

Monthly Market Roundup - Debt

December 2008

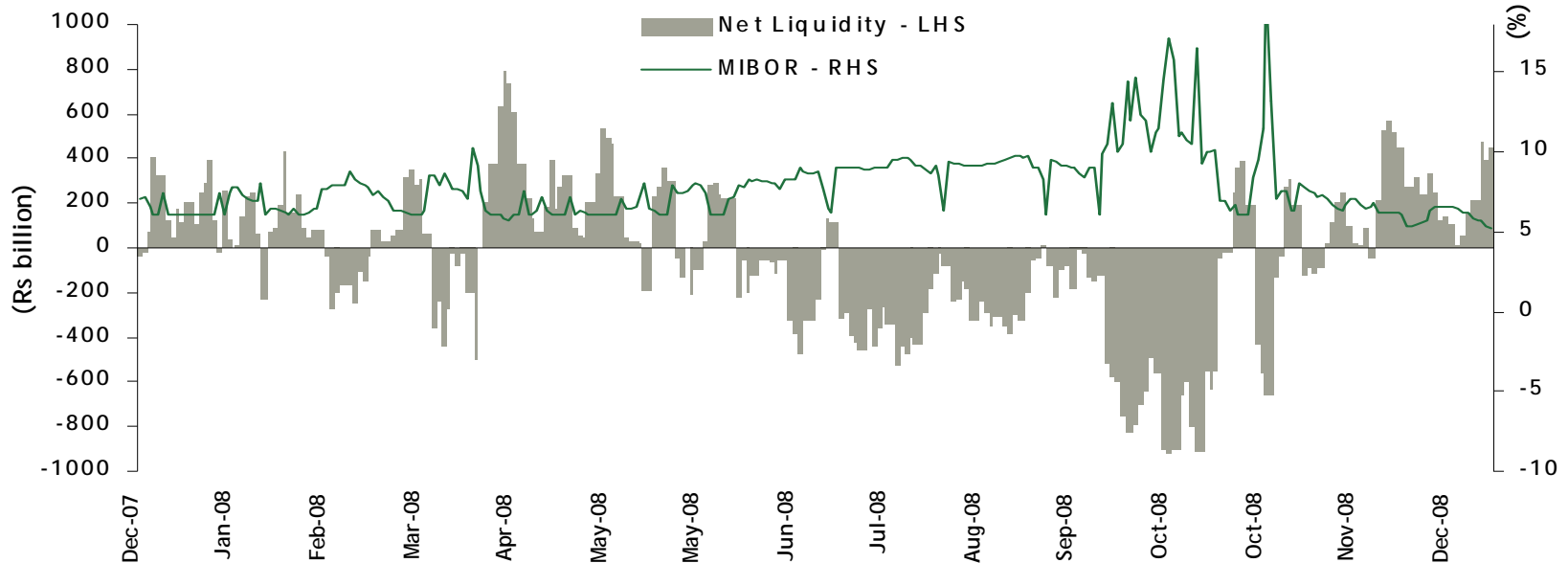
Key Events-Global

- US Financial crisis continued with economic data showing recession taking deep hold
- Federal Reserve revised the Federal Funds Target Rate to 0%-0.25% from 1% earlier thus marking the beginning of zero interest rate regime (ZIRP)
- Fed announced it would begin Mortgage Backed Securities purchase program in early January
- BoJ also moved towards ZIRP as it cut its target rate to 0.10% from 0.30%
- Commodity prices continued to fall reflecting anticipated demand contraction; crude oil touched a low of USD 33.87 per barrel on 19th Dec 08.
- US Government bailed out US automakers by pledging to lend USD 17.4 bln

Key Events-Domestic

- Indian macro economic indicators deteriorated in sync with the ongoing global recession with exports as well as IIP data dipping sharply
- RBI reduced the key policy rates taking the reverse repo rate to 5.0% from 6.0% and repo rate to 6.50% from 7.50%
- Easy liquidity conditions - System positive by average INR 288.90 billion
- Low overnight rates - NSE MIBOR touched a low of 5.27% averaging 6.02% during the month
- Crude prices continued to fall - touching a low of USD 33.87 per barrel on 19th Dec 08 versus 49.28 at the start of the month
- Key headline 10Yr Gol fell sharply on RBI rate actions and negative economic data. 10Yr Gol closed the month at 5.26% from a high of 7.06% during the beginning of the month
- INR appreciated mildly against the USD over the month from 50.29 to 48.80
- WPI Inflation continued to ease over the month with the latest reading at 6.38%

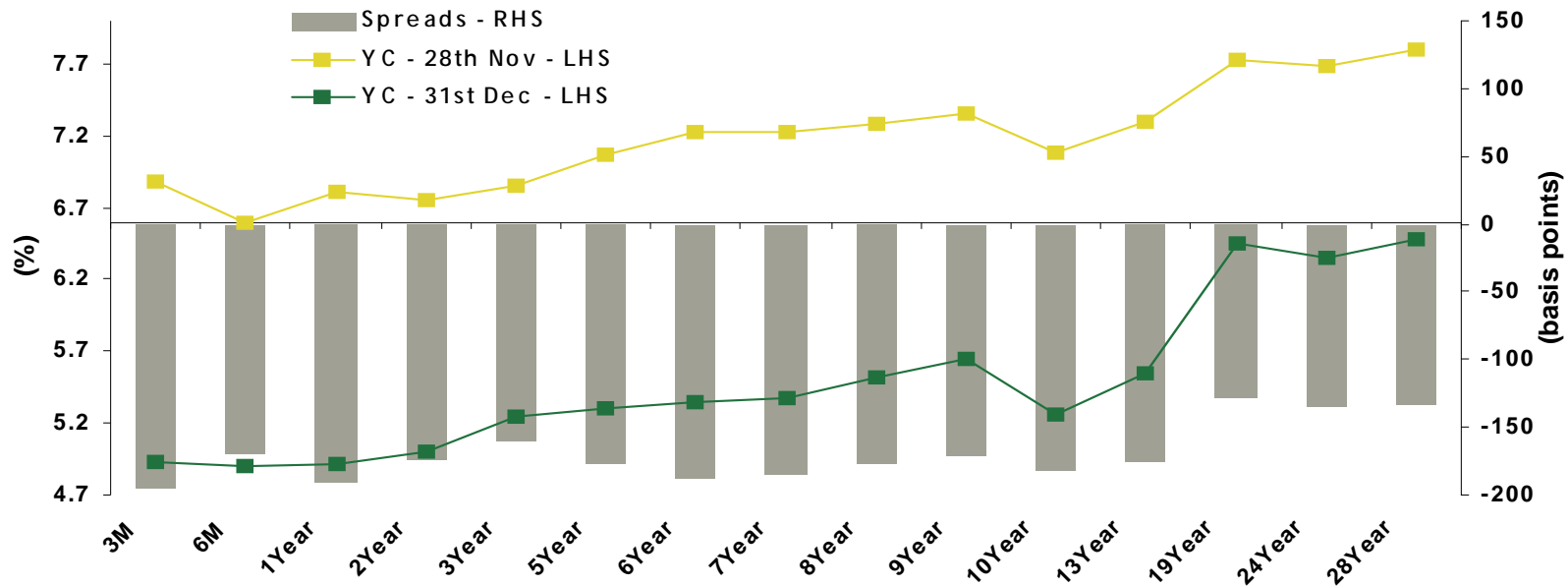
Liquidity – likely to remain comfortable.....



Source: Bloomberg

- Liquidity remained comfortable throughout the month
- Overnight Mibor touched a high of 6.62% and closed at a low of 5.27%
- CRR cuts and a slowdown in credit demand added to systemic liquidity
- Average Liquidity at (+)INR 289 bln; with a high of (+) INR 566 bln and low of (+) INR 12 bln

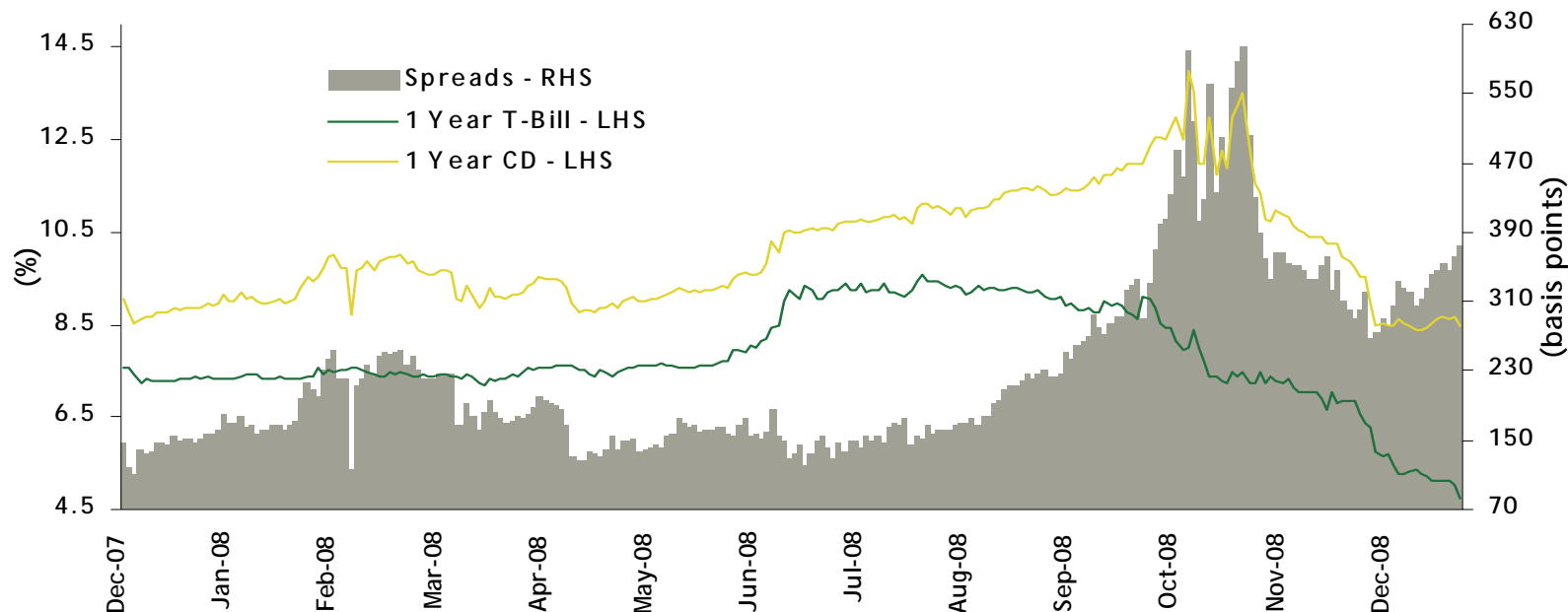
G-Sec Yield Curve - sharp easing over the month



Source: Bloomberg

- Rate cut expectations fueled gilt rally
- 10Y Gol bond most actively traded
- Active trading in benchmark securities namely 8.24% 2018 and 7.95% 2032

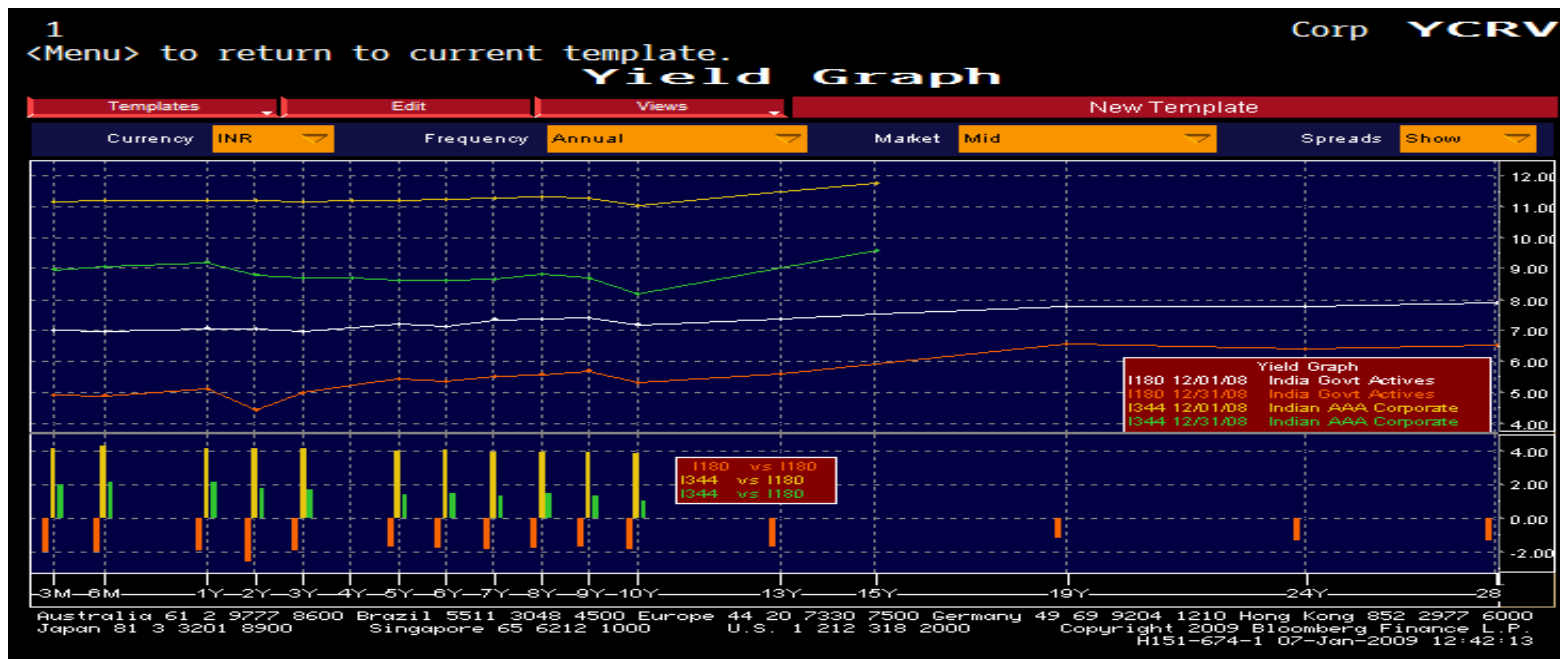
Money Market- spreads compress over sovereign



Source: Bloomberg

- CD rates moved sharply lower as RBI cut rates and liquidity conditions remained easy
- Spread over sovereign curve compressed slightly as T-bill rates also declined significantly during the month (spreads decreased by around 18 basis points during the month)
- Treasury bill yields eased by 209 basis points during the month

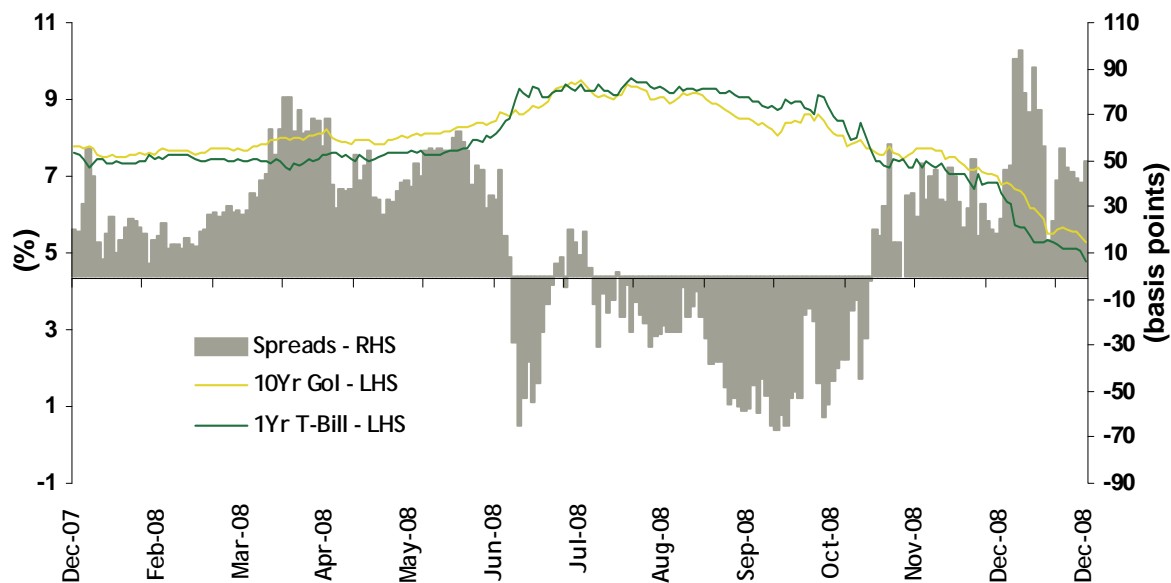
Corporate Bonds- spreads compress over sovereign



Source: Bloomberg

- Corporate bond spreads compressed even as sovereign curve moved down
- Spreads still remain attractive at around 280-300 bps on continuous supply
- Spreads likely to compress, going forward

Sovereign Spreads- curve steepens

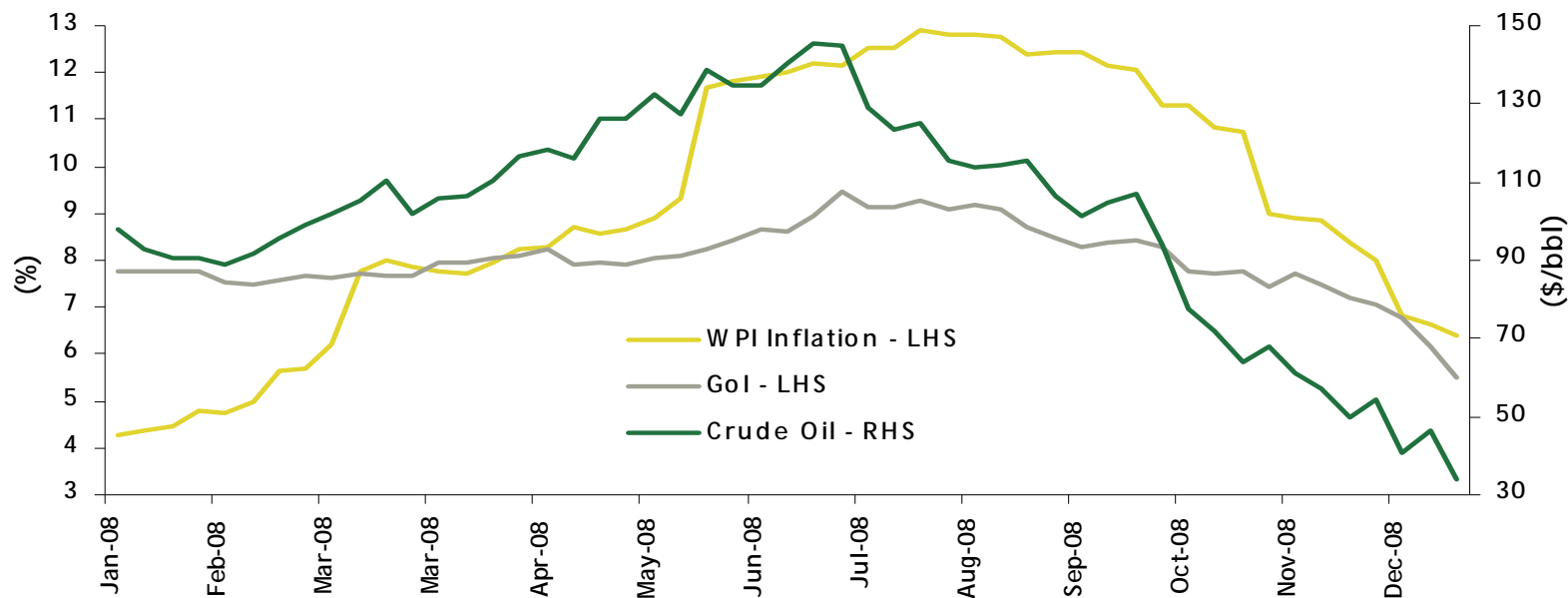


SPREAD SUMMARY	Last 1 year	Last 1 month
Last (bps)	50.24	50.24
Mean (bps)	18.0989	51.5081
Off Avg (bps)	36.1792	-1.2681
Median (bps)	23.7000	47.2800
StDev	36.1792	24.2308
Off Avg StDev	0.89	-.050
High (bps)	98.1600	98.1600
Low (bps)	-66.680	16.3900

Source: Bloomberg

- Yield Curve normalizes with T-bill rates declining significantly on liquidity infusion from the Central Bank
- Spread likely to increase as RBI may cut rates further
- Yield curve likely to steepen further

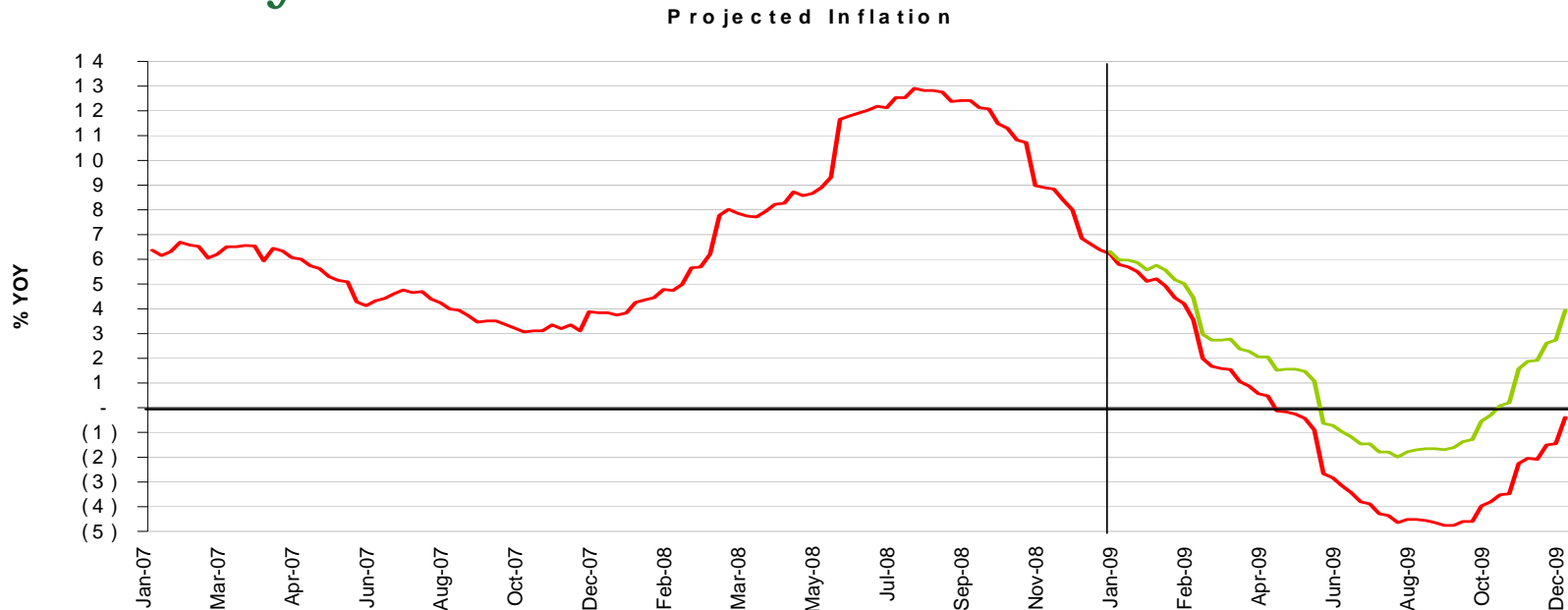
Crude and Inflation Dynamics-high correlation



Source: Bloomberg

- Crude prices have come off significantly from their peak following demand slowdown resulting from global recession
- USD likely to remain firm against other currencies as risk aversion remains high
- WPI inflation has eased significantly on domestic fuel price reduction and likely to head lower in the coming days

Projected inflation – likely to enter negative territory



Source: Bloomberg

- Falling commodity prices including crude oil reflected in the recent fall in WPI inflation
- Inflation likely to head sharply lower in the coming months mainly on base effect
- May enter negative territory towards Jun-Aug 09 before increasing again

WSS Monthly Overview-Spotlights....

- M3 meagerly increases to 44,30,231 crs (Dec 19) from 43,80,915 crs (Nov 28) -(19.6% y-o-y)
- Total Deposits outstanding at 35,48,807 (Dec 19) versus 36,49,506 (Nov 28)
- Total Bank Credit outstanding at 26,44,528 (Dec 19) from 27,21,732 (Nov 28)
- Credit to Deposit ratio nearly unchanged at 74.52 (Dec 19) from 74.58 (Nov 28)
- Investment in Gov Securities at INR 10,68,131 (Dec 19) versus 10,78,954 (Nov 28)
- Investment to Deposit ratio nearly unchanged at 30.60 (Dec 19) from 30.12 (Nov 28)
- Total FX reserves decreased to 12,20,869 crs (Dec 26) from 12,34,460 (Nov 28)
- MSS outstanding decreased to 1,20,050 (Dec 26) from 1,32,531 (Nov 28)

The month ahead...Global

- CDS spreads continue to remain wide signaling risk aversion continues
- USD expected to strengthen on risk aversion
- Crude expected to trade in the range of USD 45-55 per barrel on reduction in demand following global recession
- BoE expected to slash rates further towards the 0% levels
- BoJ expected to begin quantitative easing as rates fall to near zero levels
- Avoiding deflation is the main focus for major developed economies
- US Treasury yields to remain low as recession deepens

The month ahead...Domestic

- Growth takes precedence over inflation
- RBI likely to cut key policy rates further
- 10 yr GOI yield likely to trade in a range of 5.0%-5.50% while targeting an eventual move towards 4.50% levels
- Inflation expectation for the month ahead in the range of 5.50%-6.00%
- Likely additional borrowing from the government may temporarily halt gilt rally
- AAA PSU corporate bond spread likely to compress further
- Incoming macro data likely to continue to disappoint

Suggested Strategies For the Month Ahead

- With macro data continuing to be disappointing, expect more rate action from the RBI although the next move may come with a lag
- Gilt yields likely to consolidate in the range of 5.00%-5.50% targeting 4.50%
- AAA PSU Corporate bond spreads extremely attractive
- Maintain HIGHER duration of the bond portfolio
- Invest in Income Funds

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