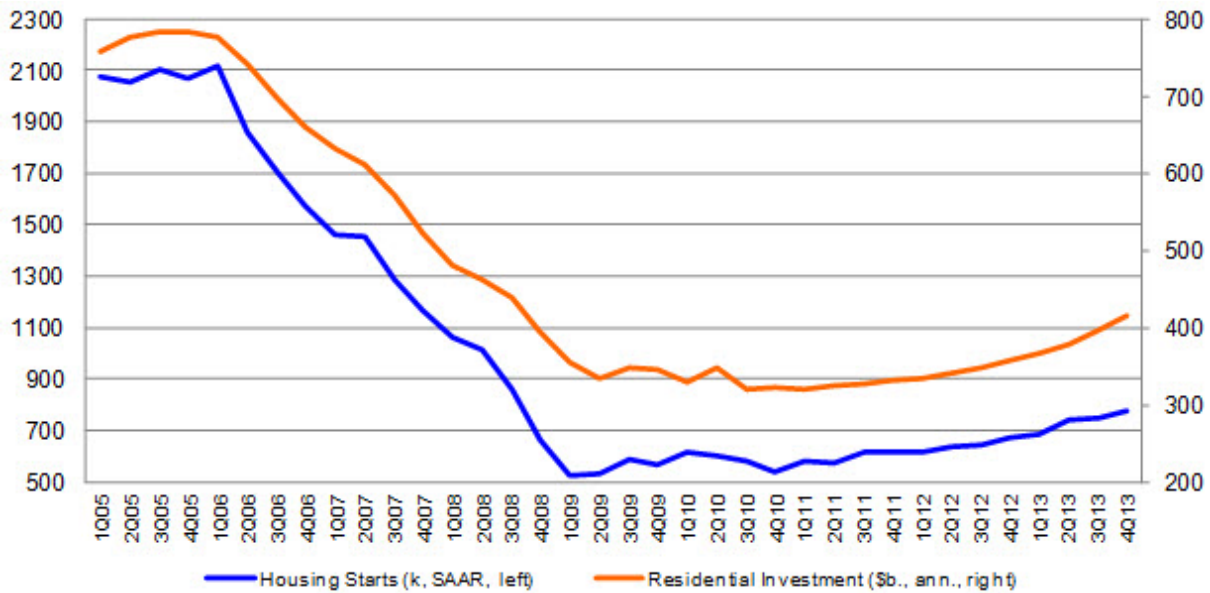
**Housing.** Housing has continued to struggle, though many measures of housing activity likely bottomed in 2010 and we are starting to see signs of slow improvement. While low mortgage rates and lower prices have made home affordability compelling, households are likely to delay home purchases until the employment picture is more certain. We continue to expect a very slow recovery in home sales and construction through the first half of 2012, with greater strength by the third quarter. (See Figure 2.)

**Figure 1. Household Balance Sheet Repair Should Continue to Constrain Consumption Growth**



Source: Bureau of Economic Analysis, ING Investment Management forecasts

Figure 2. Sustained Housing Recovery Unlikely Until 2012

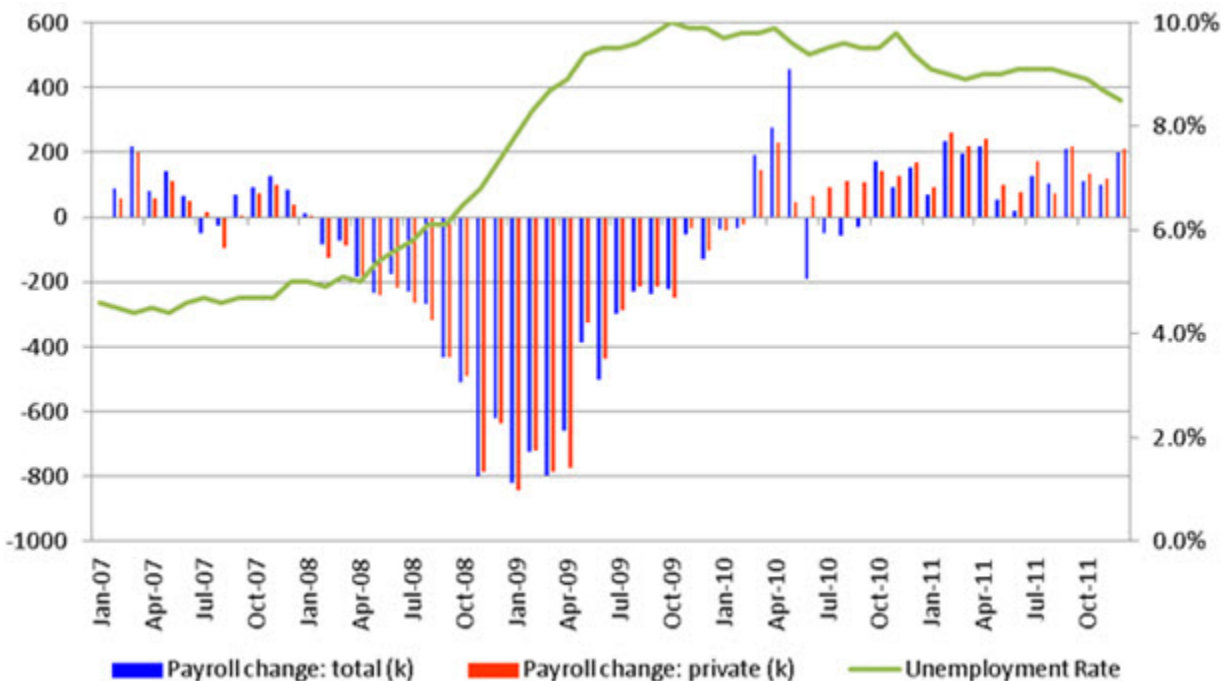


Source: U.S. Census Bureau, Bureau of Economic Analysis, ING Investment Management forecasts

**Employment.** Though the unemployment rate remains elevated, the job market has shown consistent signs of slow improvement in recent months; the most recent report from the Labor Department showed a 200,000 increase in nonfarm payrolls, the unemployment rate has moved close to a three-year low, and weekly jobless claims

are entrenched well below 400,000. We expect this progress to persist, with some acceleration in early 2012. Should employment continue to surprise on the upside, it would likely improve our outlook for personal income, consumer confidence and household spending, and thus, 2012 GDP growth. (See Figure 3.)

Figure 3. Payrolls Have Surprised on the Upside of Late

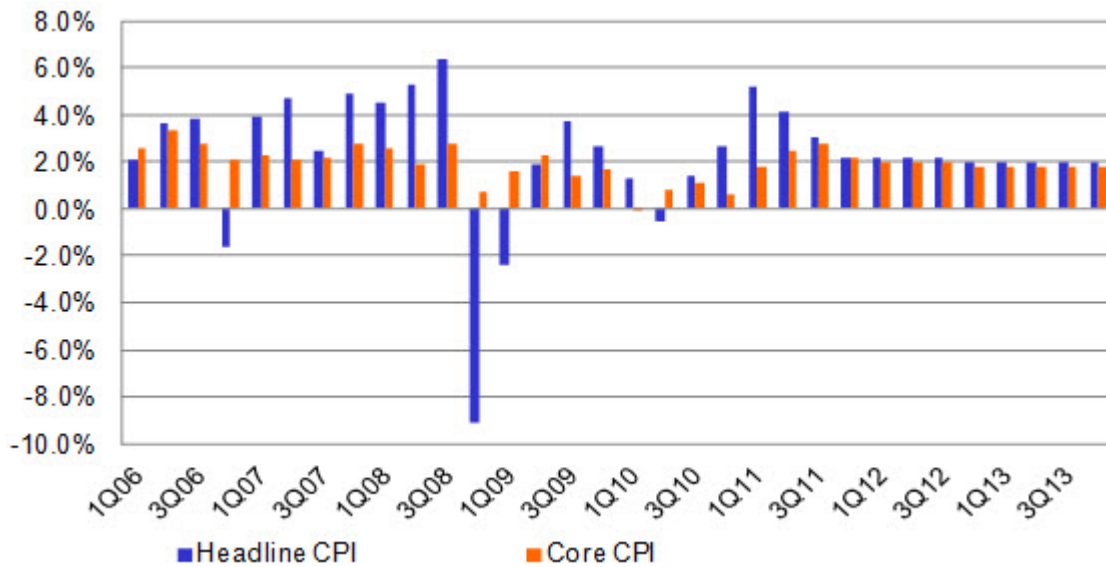


Source: Bureau of Labor Statistics

**Inflation.** Inflation surprised on the upside in early 2011 in response to higher prices for energy and other commodities. This surge has already begun to recede, however, and we expect inflation to settle in a modest 1.5–2.0% range, consistent with flat unit labor costs. (See Figure 4.)

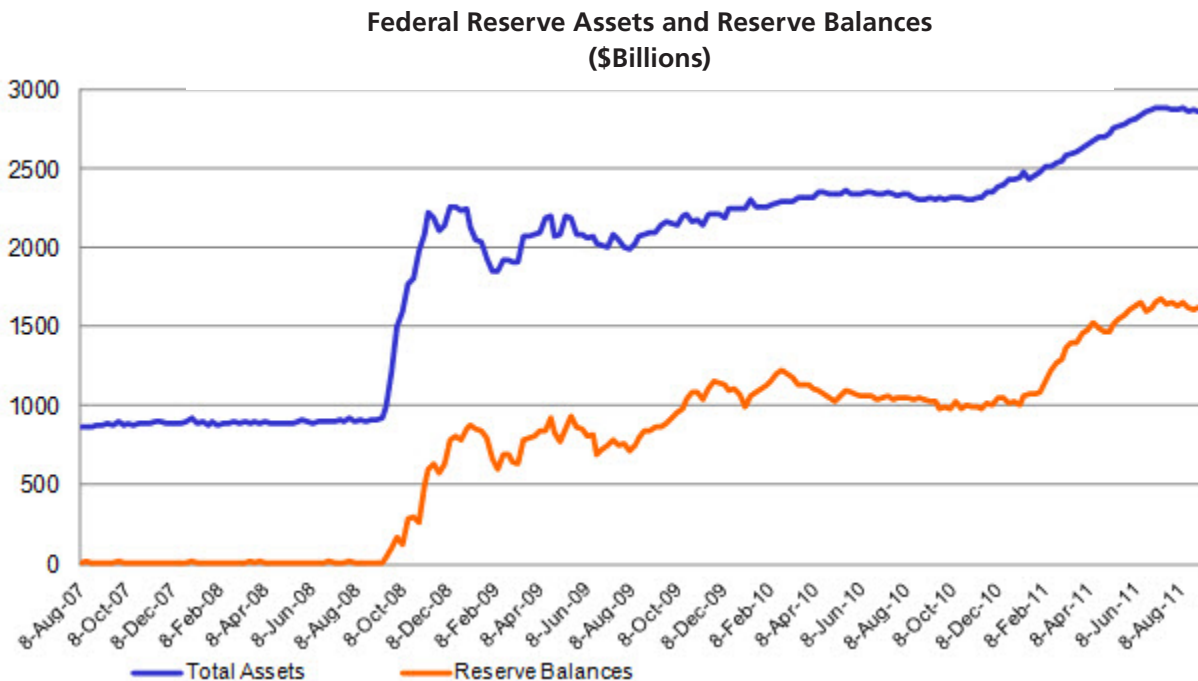
**Federal Reserve.** In recent years, the Fed has more than tripled the size of its balance sheet in order to cope with the financial crisis and recession, and to support the subsequent recovery. Given the central bank’s pledge to maintain exceptionally low rates until at least mid-2013, we expect monetary policy to remain stimulative until the Fed is convinced that U.S. GDP growth has returned to a self-sustaining path. (See Figure 5.)

Figure 4. Inflation Has Eased After and Early-2011 Surge



Source: Bureau of Labor Statistics, ING Investment Management forecasts

Figure 5. U.S. Monetary Policy Likely to Remain Stimulative through 2013



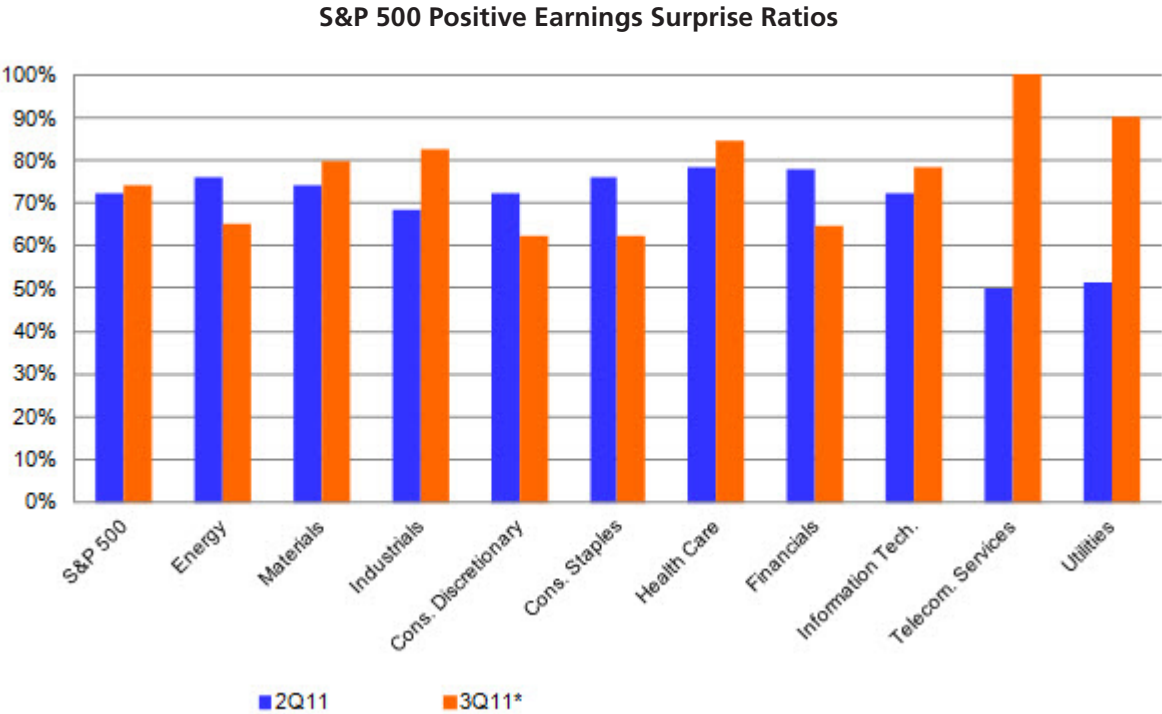
Source: Federal Reserve

**Earnings.** Corporate America has consistently impressed since emerging from the depths of the recession despite the many headwinds that have threatened profitability. In each of the past ten quarters, more than 70% of S&P 500 companies have delivered positive earnings surprises. While domestic corporations are well positioned to demonstrate strong earnings and dividend growth in 2012, recent negative pre-announcements for the fourth quarter are a source of concern and a signal that consensus expectations for earnings may be vulnerable. If the recent weakness is the result of inventory drawdowns — which appear to be moderating if not ending — then it would likely be a temporary blip with little impact on full-year 2012 results. (See Figure 6.)

**Debt.** Europe remains problematic for the markets. Recent months saw European Union leaders agreed on an intergovernmental framework for tighter fiscal discipline, on enlarging the European Financial Stability Fund and on greater involvement of the International Monetary Fund. We view these actions as necessary but insufficient for resolving the crisis — greater involvement from the European Central Bank is needed.

Meanwhile, the U.S. federal debt-to-GDP ratio remains on a troubling long-term trajectory. While the so-called Congressional “supercommittee” failed to reach a compromise on debt reduction, the \$1.2 trillion of automatic budget cuts included in the 2011 Budget Control Act would steer the economy away from its worst-case scenario should they come to fruition as scheduled in January 2013. (See Figure 7.)

Figure 6. Earnings Continue to Exceed Expectations

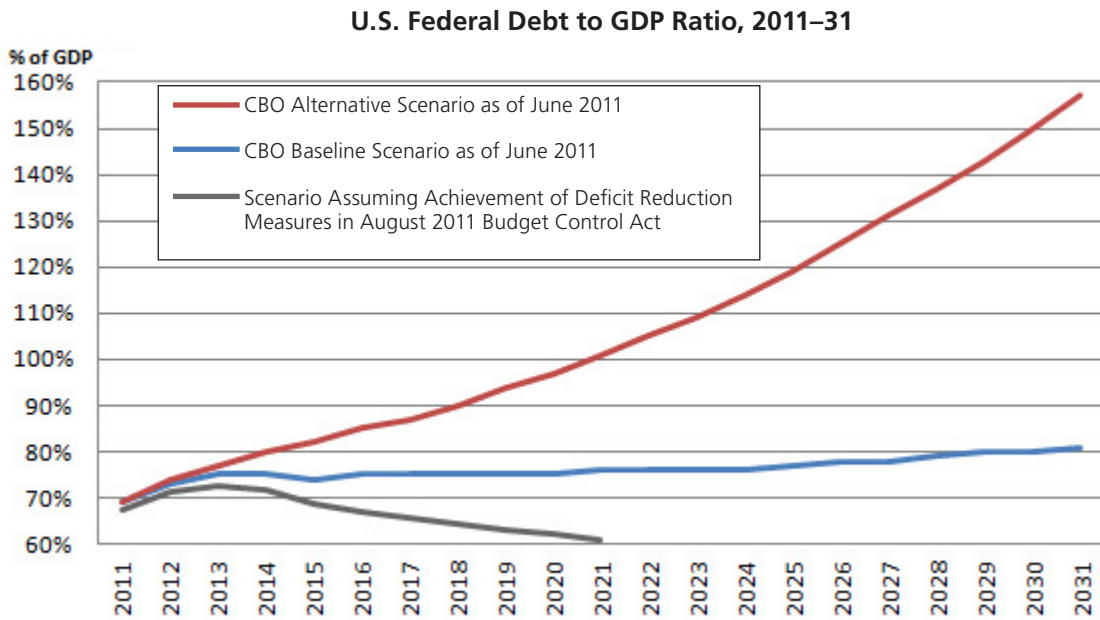


Source: Bloomberg

**Conclusion**

We expect the U.S. to deliver improved economic growth in 2012 with modest inflation. Europe remains a major risk to our forecast, though we believe the region’s policymakers will be able to sidestep disaster. Overall, the environment should be supportive of equities as well as most fixed income risk sectors, especially high yield and emerging market debt. That said, markets are likely to remain volatile.

**Figure 7. Trajectory of U.S. Government Debt Remains Ominous Unless Deficit-Reduction Efforts Succeed**



Source: Congressional Budget Office

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