

# Fixed Income Markets : Current Environment and Outlook

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# Macro Events

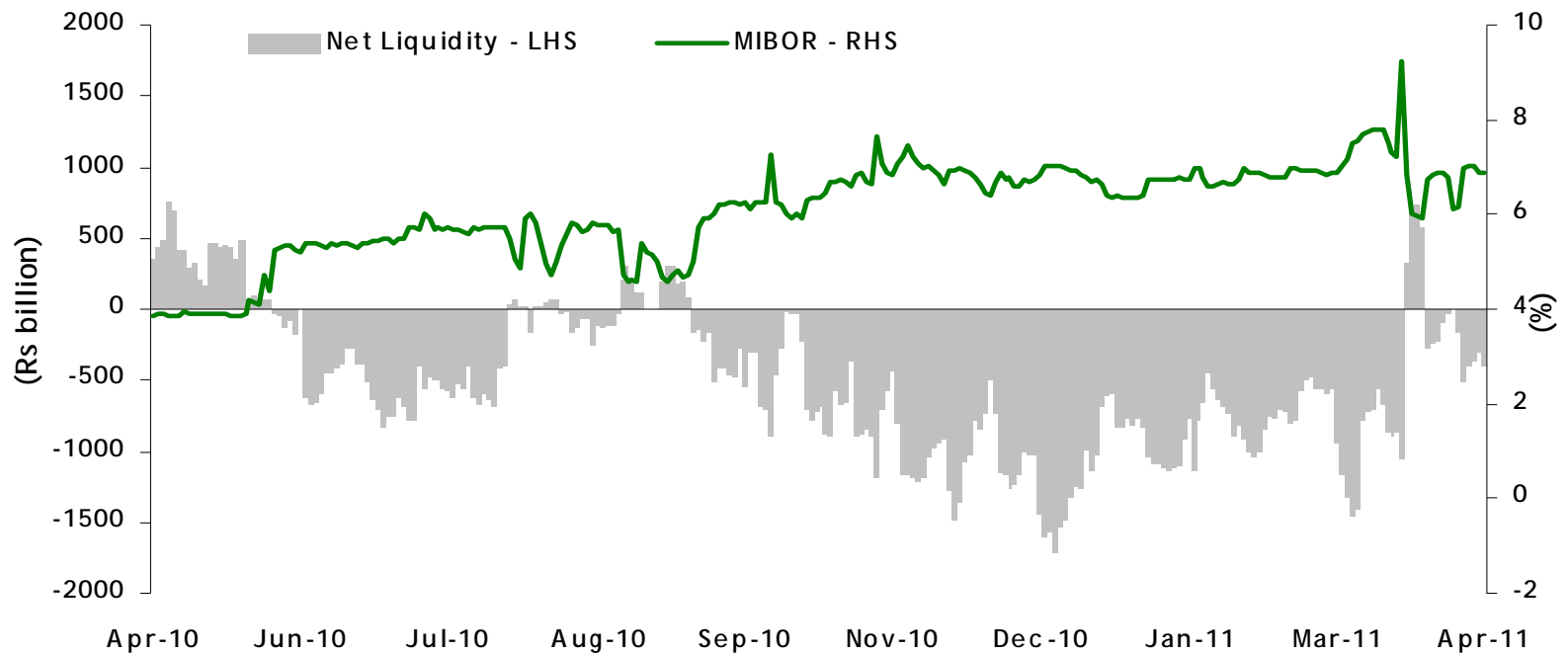
## Domestic

- India's economy (GDP) grew at a 8.2% (YoY) rate in Q3FY11, driven by expansion in the farm and financial services sectors. GDP grew by 8.6% (YoY) in 9MFY11 as against 7.4% in 9MFY10.
- Industrial production (IIP) slowed to 3.6% in Feb'11 after having risen an upwardly revised 4% YoY in the previous month (Jan'11). The cumulative growth for the period April- February, 2010-11 stands at 7.8% over the corresponding period of the previous year.
- India's (Core) Infrastructure sector output expanded by an impressive 7.4% in Mar'11 YoY, from 6.8% in Feb'11. The six core industries — crude oil, petroleum refinery products, coal, electricity, cement and finished steel — grew by 5.9% in 2010-11 compared to 5.5% in the previous year . Output in the Steel, Cement and Crude Sectors remained strong while growth in the coal sector remained weak.
- Inflation, as measured by the WPI Index, rose well above all expectations to 8.98% YoY in Mar'11, after having risen 8.3% in the previous month (Feb'11). Food prices continued to fall while the rise in prices of Non-Food items has now become a matter of serious concern.

## International

- Economic growth measured by GDP, has weakened from the post-crisis rebound in the US, UK and Euro zone . The unemployment rate in the developed economies, continues to improve slowly.
- US GDP growth rate softened to 1.8% QoQ in Q1'11 from 3.1% in the previous quarter. GDP in the UK rebounded in Q1'11 after a weather induced fall in Q4'10. GDP increased by 0.5% QoQ, with the yearly figure putting in a rise of 1.8%.

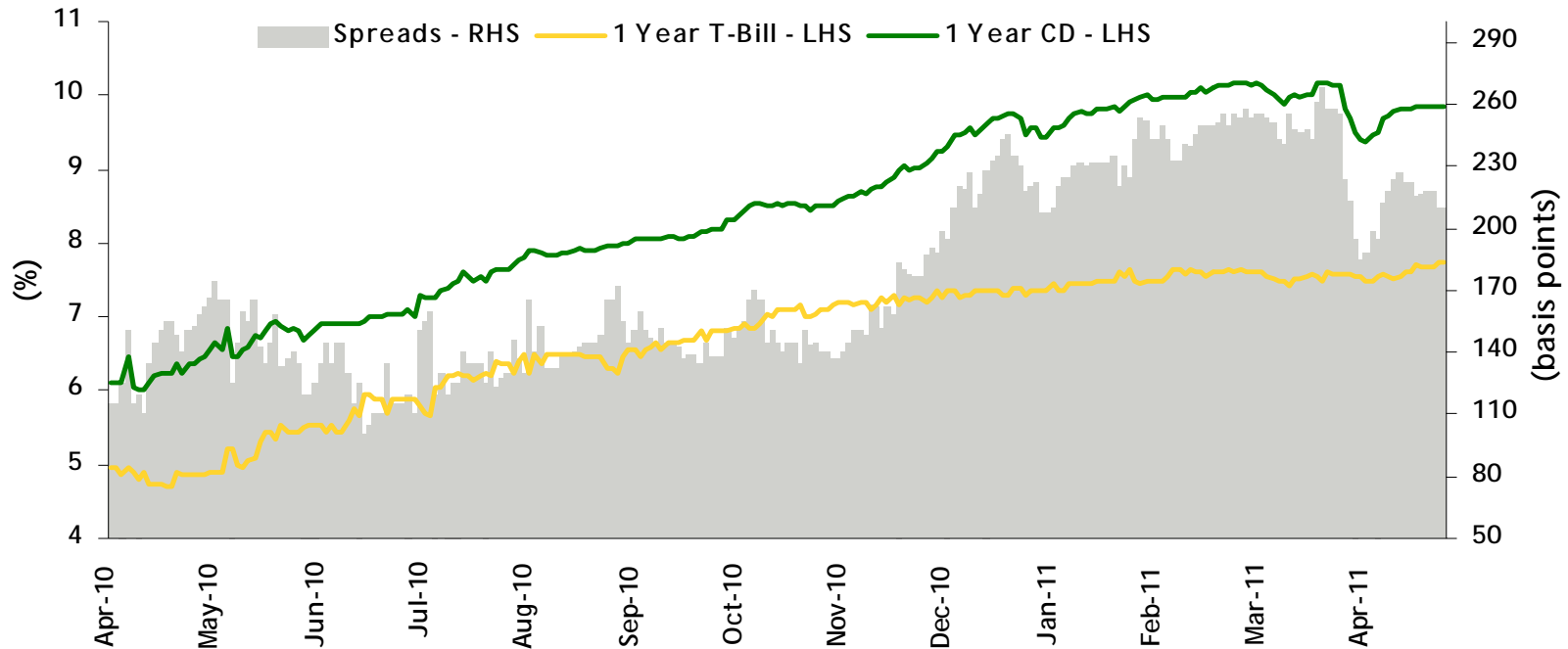
# Liquidity - remains tight



- The daily average borrowings by all the banks from RBI under LAF in the month of April'11 was around Rs.10,000 crore (Rs.82,000 crore previous month).
- The daily average MIBOR over the month of April'11 was flat at 6.78%
- The average daily borrowings by banks from RBI moved lower with improved GOI spending and draw down of surplus with RBI.

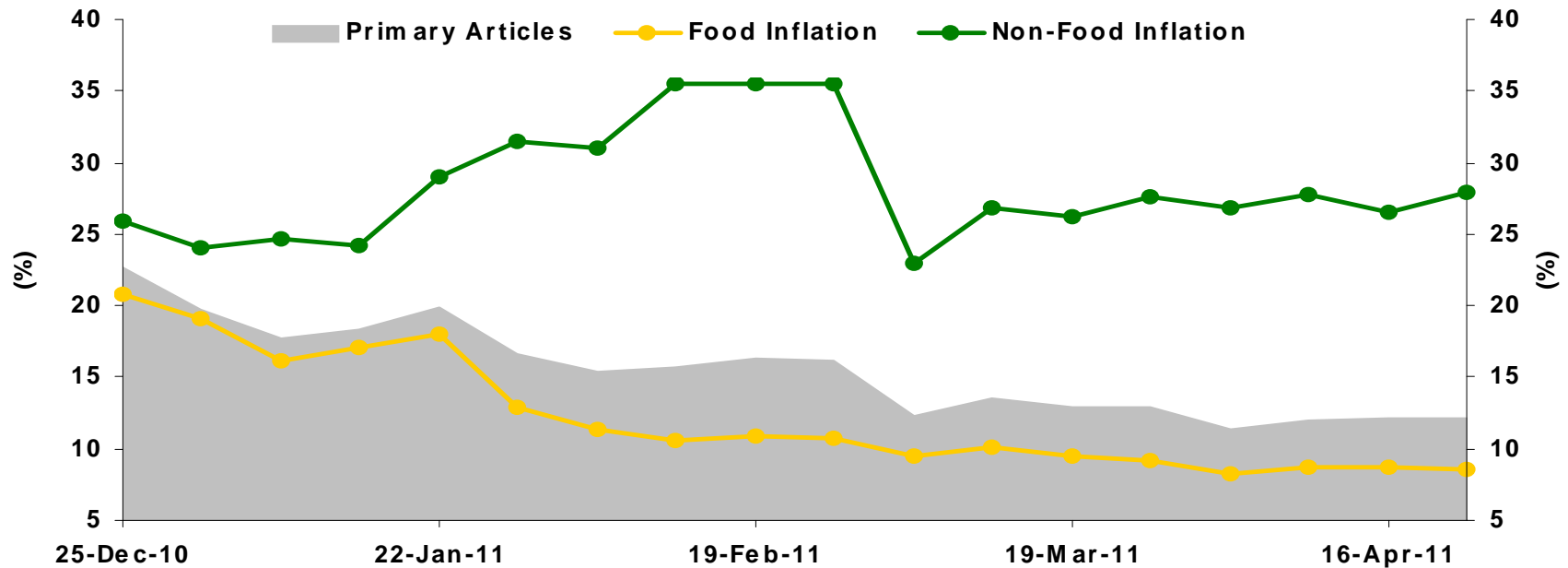


# Money Market - rates remain high amidst tight liquidity



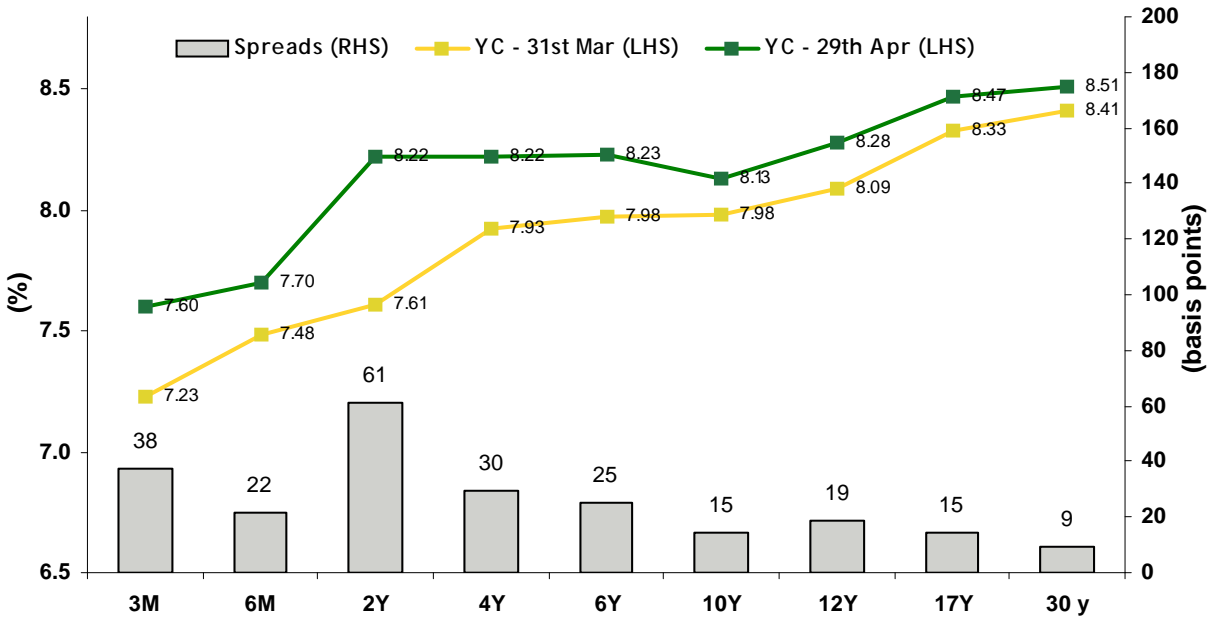
- The money market rates fell quickly in the first trading week of April'11. The 1 year CD yields fell by close to 80 bps before retracing by about 50bp over the rest of the month.
- The T-bill yields was largely stable over the month. Hence, the credit spreads of 1 year money market assets fell closer to 180bp before crossing 200bp once again.

# Inflation Dynamics - Food Inflation falling but Non-Food Inflation on the rise

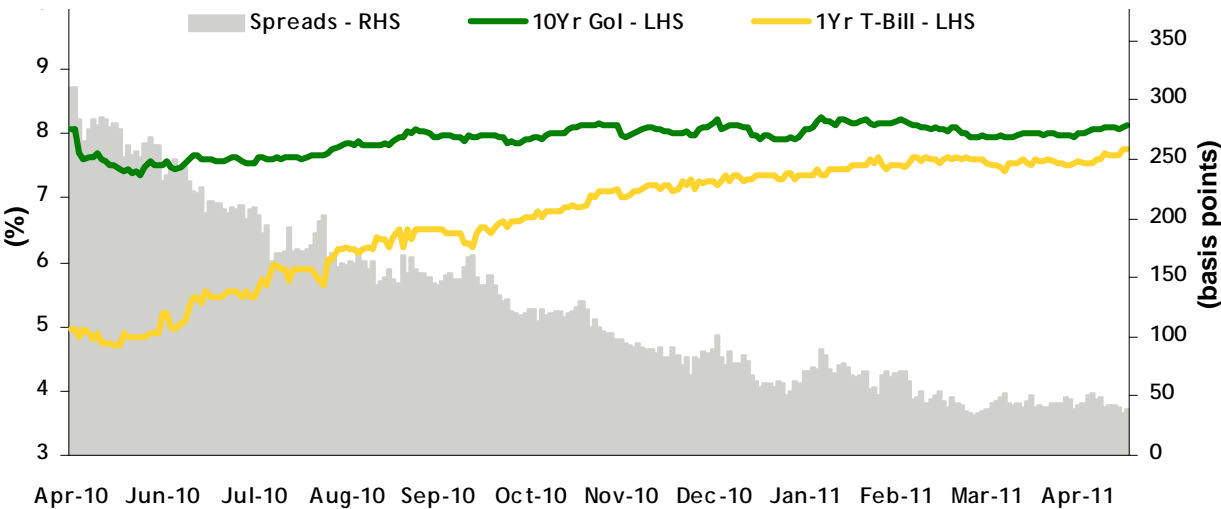


- India's Food Inflation which had risen sharply to a high in January has now eased considerably to 8.5% in the week to Apr 23, 2011 from a high of 20.8% in the week ending Dec 25, 2010. Prices of essential commodities like fruits and vegetables are well below the pre-crisis levels.
- However, the prices of Non-Food articles have become a threat to the overall WPI Inflation rate. Non-Food article Inflation was at 27.8% in the week to Apr 23, 2011.

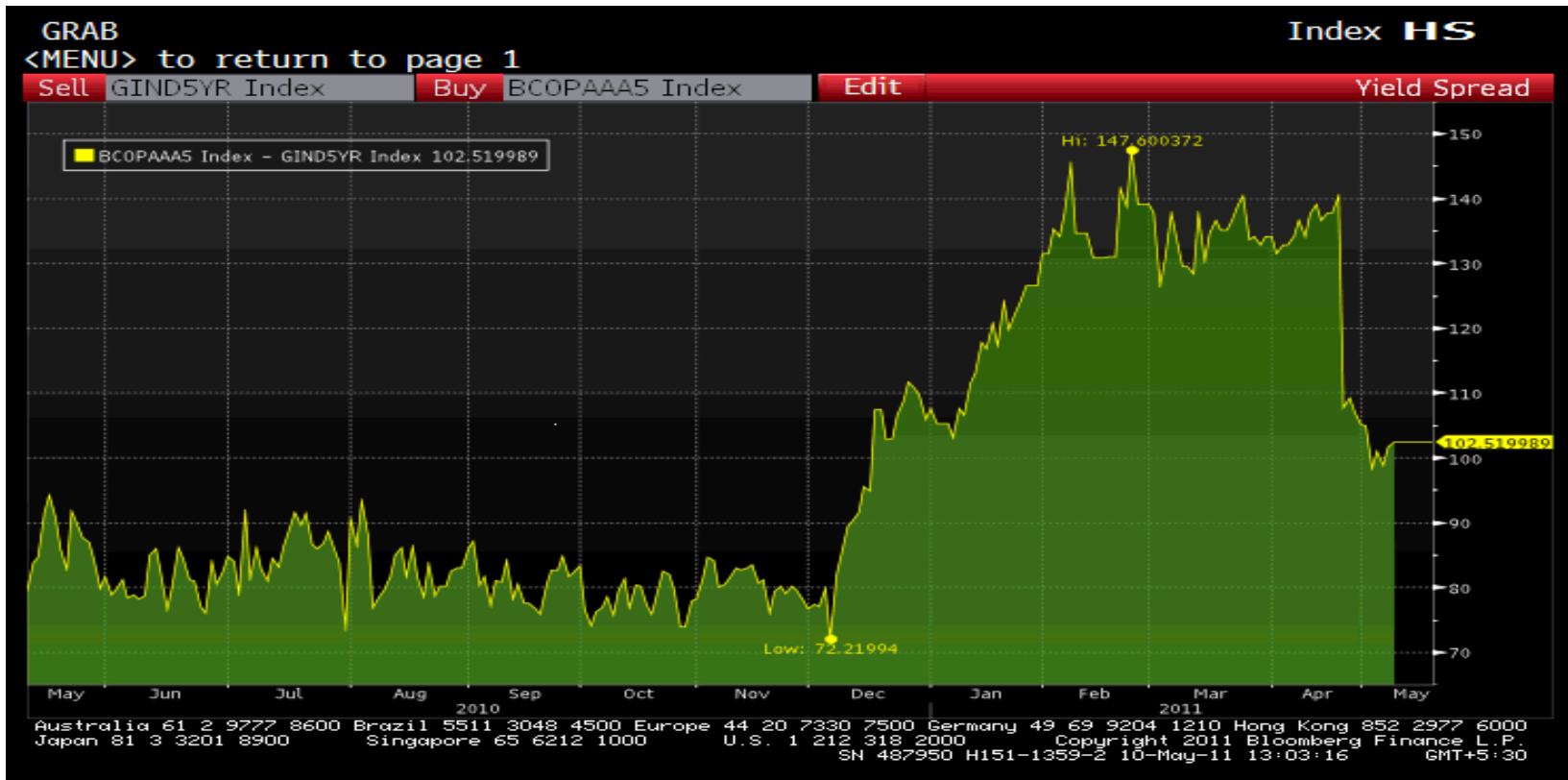
# G-Sec Yield Curve - Upward Shift



- The G-Sec yield curve shifted upwards in the month of April with yields on the shorter segment of the curve rising more than yields on the longer end.
- The yield on the 10yr benchmark rose 15 bps over the month of April'11 to 8.13%.
- In the latest T-Bill Auction on Apr 20, the 91-day T-bill was issued at 7.44% and the 364-day paper yielded 7.76%.
- Current 10yr vs.1yr GOI spread was at 40 basis points during April. The spread has averaged 150 bps during the last year.



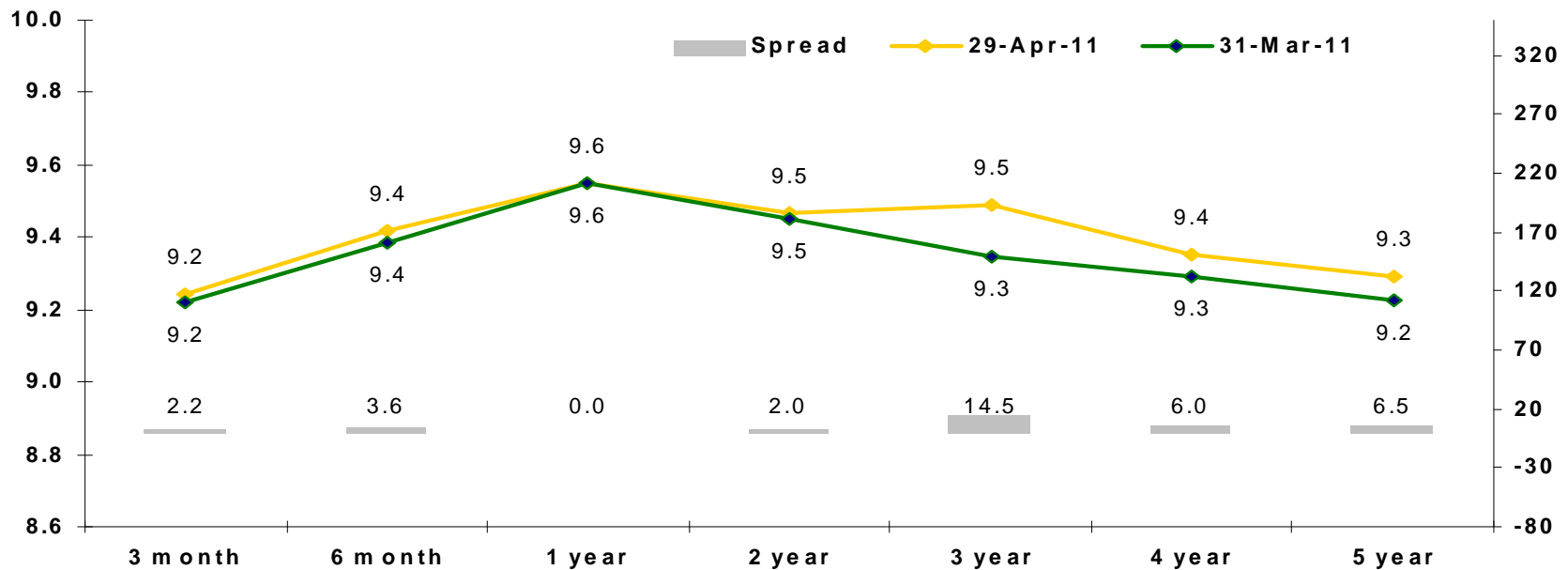
# Corporate Bonds spread - contracted



- The 5 year AAA spreads are currently at 102bp almost at the previous 1 year average of 102bp.



# Corporate Bond yield curve – flattening



Source: Bloomberg. Indian AAA Composite Curve.

- The 5 year AAA corporate bond credit spread over corresponding 5-year gilt widened by about 6 bp over the month of April'11.
- The 5 year AAA corporate bonds averaged 9.29% during the month of April 2011.

# Religare MF: Fixed Income Outlook and Opportunities

# Fixed Income Market Outlook

- RBI's hawkish stance on inflation and the 50bp rate hike will get adjusted in the yield movements over the month. The yields at the longer end is expected to move higher than the movement at the shorter end.
- As summarized in the earlier reports, the banks are expected to continue their attractive rates, and hence the credit deposit growth gap might narrow down over the next one quarter. The liquidity situation might stabilize at these narrower deficit levels.
- With a temporary improvement in liquidity standards the yield curve is expected to steepen out over time. However, the issuances from the banking sector is expected more in the 1 year segment.
- The temporary build up of liquidity might not last throughout the quarter. Moreover, it will be a function of both GOI auctions and expenditure. Any gap in their borrowing and lending schedule might quickly change the sentiment from positive to negative or vice-versa.
- The issuance of short dated cash management bills might keep in check any excessive build up of any liquidity.
- However, the elevated inflation situation, inflationary crude prices is expected to determine the shape of the yield curve over the next few quarters. RBI's anti-inflationary stance is expected to be hawkish amidst rising food and non-food articles and continue till the economic conditions change.

# Portfolio Actions during the month

- **Religare Liquid Fund**
  - High quality, very well diversified credit mix. 41 separate credit exposures
  - Maintaining a low duration portfolio in order to generate a market related return.
- **Religare Ultra Short Term Fund**
  - Managing a low duration in line with the current liquidity conditions and rising yields.
  - Very well diversified portfolio. 34 separate credit exposures
- **Religare Short Term Plan**
  - Continue to maintain a low duration with rising yield and hawkish RBI rate stance
- **Religare Credit Opportunities Fund**
  - A low duration of around 2.5 months so as to reduce interest rate risk and maintain a high accrual
- **Religare Active Income**
  - The portfolio has lowered duration to between 5-6 months. Post the rate hike of 50bp we have decided to run a duration of 5-6 months in order to capture the kink in the yield curve in the segment upto 1 year.

# Ideas for investors

- Post the rate hike of 50bp the yields of papers of 3-6 month maturity has moved higher by about 35-40bp. The steepness of the yield curve is clearly visible.
- Hence, investors are encouraged to select funds in line with their investment horizon.
- Investors with a horizon of 2-3 weeks can look to invest in the Religare Ultra Short Term Fund.
- The Religare Short Term Income Plan and Religare Credit Opportunities Fund offers attractive accrual with reduced interest rate risk.
- The Religare Medium Term Bond Fund offers higher current yield and a highly liquid portfolio. The present duration of around 11 months opens up opportunities of capital appreciation over a 3-6 month investment horizon for investors with moderate risk appetite.

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