

Fixed Income Markets : Current Environment and Outlook

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Macro Events

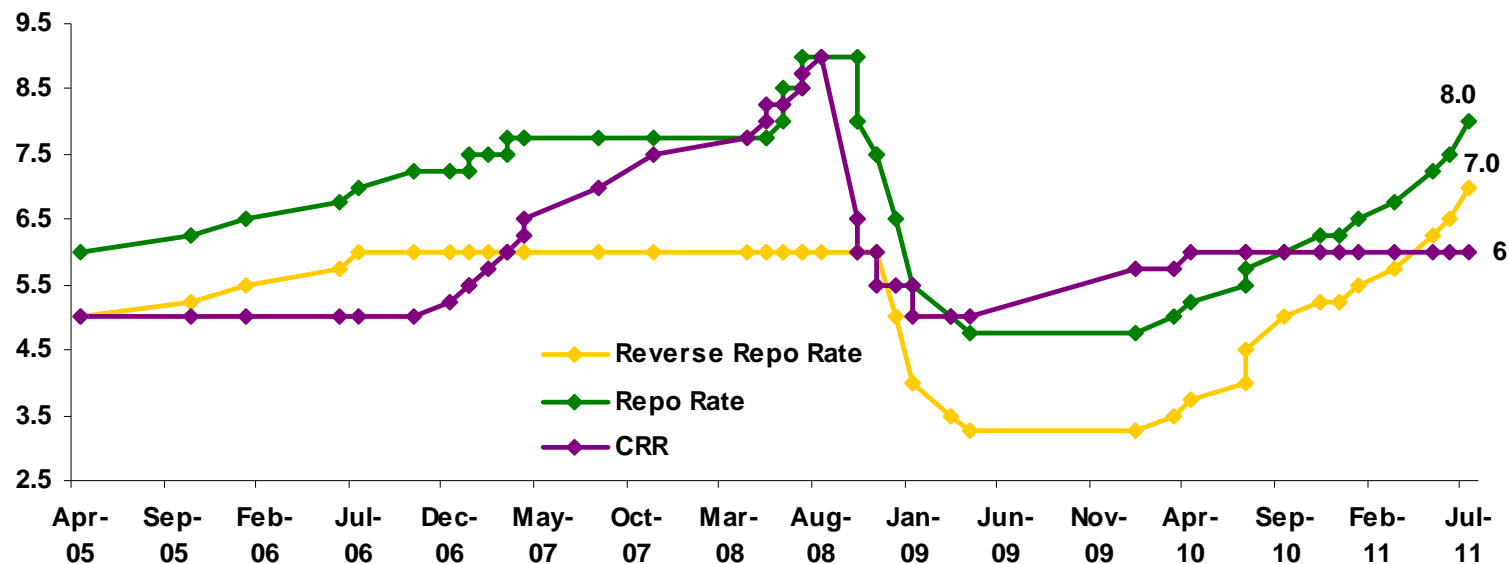
Domestic

- India's economic (GDP) growth slowed to the slowest pace in 6 quarters to a 7.7% (YoY) rate in Q1FY12, lower than a downward revised 8.8% rate in Q1FY11, boosted mainly by a strong performance by the services sector which grew at an impressive 10% (10.4% in Q1FY11). Agricultural sector showed an improvement, rising to a 3.9% growth rate (2.4% in Q1FY11) while the Industrial sector has slowed substantially, recording a growth rate of just 5.1% in Q1FY12 down from 9.1% in Q1FY11.
- The Index of Industrial production (IIP) growth rebounded to a 8.8% rate in June 2011 after having risen 5.9% YoY in the previous month (May 2011) and 7.5% in June 2010. The Manufacturing sector, which constitutes ~75% of the IIP, expanded impressively with a growth rate of 10% YoY in June 2011 from 6.1% in the previous month (May 2011).
- Headline WPI inflation rate moderated to 9.22% YoY in July 2011 from 9.44% in June 2011. WPI Inflation was at 9.98% during the corresponding month of the previous year (July 2010). The May 2011 WPI Inflation rate was revised higher to 9.56% YoY from a provisional 9.06% earlier. The revision was just 50 bps compared to a 108 bps in the previous month.

International

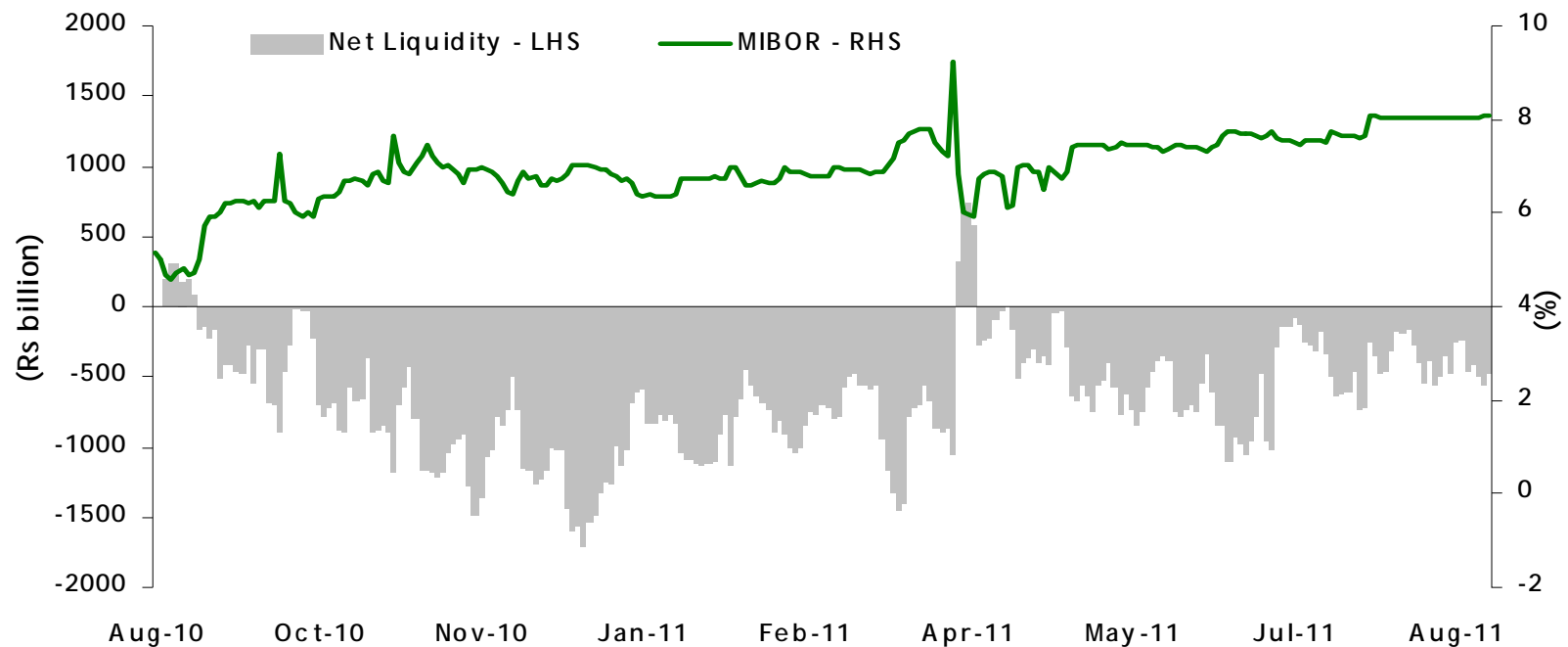
- Economic growth measured by GDP, has weakened considerably from the post-crisis rebound, in the US, UK and Euro zone. Also, recently revised figures have shown that the economic growth in the past was far lower than previously thought. Economic contraction during the slowdown was deeper and more prolonged while the growth during the rebound was weaker. The unemployment rate in the developed economies has failed to show any significant improvement.
- US GDP growth rate was revised lower to a low 1% (Ann/QuoQ) for Q2'2011 from a meager 0.4% (Ann/QuoQ) in the previous quarter (Q1'2011). GDP growth in the UK came in at a lower 0.2% (QoQ) rate in Q2' 2011 from a more positive 0.5% rate in the previous quarter (Q1' 2011).

RBI- has tightened rates



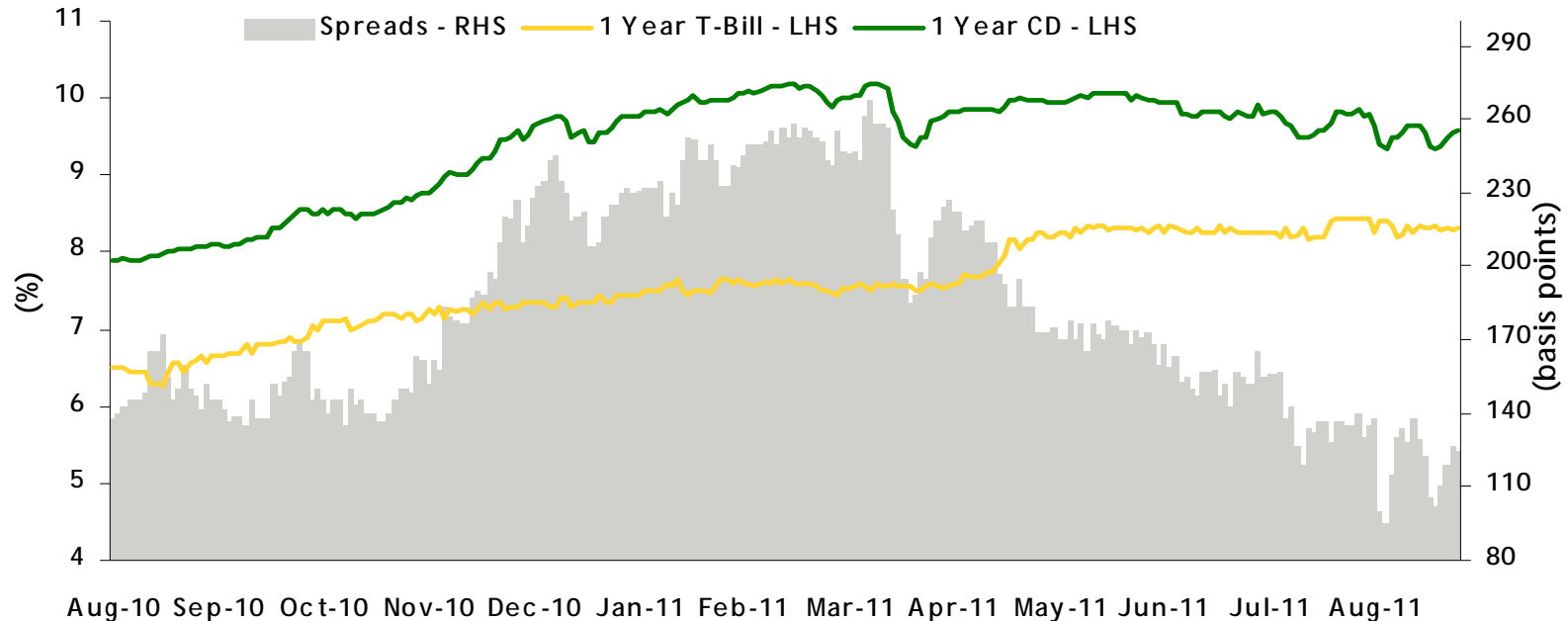
- In its last monetary policy review, the Reserve Bank of India (RBI) hiked the benchmark repo rate to 8.0%, while the Reverse Repo rate and the Marginal Standing Facility were automatically revised to 7.00% and 9.00%, respectively. The Bank Rate remains unchanged at 6%; Cash Reserve Ratio (CRR) remains unchanged at 6% of Net Demand and Time Liabilities (NDTL).
- The central bank has raised its key policy rate (repo rate) 11 times, totaling 325 basis points since March 2010.
- The next RBI monetary policy meeting is due on September 16, 2011.

Liquidity



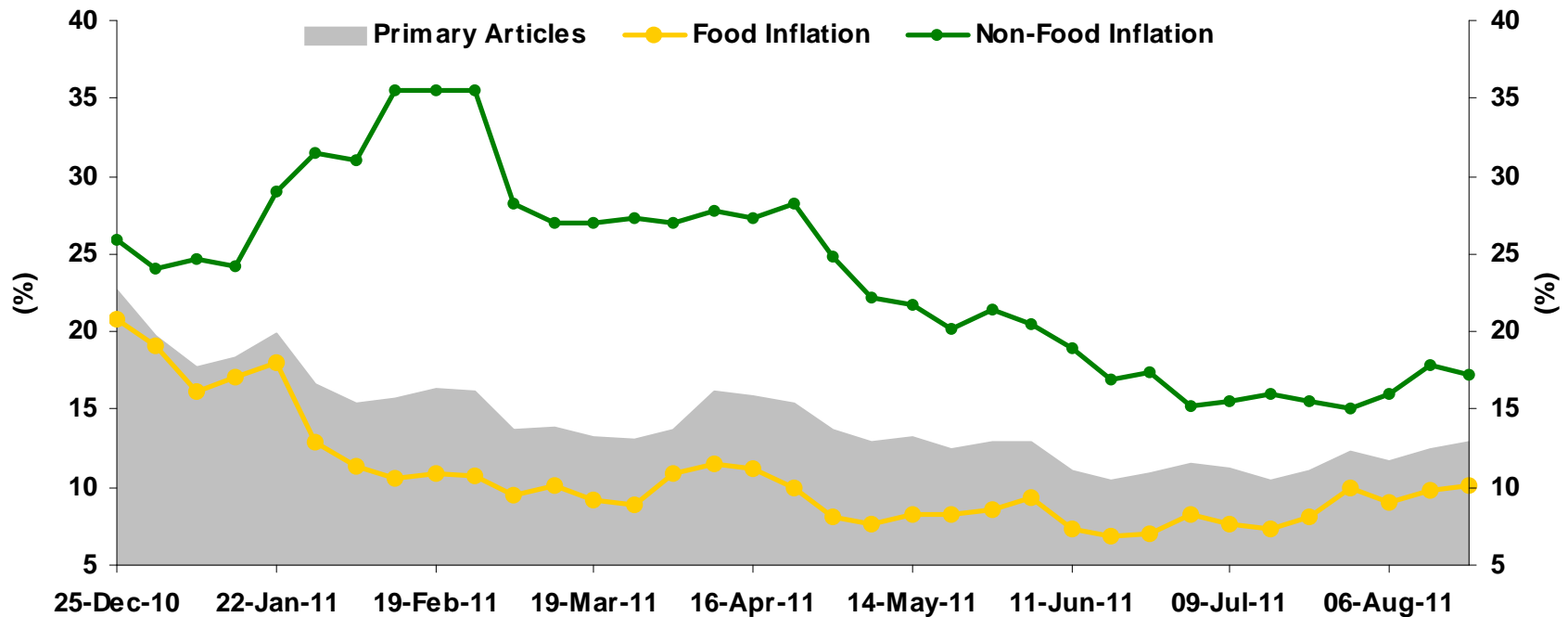
- The daily average borrowings by all the banks from RBI under LAF in the month of August'11 was around Rs.38,000 crore (Rs.38,000 crore previous month).
- The daily average MIBOR over the month of Aug.'11 was at 8.04% (7.66% previous month).

Money Market



- The money market rates softened over the month of Aug'11. The yields of money market papers from 3m till 12 months moved lower over the month. However, the shift was not parallel.
- The yields of T-Bills were flat over the month.

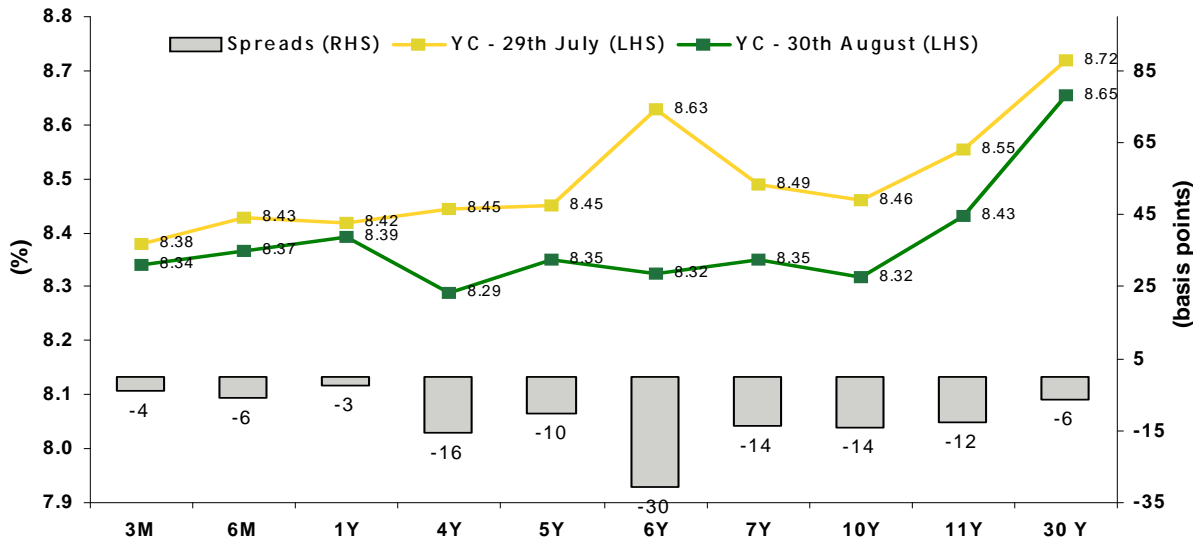
Inflation Dynamics - Primary articles inflation seen rising again



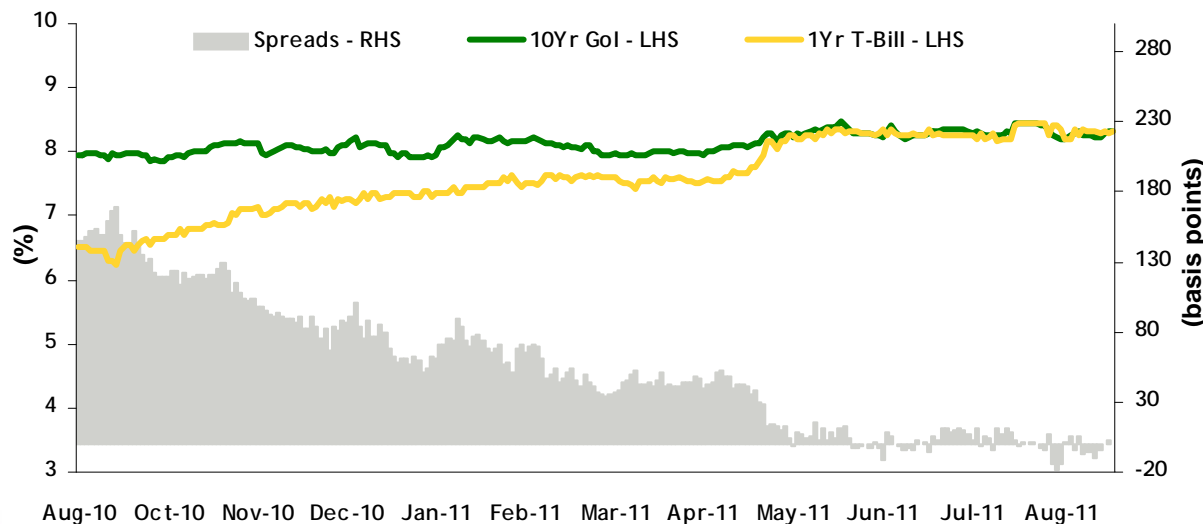
- India's Food Inflation which has seen a substantial correction this year, rose to 10.05% for the week ending August 20, 2011. It had been as high as 20.8% on December 25, 2010 and then fell to a low of just 6.9% on June 18, 2011. Non-Food articles Inflation, which had been disturbingly high in the first quarter of 2011 has softened substantially. Non-Food article Inflation rose to 17.2% for the week ended August 20, 2011 from a low of 15.1% on July 30, 2011. It had been as high as 35.5% on Feb 26, 2011.
- The differential in the rate of Inflation between Non-food articles and food articles has fallen to as low as 7.1% during the week ended August 20, 2011 from as high as 24.9% in the week ended February 12, 2011.



G-Sec Yield Curve - downward shift



- The G-Sec yield curve shifted lower in the month of August, with yields falling across all the segments.
- The yield on the 10yr benchmark fell 14 bps over the month of August to 8.32% from 8.46% at the end of July.
- In the latest T-Bill Auction held on August 24, 2011 the 91-day T-bill was issued at 8.35% and the 364-day paper yielded 8.31%.
- The 10yr vs.1yr GOI spread was negative in the month of August. The spread has averaged around 60 bps during the last year.



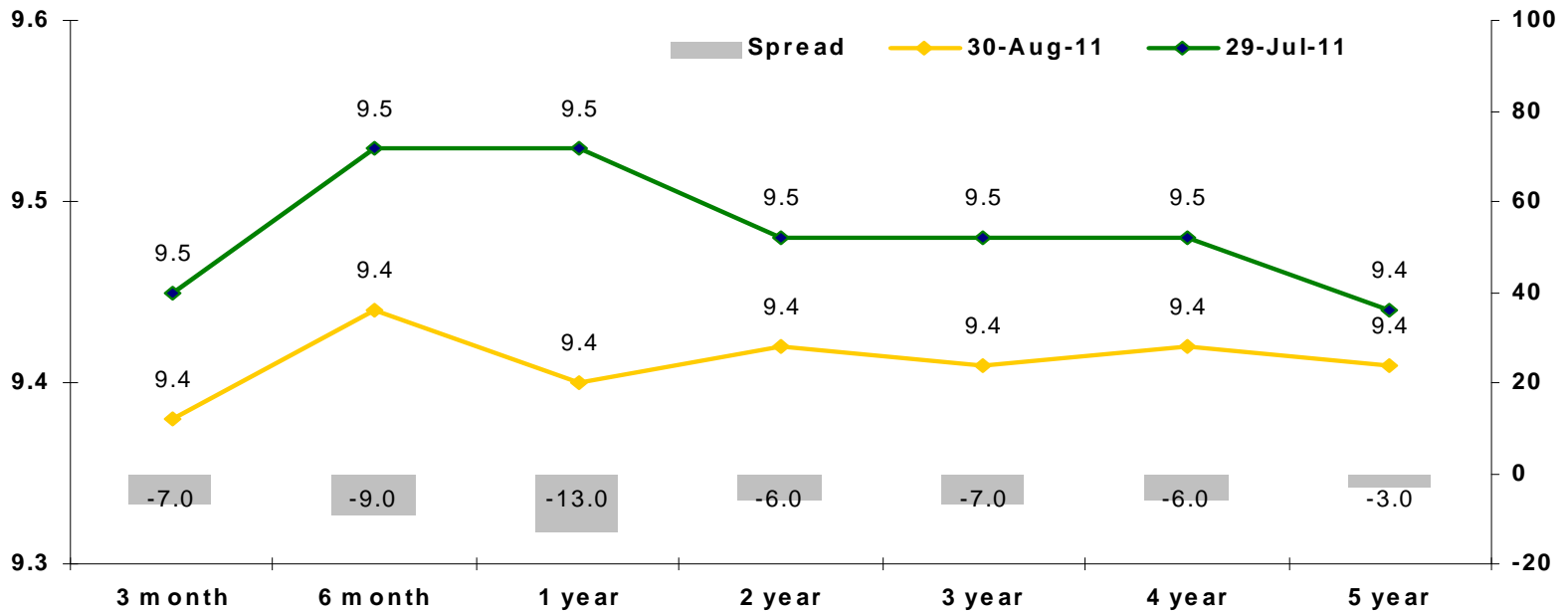
Corporate Bonds spread - stable



- The 5 year AAA spreads are currently at 110bp. Almost unchanged over the previous 1 month.



Corporate Bond yield curve – downward shift



Source: Bloomberg. Indian AAA Composite Curve.

- The AAA corporate bond yield curve shifted downwards in the month of August 2011.
- The shift is not parallel.
- The credit curve has become more steeper now.

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- The liquidity situation in the month of Sept'11 will be watched as corporate make room to pay for the second tranche of advance tax.
- The deficit liquidity situation is expected to worsen from the present levels once again temporarily before improving by the month end with increased government expenditure.
- 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.
- Our outlook for liquidity, rates and inflation remain mixed. We feel the elevated inflation levels to continue well over the next 2 months and a pause from RBI post an expected 25bp rate hike on 16th Sept.'11.
- It appears that the whole economy is getting re-adjusted to a new 'normal' inflation in an environment of higher food prices, and higher real wages.

Portfolio Actions during the month

- **Religare Liquid Fund**
 - The fund has continued to maintain a low duration, Liquid well diversified portfolio.
- **Religare Ultra Short Term Fund**
 - The fund has also maintained a lower duration well diversified portfolio.
- **Religare Short Term Plan**
 - The fund has increased duration to over 6 months over the month, by aligning in high liquid, high credit 3 year corporate bonds.
- **Religare Credit Opportunities Fund**
 - The fund has been successfully been investing in mispriced credits with low interest rate risk.
- **Religare Active Income**
 - The fund has maintained a duration below 1 year, and invested in a mix of low duration money market assets and short maturity debentures.

Ideas for investors

- In an environment of stiff inflation and deficit liquidity, investors are encouraged to select funds in line with their investment horizon.
- The **Religare Credit Opportunities Fund** offers attractive opportunity for investors with short investment horizons of 1-3 months and moderate level of credit risk appetite. The fund is ideally positioned to capture mis-priced risk in an environment of deficit liquidity and varying credit spreads of short maturity papers.
- The **Religare Short Term Plan** offers attractive accrual with reduced interest rate risk. Ideal for investors with 2-4 months investment horizon. The fund intends to extend duration to beyond 12 months around the next credit policy review.
- The **Religare Medium Term Bond Fund** offers higher current yield and moderate interest rate risk. The present duration of between 8-9 months opens up opportunities of capital appreciation over a 3-6 month investment horizon for investors with moderate risk appetite.
- The **Religare Active Income Fund** The portfolio intends to run a duration between 5-8 months. It opens up opportunities of capital appreciation in an environment of yield curve steepening and active duration management. It is intended for investors with moderate risk appetite.

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