SEEING THE BIG PICTURE:
A GLOBAL APPROACH TO INVESTING

An ING Funds White Paper

by Thomas D. Saler

On Christmas Eve 1968, as a violent and bitterly divisive year drew to a close, the astronauts of Apollo 8 found perspective a quarter-million miles from home. As they emerged from the far side of the moon to become the first humans to see the earth in its entirety, the political and economic differences that once seemed so daunting virtually disappeared. From that distance, astronaut Jim Lovell concluded, "The earth is really a grand oasis in the vastness of space."[1]

A generation later, Lovell's cosmic view of a planet that nurtures and unites has become reality for many consumers. "Just think about your typical day," says Brandes Investment Partners, L.P., Bob Gallagher, Director of Portfolio Management for ING Emerging Countries Fund, "Before bed, you might have a Ben & Jerry's ice cream and a cup of Nescafé. The next morning you stop at Dunkin' Donuts® or 7-Eleven®, then drive to work in your Toyota or BMW. Those are all products produced by foreign companies. Without even realizing it, the average American uses a wide array of products from overseas every day just to live."

Table of Contents

An investor should understand that investments in foreign or developing countries include risks such as currency fluctuation and economic and political risks not found in investments that are solely domestic, and therefore, should allocate only an appropriate portion of their overall portfolio based on their investment objectives, investment time horizon and risk tolerance.

This paper illustrates general principles of investing using the historical performance of various market indices. Unlike a mutual fund, the performance of an index assumes no taxes, transaction costs, management fees or other expenses.

[1] "One Giant Leap." Public Broadcasting System.

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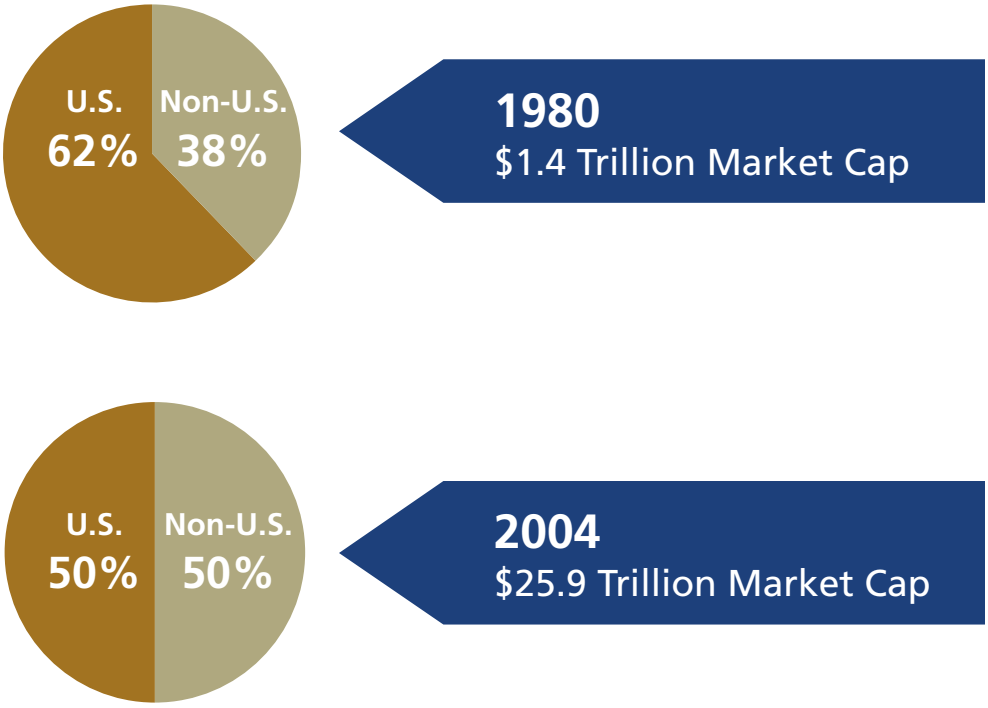
Growth of Foreign Economies

The growth of foreign economies is apparent in global securities markets. In 1980, only about 38 percent of equity-market capitalization was domiciled abroad; by 2004, that number had jumped to 50 percent.

FIGURE 1

Equity Market Capitalizations 1980 – 2004



Source: MSCI, Nicholas-Applegate as of December 2004. Values are expressed in U.S. dollars.

Currently, forty-five of the largest 100 businesses are headquartered overseas.[2] Yet while fully half the value of all publicly traded companies are foreign-based, Americans hold investment portfolios that are only minimally integrated into the global economy of the early 21st century. By one estimate, only about five percent of the average American's equity holdings are in foreign companies,[3] a number far below even the relatively conservative 20 percent weighting that is often deemed appropriate by professional investors." When it comes to investing, Americans are still quite provincial." says Gallagher.

"Currently, forty-five of the largest 100 businesses are headquartered overseas."

[2] Brandes Investment Partners, L.P.

[3] Michael Mullane, "Everything You Wanted to Know About International Investing But Were Afraid to Ask." NWQ Investment Management Company, LLC.

Opportunity Cost

Domestic investors could be paying a steep price for their reluctance to seek opportunity beyond U.S. borders. Between 1985 and 2003, total returns on Wall Street lagged most developed equity markets, including Spain, Hong Kong, France, Sweden, Switzerland, Italy, and the United Kingdom.[4] In fact, the U.S. was not the world's top-performing market on even one occasion between 1992 and 2004.[5] In 1999 alone, Finland beat American stocks by a whopping 132 percent.[6] While allocating more of your portfolio to overseas markets cannot assure a profit or protect against loss, it may help you diversify your portfolio, and seek to reduce overall volatility.

FIGURE 2

Top Performing World Markets 1995 –2004

1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Switzerland 44.1%	Spain 40.1%	Switzerland 44.3%	Finland 121.6%	Finland 152.6%	Switzerland 5.9%	New Zealand 8.4%	New Zealand 28.7%	Greece 69.6%	Austria 71.5%
USA 37.1%	Sweden 37.2%	Italy 35.5%	Belgium 67.8%	Singapore 99.4%	Canada 5.3%	Australia 1.7%	Austria 17.4%	Sweden 66.0%	Norway 53.3%
Sweden 33.4%	Finland 33.9%	Denmark 34.5%	Italy 52.5%	Sweden 79.7%	Denmark 3.4%	Ireland -2.8%	Australia -0.3%	Germany 64.8%	Greece 46.1%
Spain 29.8%	Hong Kong 32.1%	USA 33.4%	Spain 49.9%	Japan 61.5%	Norway -0.9%	Austria -5.7%	Italy -6.4%	Spain 58.9%	Belgium 43.5%
Netherlands 27.7%	Ireland 32.0%	Spain 25.4%	France 41.5%	Hong Kong 59.5%	Italy -1.3%	Belgium -10.9%	Norway -6.5%	Austria 57.8%	Ireland 43.0%

Source: MSCI; Nicholas-Applegate as of December 31, 2004. Values are expressed in U.S. dollars.

Past performance does not guarantee future results. This chart is for illustrative purposes only and is not indicative of any ING Fund or any other actual investment. The performance quoted represents past performance. Material differences among individual countries represented include the varying number of stocks in each index, the differing average market capitalization of the indices and the differences among currencies.

Part of the potential return advantage from international equity markets can be explained by the fact that some key industries are dominated by foreign companies. Eight of the 10-biggest building product and metals companies, nine of the 10-largest tobacco, airline, engineering, construction materials, and oil and gas companies, and each of the 10-largest marine and transportation-infrastructure companies are based overseas.[7] Clearly, when those foreign-dominated sectors are performing strongly, international stocks are likely to be beating their American counterparts.

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4 Wellington Management. "As The World Turns, Does Your Client's Portfolio?" November 2004.

5 Brandes Investment Partners, L.P.

6 *Ibid.*

7 *Ibid.*

"Globalization across various industry groups has diminished the importance of looking at a country," notes Richard Pell, Chief Investment Officer at Julius Baer Investment Management and Co-Portfolio Manager of the ING Foreign Fund. "Asking questions about what is happening within an industry like technology or pharmaceuticals is more meaningful than asking what one might think about Italy. Not all industries are global, but about 70 percent of the world's market cap is subject to significant global factors."

Correlation

Historically, correlations between U.S. and foreign markets has been low. But in the age of the global economy, it's common to assume that stock markets around the world move in lockstep and that there's little need to invest in more than one country.

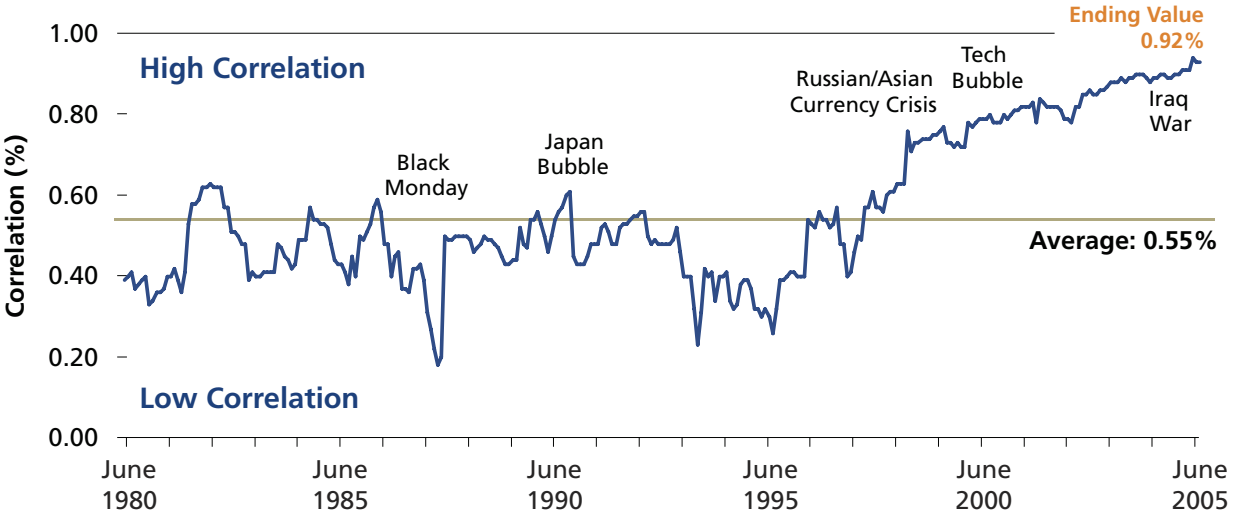
However, there are periods of high correlation between U.S. and foreign markets followed by periods of low correlation. High correlation has occurred, for instance, in times of global crises. But there are other times when markets do not move in lockstep. In fact, much of the time, international markets are driven by local conditions rather than what is occurring in U.S markets.

FIGURE 3

Rolling 36 Month Correlation: MSCI EAFE Index[8] to S&P 500 Index[9]

June 1980 –June 2005

The correlation between the performance of U.S. and international stocks can vary widely. High correlation has often occurred in times of global crises.



Past performance does not guarantee future results. This chart is for illustrative purposes only and is not indicative of any ING Fund or any other actual investment.

Source: ING Funds with data from Morningstar. 36-month rolling correlations, capitalization weighted, U.S.-dollar hedged returns. Correlations based on MSCI EAFE Index vs. S&P 500 Index. A correlation of 1.00 is equivalent to 100% correlation. Values are expressed in U.S. dollars.

[8] The MSCI Europe, Australasia and Far East Index (EAFE) is an unmanaged index that measures the performance of securities listed on exchanges in markets in Europe, Australia and the Far East. Each MSCI country index is created separately, then aggregated, without change, into regional MSCI indices. EAFE performance data is calculated in U.S. dollars and in local currency.

[9] The Standard & Poor's 500 Index is an unmanaged index that measures the performance of securities of approximately 500 large-capitalization companies whose securities are traded on major U.S. stock markets.

Investors cannot invest directly in an index.

The fact that U.S and foreign stock markets experience periods of low correlation is another reason to consider investing internationally, in an effort to help spread risk and mitigate volatility in a portfolio. International investing can give a portfolio a chance to perform better during periods when U.S. stock markets are struggling and exposure to U.S. stock markets could help a portfolio perform better during periods when international stocks are performing poorly.

Still, gaining access to more stocks in more industries — and the corresponding potential for higher returns — is not the sole rationale for viewing the world as a single investment entity. Despite massive increases in global trade during the last century, national business cycles remain largely unsynchronized. In other words, while the United States may be entering a mature phase of an economic expansion, other nations could be in relatively early stages. As such, the types of stocks and sectors that might outperform at any given time are likely to vary by nation or by region.

Historically, the United States and Japan have been among the least correlated major equity markets, with a current reading of less than 0.40.[10] The tendency of stocks in various nations to move either in opposite directions or by differing amounts if in the same direction underscores the potential diversification benefit that accompanies a global asset allocation approach.

"The diversification benefit of uncorrelated assets is one of the few aspects of investing that is virtually free."

FIGURE 4

Regional Correlation to the S&P 500 Index
(July 1, 2002 – June 30, 2005)

MSCI EAFE Index	0.92
MSCI Europe Index[11]	0.93
MSCI EM Index[12]	0.83
MSCI AC Far East ex Japan Index[13]	0.75
MSCI Japan Index[14]	**0.35**
MSCI EM Eastern Europe Index[15]	0.60
MSCI EM Latin America Index[16]	0.81

Source: Morningstar. Values are expressed in U.S. dollars.

Past performance does not guarantee future results. This chart is for illustrative purposes only and is not indicative of any ING Fund or any other actual investment.

It is important to note that international investing is not without risks, including currency fluctuation and economic and political risks not found in investments that are solely domestic.

[10] Brandes Investment Partners, L.P.

[11] The MSCI Europe Index is an unmanaged, market value-weighted average of the performance of over 500 securities listed on the stock exchanges of 15 countries in the European region.

[12] The MSCI Emerging Markets (EM) Index is an unmanaged Index that measures the performance of securities listed on exchanges in developing nations throughout the world.

[13] The MSCI AC (All Country) Far East ex Japan Index is an unmanaged free float-adjusted market capitalization index that is designed to measure equity market performance in the Far East, excluding Japan.

[14] The MSCI Japan Index is an unmanaged market capitalization weighted index composed of approximately 277 issues, and is generally representative of the market structure of Japan

[15] The MSCI EM (Emerging Markets) Eastern Europe Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the emerging market countries of Eastern Europe, the Middle East and Africa.

[16] The MSCI EM (Emerging Markets) Latin America Index is an unmanaged free float-adjusted market capitalization index that is designed to measure equity market performance in Latin America.

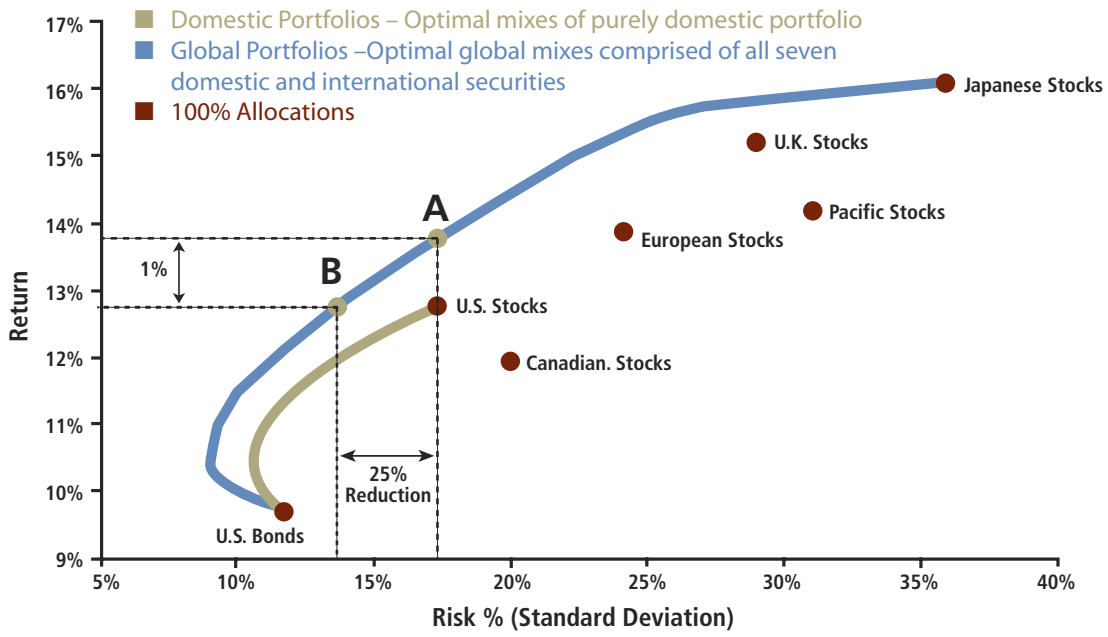
Investors cannot invest directly in an index.

The Efficient Frontier

"The diversification benefit of uncorrelated assets is one of the few aspects of investing that is virtually free," says Shiv Mehta of ING Investment Management. "For the same amount of risk you could get a higher total return; or for the same total return you could get a lower amount of risk. It is really a kink in the efficient frontier." An efficient frontier is the line that connects the combinations of securities that maximize expected return for a given level of expected risk, or that minimize expected risk for a given level of expected return. The latest academic data confirms the potential risk-reward benefits of a truly global approach. As shown in the chart below from Ibbotson Associates covering the 34-year period 1970 through 2004, a global portfolio [**A**] would have returned about 1 percent more per year with the same degree of risk (as measured by standard deviation) as a U.S.-only equity portfolio. Conversely, the global portfolio would have achieved the same total return with about a 25 percent reduction in volatility [**B**][17]. Standard deviation depicts how widely the returns varied over a certain period of time. When there is a high standard deviation, the predicted range of performance is wide, implying greater volatility.

FIGURE 5

Efficient Frontier – International Enhances Domestic Portfolios
International Regions – 1970 - 2004



Source: ING Funds and Ibbotson Associates. U.S. Bonds - 20-year U.S. Government Bond; U.S. Stocks - S&P 500, which is an unmanaged group of securities and considered to be representative of the stock market in general; Canadian Stocks - MSCI Canada Index; European ex U.K. Stocks - MSCI Europe ex U.K. Index; U.K. Stocks - MSCI U.K. Index; Japanese Stocks - MSCI Japan Index; Pacific ex Japan Stocks - MSCI Pacific ex Japan Index. Values are expressed in U.S. dollars.

Past performance does not guarantee future results. This chart is for illustrative purposes only and is not indicative of any ING Fund or any other actual investment. The optimal portfolios represented by the efficient frontier are derived from past performance. There can be no guarantee that the same portfolios will continue to be optimal in the future. The illustration does not take into account transaction costs, management fees, taxes and other expenses that would reduce the return on an actual portfolio.

[17] Ibbotson Associates.

Currency Boost

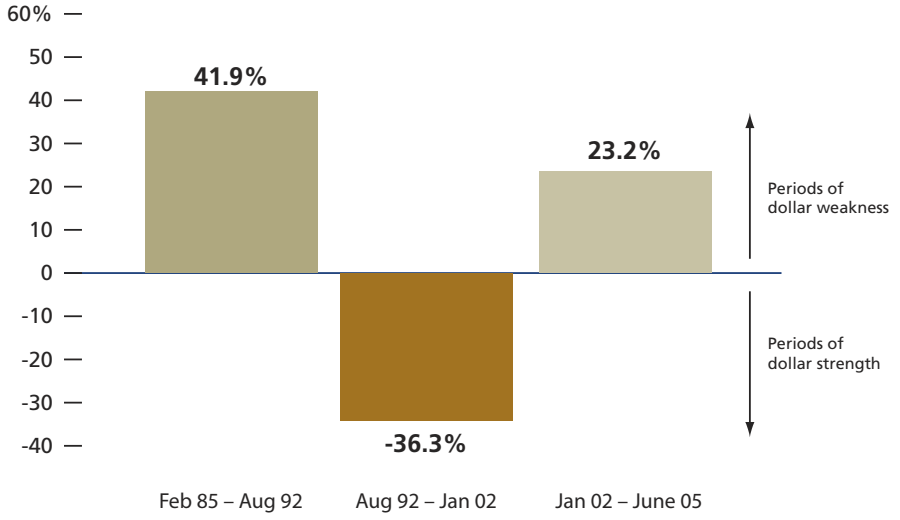
From a purely tactical perspective, returns for U.S. investors from overseas stock markets could get a boost in coming years from additional weakness in the dollar. Like any asset class, of course, currencies experience bull and bear phases that can last several years. The dollar, for instance, rose sharply against a trade-weighted basket of currencies between 1996 and 2002. Since then, however, the greenback has been mired in what some observers believe is the early stages of a secular decline brought on by a gaping shortfall in the nation's current account. Even legendary investor Warren Buffett has placed bets against the dollar." During 2002, we entered the foreign currency market for the first time in my life, and in 2003 we enlarged our position, as I became increasingly bearish on the dollar," wrote Buffett in *Berkshire Hathaway's 2003 Annual Report*.[18] If the "dollar bears" are proven correct, currency moves could represent a meaningful tailwind behind international portfolios in coming years, since, all things being equal, foreign-denominated securities rise in value as the dollar declines. Of course, if they are wrong, and the dollar actually rises, foreign-denominated securities will fall in value.

"All things being equal, foreign-denominated securities rise in value as the dollar declines."

As illustrated in the chart below, 41% of the MSCI EAFE Index's total return between 1985 and 1992 was attributable to a weak dollar. Conversely, in the period between 1992 and 2002, 36% of the decline in the MSCI EAFE Index was attributable to a strong dollar.

FIGURE 6

Percent Gain in International Returns Attributable to Movement in Dollar's Exchange Rate



Source: MSCI, Nicholas-Applegate, Data of June 30, 2005. Values are expressed in U.S. dollars.

Past performance does not guarantee future results. This chart is for illustrative purposes only and is not indicative of any ING Fund or any other actual investment.

Based on a paper by University of California economist Maurice Obstfeld and former IMF head Kenneth Rogoff, the dollar could decline in trade-weighted terms by another 20 percent to 40 percent, depending upon how quickly America's external deficits are reversed.[19] And former Federal Reserve Chairman Paul Volcker — the man who preceded Alan Greenspan at the U.S. central bank and who is largely credited with

[18] Berkshire Hathaway Inc. *2003 Annual Report*. Page 21.

[19] "How low might the dollar sink?" *The Economist*, November 13, 2004, Page 84.

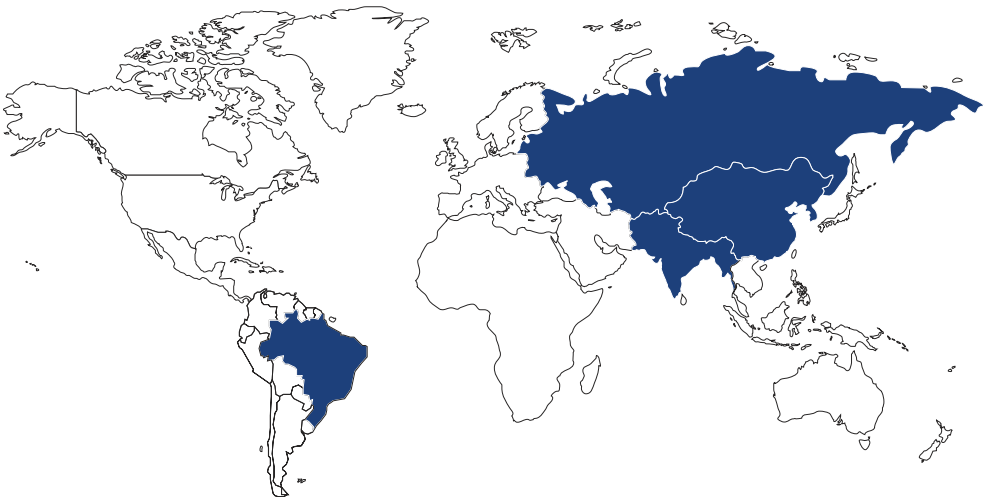
slaying inflation in the early 1980s — has predicted a 75 percent probability of a dollar crisis within five years.[20] ING's Mehta concurs that the dollar looks shaky, despite its recent countertrend rally. "In the long-term, the dollar needs to depreciate," he says. "We see a lot of volatility in the currency and there could be more strengthening near term, but over the next two to three years, we do see a weaker dollar." However, a further decline in the greenback would not necessarily have to be severe or disorderly. In fact, mild adjustments in exchange rates can actually be a healthy way for imbalances within the global economy to be rectified.

Rise of the BRICs (Brazil, Russia, India and China)

Over the long term, investors embracing a global approach also could profit from the seemingly inevitable integration of developing nations into the global economy. A century ago, few analysts would have predicted that the United States would vault past Great Britain, Germany and other European powers to become the world's largest economy within two generations. In fact, U.S. gross domestic product in 1900 totaled a paltry $20 billion,[21] or roughly the size of the modern Brazilian economy in current dollars.[22] By 2004, however, U.S. output had grown 500-fold to $10 trillion.[23]

"...international markets could be poised to extend a run of outperformance that began in 2002."

Yet even though America remains the fastest-growing rich country on earth, it could be surpassed in size within 40 years by at least four developing economies. According to a study by the Goldman Sachs, **Brazil, Russia, India and China** (the "BRICs") each will have larger output than the United States by 2041.[24] Naturally, the path to economic stardom for developing countries will doubtless be afflicted with the same boom-bust cycles that dogged the American economy during the 20th century. Yet room for mega-growth is clearly present; while emerging markets represent 81 percent of the world's population, they account for only four percent of world equity market capitalization.[25]



[20] National Bureau of Economic Research and U.S. Dept. of Commerce.

[21] Author's calculations; "World in Figures." 2004 Edition, *The Economist,* Page 24.

[22] "World in Figures." 2004 Edition, *The Economist,* Page 24.

[23] "Follow the Yellow BRIC Road." *The Economist*, October 11, 2003, Page 74.

[24] Brandes Investment Partners, L.P.

[25] *Ibid.*

Mehta believes that developing countries can be profitable places to invest, but adds a powerful caveat. "Small allocations to emerging markets, if done appropriately and managed professionally, may add return to a portfolio," he says. "But you need to have expertise in asset allocation and stock selection. In both cases, the alpha is substantial and significant." (Alpha measures the difference between a fund's actual return and its level of risk as measured by beta. An alpha of 0.5 implies the fund performed 0.5% better than the market would predict. The figure is calculated on a three-year basis relative to the benchmark.) Some experts believe that stock-picking is more readily rewarded in smaller equity markets since fewer analysts are beating the investment bushes, thus making it less likely that a competitor will be first to uncover a buried corporate gem. Among large-cap companies, only nine analysts cover each emerging-market stock versus an average of 17 analysts covering developed markets.[26]

Keep in mind, however, that the risks of international investing are generally greater in emerging markets. Compared to developed countries, the securities regulations and accounting and disclosure standards of developing countries may be less stringent; the securities markets may be less liquid; and the potential for market disruption due to political or social upheaval may be greater.

"...focusing only on economic growth rates misses an essential component of successful investing."

The Multinational Approach

Skeptics of a global approach argue that investors could derive the same level of geographic diversification simply by owning U.S. multinationals, since companies comprising the large-cap S&P 500 Index get about one-quarter of revenues from overseas.[27] "There is some merit in that argument," says Mehta. "But the question is, do you want a sharp knife or a blunt knife? If your objective is to buy non-U.S. growth, domestic multinationals may not be the best way to get that done."

According to Mehta, U.S. multinationals do not experience the same degree of exposure to foreign factors as international companies. In addition, investors relying on American multinationals as a proxy for foreign-based businesses are not sidestepping currency risk; if the dollar appreciates, the price of American goods rise in overseas markets, thereby cutting into sales. A strong U.S. currency also slices into profits when those foreign sales are repatriated into dollars. Finally, it is important to note that smaller domestic businesses (as measured by the S&P SmallCap 600 Index[28]) get only about 12 percent of revenues internationally.[29]

Proponents of a stay-at-home strategy also point out that the United States is growing faster than developed Europe or Japan. But according to Mehta, focusing only on economic growth rates misses an essential component of successful investing. "Stock markets do not pay for actual growth; they pay for mis-priced growth," he says. "If one company is growing at 6 percent and the other is growing at 10 percent, the price-to-earnings ratio of the 10-percent grower will be higher. It doesn't necessarily mean that the faster-grower will make the most money for investors." In other words, when investors expect rapid earnings growth, they typically pay more to own that company's shares. The higher purchase price, in turn, could make it more difficult for shareholders to turn a profit on their original investment.

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[26] "International Departures." Daniel Akst. *Bloomberg Wealth Manager*. April 2005.

[27] *Ibid.*

[28] The S&P SmallCap 600 Index is an unmanaged index used to measure stock market performance composed of companies with a weighted average market value of approximately $600 million. **Investors cannot invest directly in an index.**

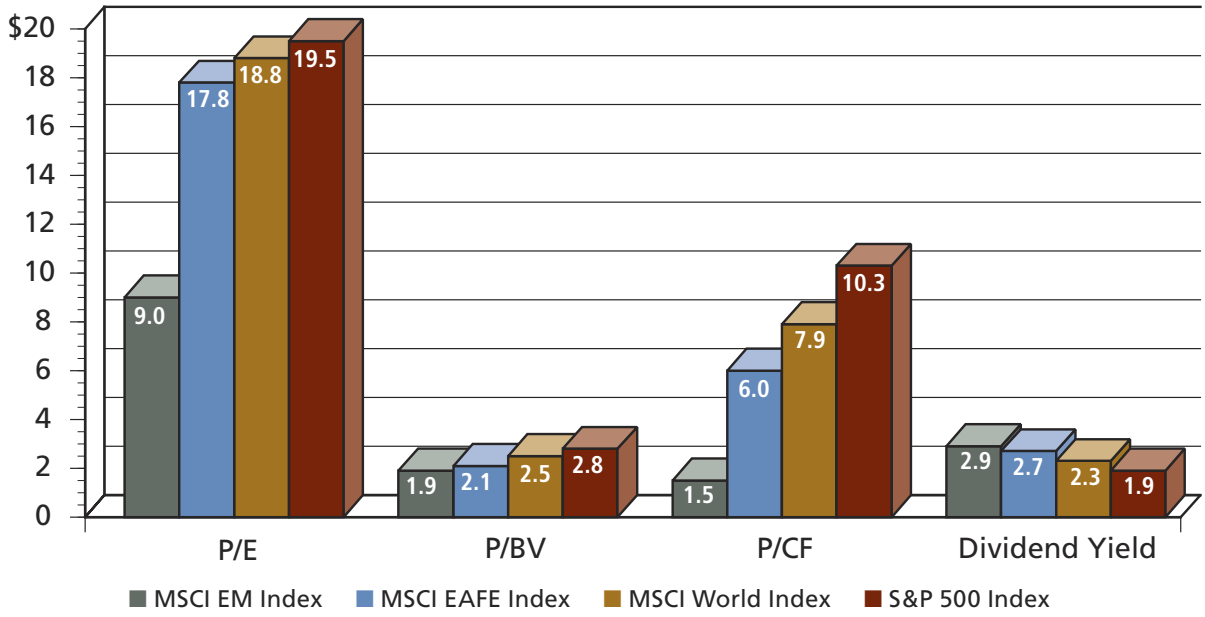
[29] "International Departures." Daniel Akst. *Bloomberg Wealth Manager*. April 2005.

One Big Bucket

To the extent that price still matters — and it almost certainly does — international markets could be poised to extend a run of outperformance that began in 2002. As of June 30, 2005, the MSCI EAFE benchmark was cheaper than the S&P 500 Index in terms of price-to-earnings (17.84 vs. 19.49), price-to-book (2.11 vs. 2.82), and price-to-cash flow (5.97 vs. 10.25).[30] EAFE stocks also sport a higher dividend yield (2.73 percent vs. 1.90 percent) than its U.S. counterpart.[31]

FIGURE 7

Global Valuations (%) as of 6/30/05



Source: ING Funds. Values are expressed in U.S. dollars.

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And although market leadership can change from year-to-year, broad relative strength trends often persist for long periods. For example, the U.S. equity market outperformed its international cousins between 1990 and 2002 while overseas bourses dominated Wall Street in the late 1970s and the late 1980s.[32] It is important to keep in mind that past performance does not guarantee future results.

In the final analysis, however, the question is not whether domestic or international stocks make better investments. History is clear that each has its day in the sun, and that no trend lasts forever. Instead, the real issue may be to provide investors with the ability to diversify between the world's asset markets.

[30] Michael Mullane. "Everything You Wanted to Know About International Investing But Were Afraid to Ask." NWQ Investment Management Company, LLC.

[31] *Ibid.*

[32] Wellington Management. "As The World Turns, Does Your Client's Portfolio?" November 2004.

Such flexibility can make a major difference in performance. Brandes Investment Partners, L.P., which manages ING's Emerging Countries Fund, examined returns from seven major global investment categories between 1992 and 2004. Their findings underscored the importance of choice and flexibility in the asset allocation decision. Over that period, the average differential between the best- and worst-performing subsets was a resounding 29.56 percent per year.[33] While it is unreasonable to assume that portfolio managers will always have the optimum under- and overweights in place, the gaping disparity in returns suggests that asset allocation can be a major contributor of alpha to global portfolios.

So how much is too much to appropriate overseas? There is no single right answer to the question, because individual circumstances vary and because the global economy is a dynamic system. "It depends on what you are trying to do with your portfolio," says Mehta. "There are circumstances in which 25 percent exposure is an entirely rational number and there are other circumstances in which 10 percent is appropriate." Whatever the figure, the time has arrived to view the vast universe of global businesses as a single entity with many pockets of opportunity. Importantly, the role of an investment adviser is to help their clients determine the percentage allocation to international stocks that is best for their goals and risk tolerances.

"…the time has arrived to view the vast universe of global businesses as a single entity with many pockets of opportunity."

Thinking Big

In his bestselling book, *The World is Flat: A Brief History of the Twenty-First Century,* author Thomas L. Friedman describes standing on the first tee of a golf course in Bangalore, India, and asking for directions from his playing partner. "Aim at either Microsoft or IBM," he was told, a reference to the names of two gleaming buildings off in the distance. Everywhere he looked, Friedman saw evidence that the world economy had become integrated in ways that few could have imagined a generation ago. "No, this definitely wasn't Kansas," Friedman remembered. "It didn't even seem like India. Was this the New World, the Old World, or the Next World?"[34]

Actually, it was the same world that the Apollo 8 astronauts first observed with childlike wonder from lunar orbit 37 years earlier. Flat or round, old or new, it remains a "grand oasis" which brings together far-flung nations and peoples in a common goal to prosper. Keeping that global vision in mind may help investors prosper as well. ■

Commentary reflects views of the author and portfolio managers, and is subject to change based on market and other conditions. It should not be assumed that any security transactions, holdings, or sector discussed were or will be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance discussed herein.

About the Author
Thomas D. Saler is the author of three investment books and a regular contributor to a variety of financial publications, including *Bloomberg Personal Finance*, *Your Money*, *Mutual Funds* and *Consumers Digest*.

[33] Author's calculations using data from Brandes Investment Partners.

[34] Thomas L. Friedman. *The World is Flat: A Brief History of the Twenty-First Century*. Farrar, Strauss and Giroux; 2005. Pages 3-4

For More Information

For more complete information, or to obtain a prospectus on any ING fund, please call your Investment Professional or ING Funds Distributor, LLC at (800) 992-0180 or log on to www.ingfunds.com. The prospectus should be read carefully before investing. Consider the fund's investment objectives, risks, and charges and expenses carefully before investing. The prospectus contains this information and other information about the fund. Check with your Investment Professional to determine which funds are available for sale within their firm. Not all funds are available for sale at all firms.

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