

Fixed Income Markets : Current Environment and Outlook

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Macro Events

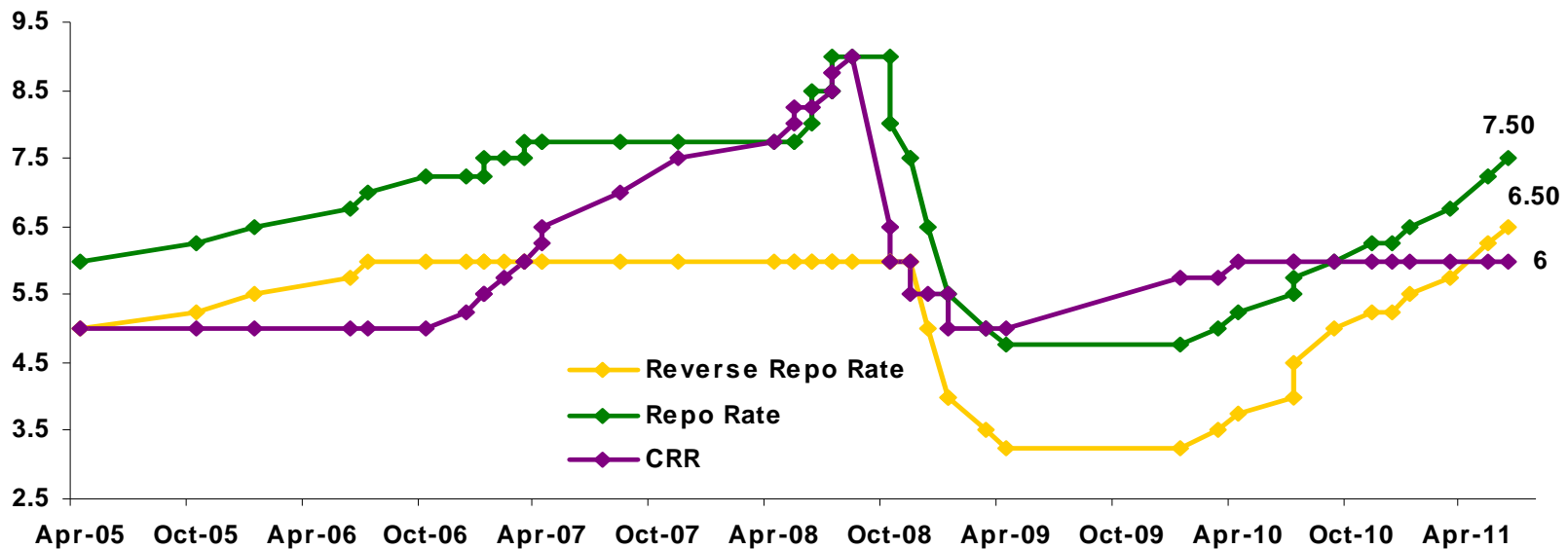
Domestic

- In the Mid-Quarter Monetary Policy Review on June 16, 2011, RBI raised the repo rate -the key policy rate, and reverse repo rate by 25bps each to 7.50% and 6.50% respectively
- India's economic (GDP) growth slowed to 7.8% (YoY) rate in Q4FY11 (9.3% in Q1FY11, 8.9% in Q2FY11, 8.3% in Q3FY11), boosted by a considerable 7.5% growth in the agricultural sector. GDP growth for FY11 was revised to 8.5% (YoY) lower than the 8.6% growth rate that had been released in the advanced estimate
- Industrial production (IIP) growth rebounded to 6.3% in Apr'11 having risen a strong 8.8% YoY in the previous month (Mar'11). The cumulative growth for the financial year April-March, 2010-11 was at 8.2% over the corresponding period of the previous year
- Headline WPI inflation rate came at 9.06% YoY for the month of May' 2011 as compared to 8.66% for the previous month (Apr'11) and 10.5% during the corresponding month of the previous year (May'10). The Mar'11 inflation rate was revised up to 9.68% YoY from a provisional 9.04% earlier

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 1.9% 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 up from a negative 0.5% QoQ in Q4'10

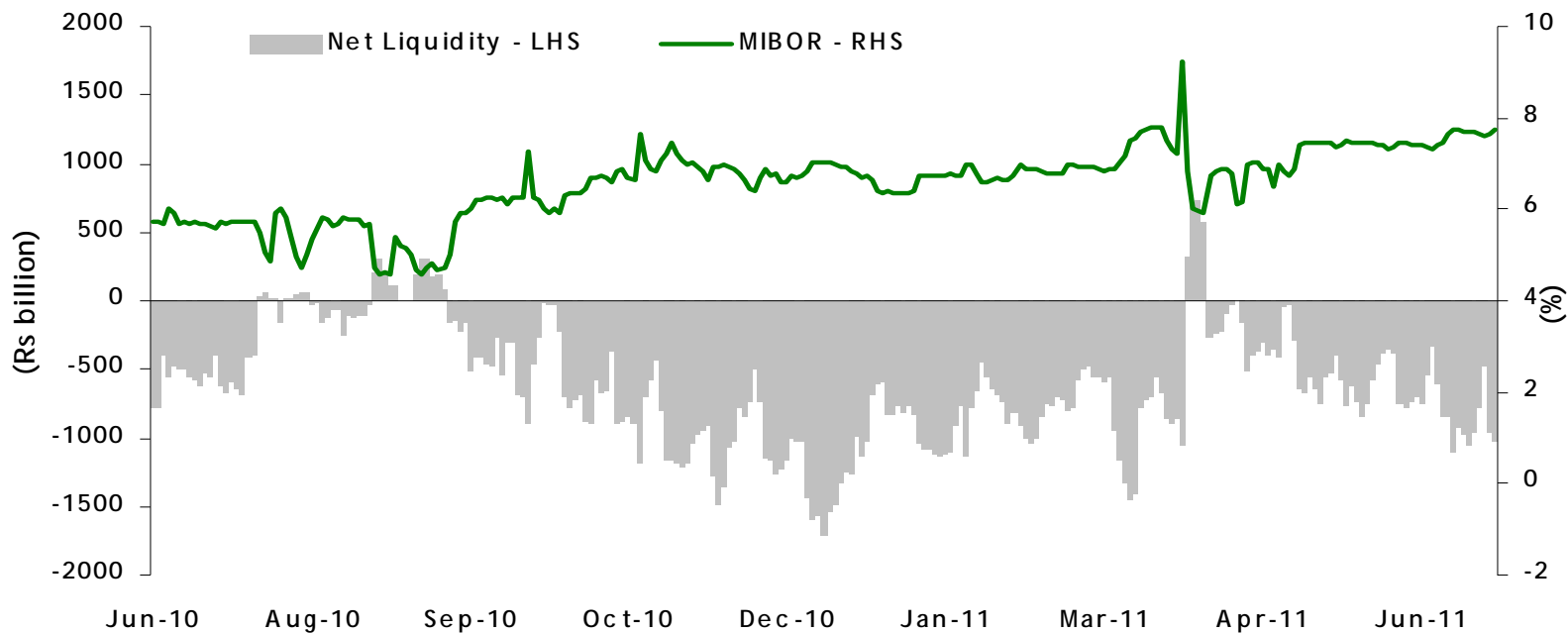
RBI continues tightening rates in it's Monetary Policy



- In its Mid-Quarter Monetary Policy review on June 16, 2011. The Reserve Bank of India (RBI) hiked the repo rate by 25 bps and the reverse repo rate by 25 bps.
- With this hike, the central bank has raised its key policy rate ten times in the past 17 months.
- The Reverse repo rate and Marginal standing facility (MSF) rate are now automatically set at 6.50 per cent and 8.50 per cent, respectively.



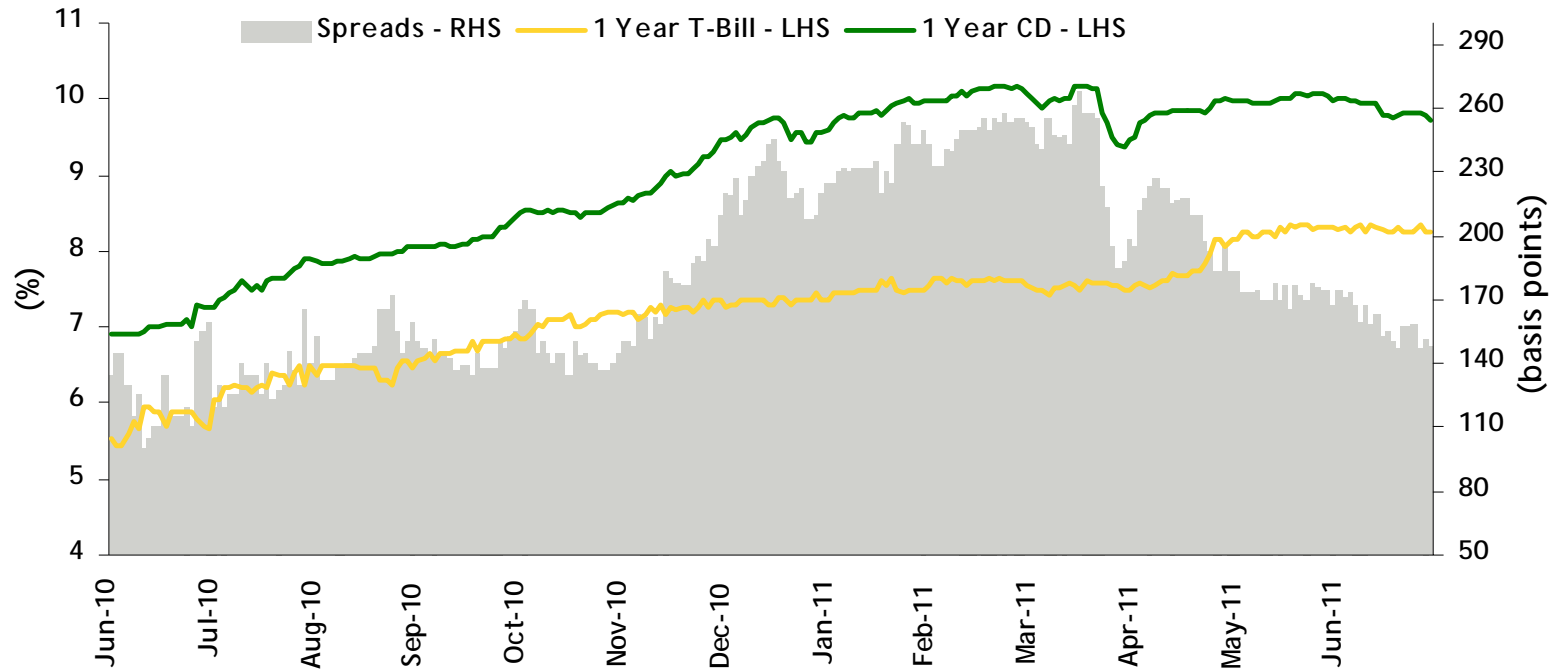
Liquidity - remains tight



- The daily average borrowings by all the banks from RBI under LAF in the month of June'11 was around Rs.75,700 crore (Rs.53,000 crore previous month)
- The daily average MIBOR over the month of June'11 was at 7.53% (7.29% previous month)
- The average daily borrowings by banks from RBI moved higher compared to June'11

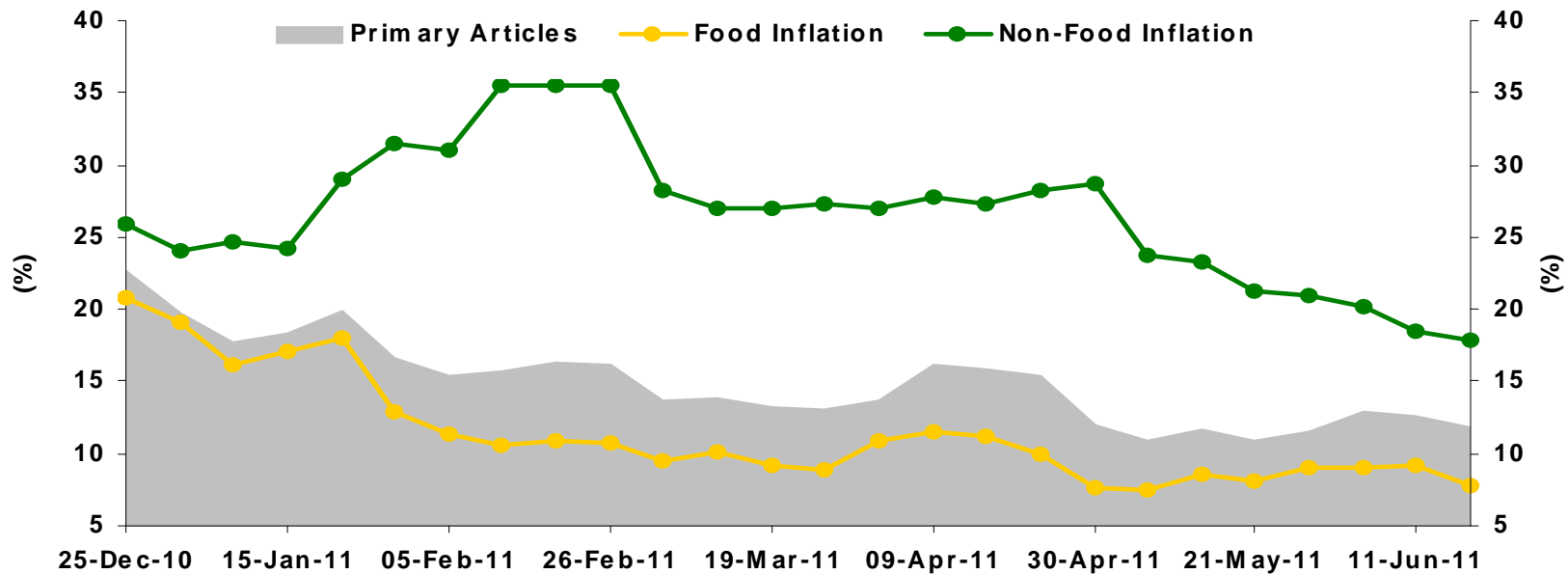


Money Market - rates remain high amidst tight liquidity



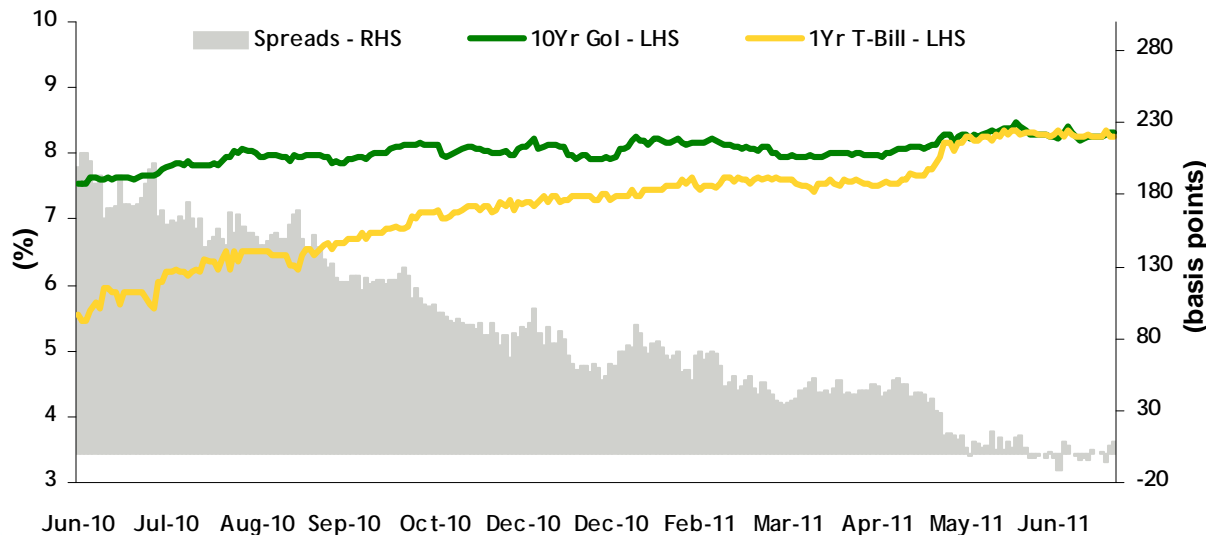
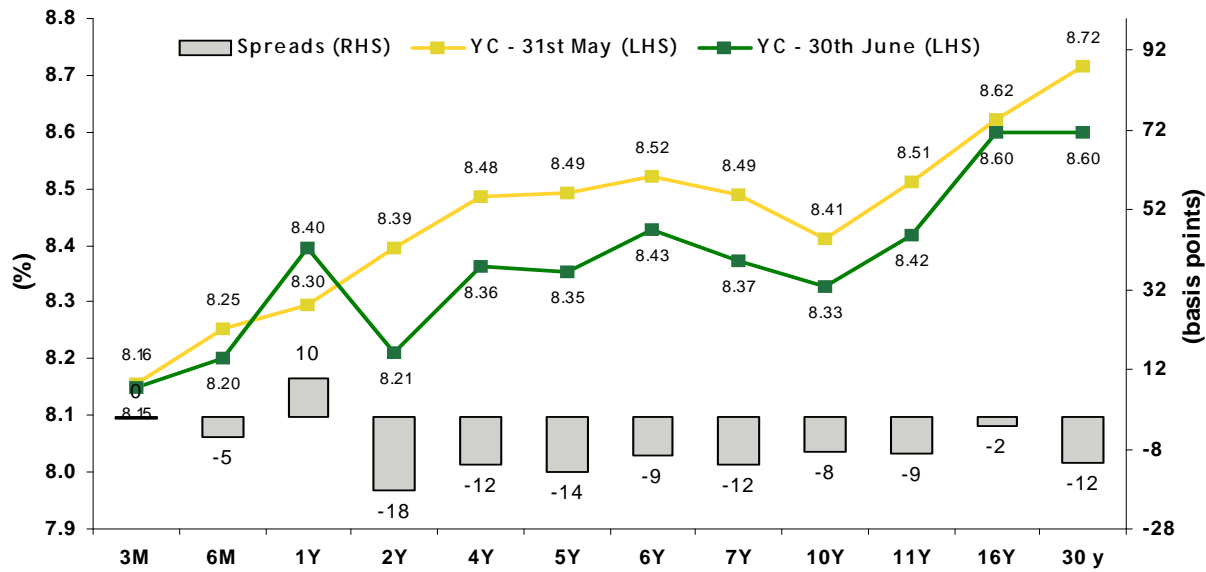
- The money market rates softened over the month of June'11. Although, RBI raised repo rate by 25bp, 3m CD yields dropped by about 140bp over the month. The 1 year CD yields also moved lower by about 30-35bp
- However, the T-bill yields remained flat over the month of June'11

Inflation Dynamics - Non-Food Inflation too starts to ease



- India's Food Inflation which had risen sharply, remained subdued at 7.8% in the week ending Jun 18, 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.
- Non-Food articles Inflation, which had been stubbornly high for the last few months, reversed its uptrend and continued to fall for the second consecutive month in June. Non-Food article Inflation fell further to 17.9% for the week ended Jun 18, 2011. It had been as high as 35.5% on Feb 26, 2011

G-Sec Yield Curve - shifted lower



- The G-Sec yield curve shifted lower in the month of June, with yields on the medium to longer segment of the curve falling significantly
- The yield on the 10yr benchmark fell 8 bps over the month of June'11 to 8.33%
- In the latest T-Bill Auction on Jun 29, 2011 the 91-day T-bill was issued at 8.19% and the 364-day paper yielded 8.29%
- Current 10yr vs.1yr GOI spread fell further and even turned negative in the month of June. The spread has averaged 100 bps during the last year



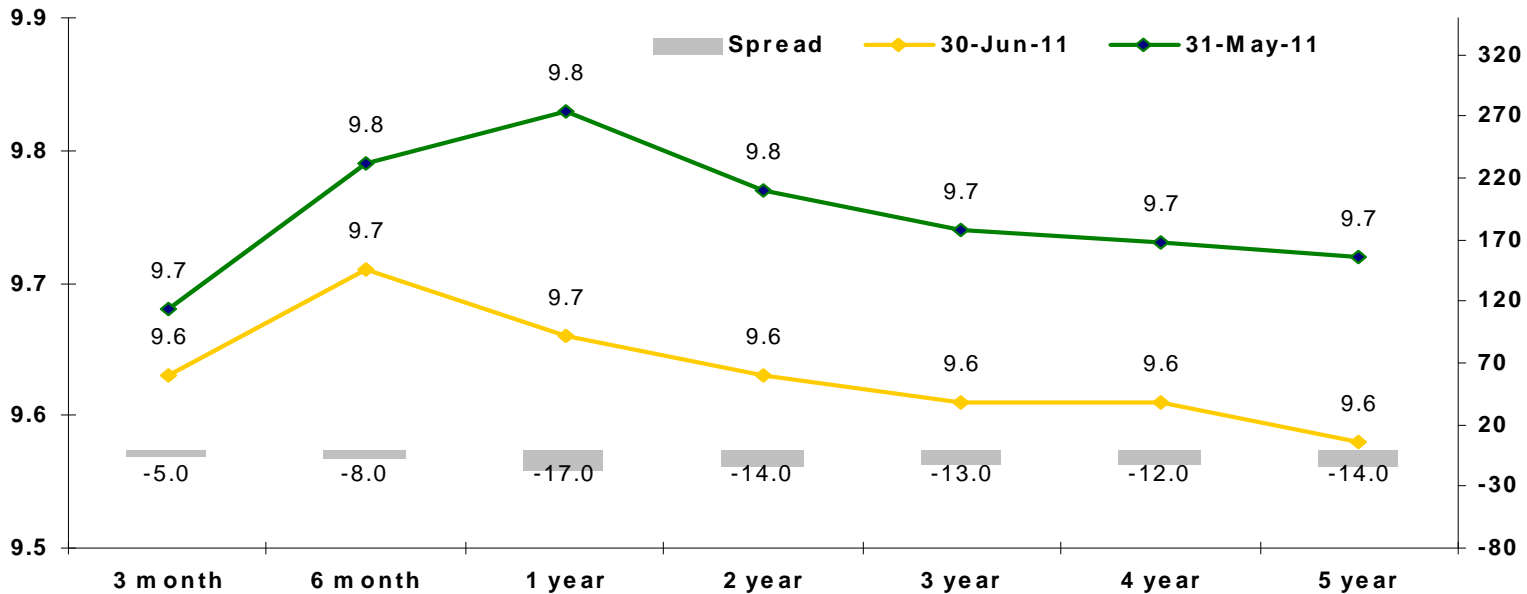
Corporate Bonds spread - Contracted



- The 5 year AAA spreads are currently at 117bp. About 13bp higher than the previous 1 year average of 104bp



Corporate Bond yield curve – downward shift



Source: Bloomberg. Indian AAA Composite Curve.

- The 5 year AAA corporate bond yield curve moved southwards over the month of June'11. The yields softened by over 10bp
- The 5 year AAA corporate bonds averaged 9.6% during the month of June 2011

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- The liquidity situation in the current quarter, RBI's monetary policy on 26th July'11 and inflation targeting and on going policy actions will determine the yield movement over the quarter.
- The banks are expected to continue their attractive rates and hence the credit deposit growth gap might narrow down over the months.
- In addition as the banking sector hikes their deposit rates, deposit mobilization is expected to continue to improve over the months.
- However, the deteriorating inflation situation within food and non-food category is expected to temporarily improve over the months.
- With a temporary improvement in liquidity standards the yield curve is expected to steepen out over time. However, the issuances from the banking sector might continue well over the month and is largely expected in the 1 year segment.
- 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.
- The bigger change could be in the shape of the yield curve. The steepness of the curve is expected to get further accentuated over the month/quarter as liquidity conditions are improving.

Portfolio Actions during the month

- **Religare Liquid Fund**
 - The portfolio continued to maintain a low duration, well diversified portfolio
- **Religare Ultra Short Term Fund**
 - The portfolio continued to maintain a low duration, well diversified portfolio
- **Religare Short Term Plan**
 - The portfolio is maintaining a duration upto 3 months.
- **Religare Credit Opportunities Fund**
 - The portfolio is maintaining fully invested position and a duration upto 3 months.
- **Religare Active Income**
 - The portfolio has been able to capture the changing shape of the yield curve as the yield curve turned steeper. The fund has maintained a average portfolio duration between 4-6 months.

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 Income Plan*** offers attractive accrual with reduced interest rate risk.
- 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*** is currently positioned between the Short Term Plan and the Medium Term Bond 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 with moderate risk appetite.

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