

Fixed Income Markets : Current Environment and Outlook

Sujoy Das, Head of Fixed Income
March 2011

Macro Events

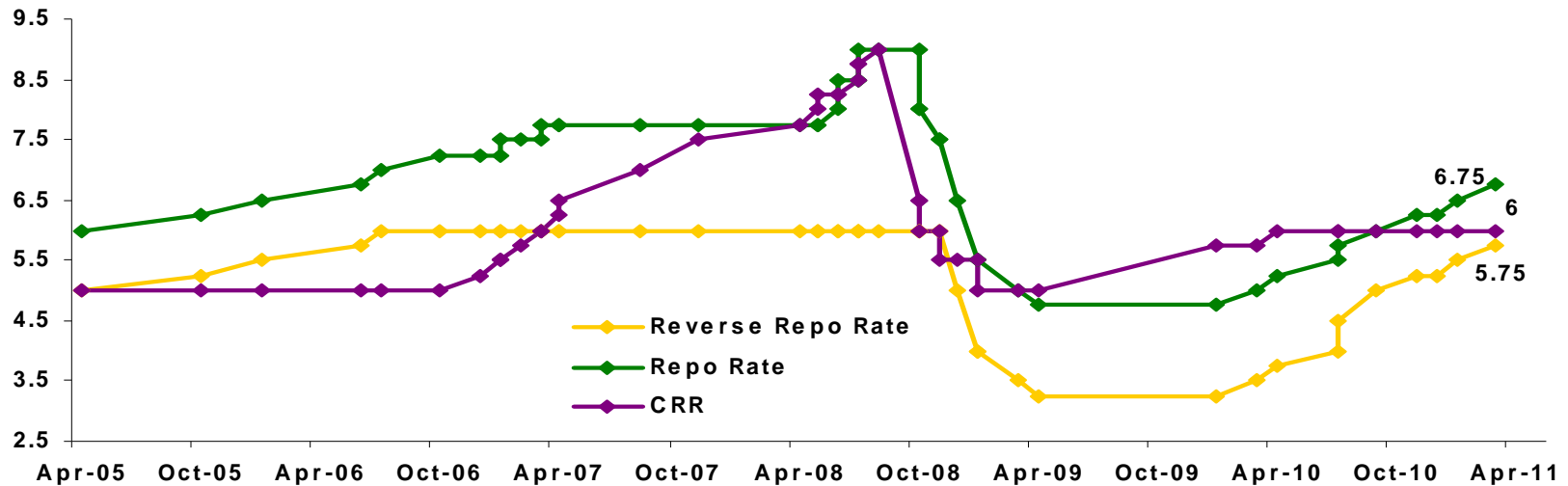
Domestic

- In line with expectations, the RBI raised both repo (liquidity injection rate) and reverse repo (absorption rate) rates by 25bps each while raising its forecast for March-end WPI Inflation to 8%.
- 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) rose marginally to 3.7% in Jan'11 after having fallen to a low of 2.5% YoY in Dec'10. The cumulative growth for the period April- January, 2010-11 stands at 8.3% over the corresponding period of the previous year.
- India's (Core) Infrastructure sector output rose to 6.8% in Feb'11 YoY, from 7.2% in Jan'11. The six core industries — crude oil, petroleum refinery products, coal, electricity, cement and finished steel — had grown by 4.2% in Feb'10. Output in the Steel and Crude Sectors remained strong, the cement sector saw a rebound while growth in the coal sector weakened further.
- Inflation, as measured by the WPI Index, rose above expectations to 8.3% YoY in Feb'11, after having risen to 8.2% in Jan'11. Food prices continued to fall while the rise in prices of Non-Food items has now become a concern.

International

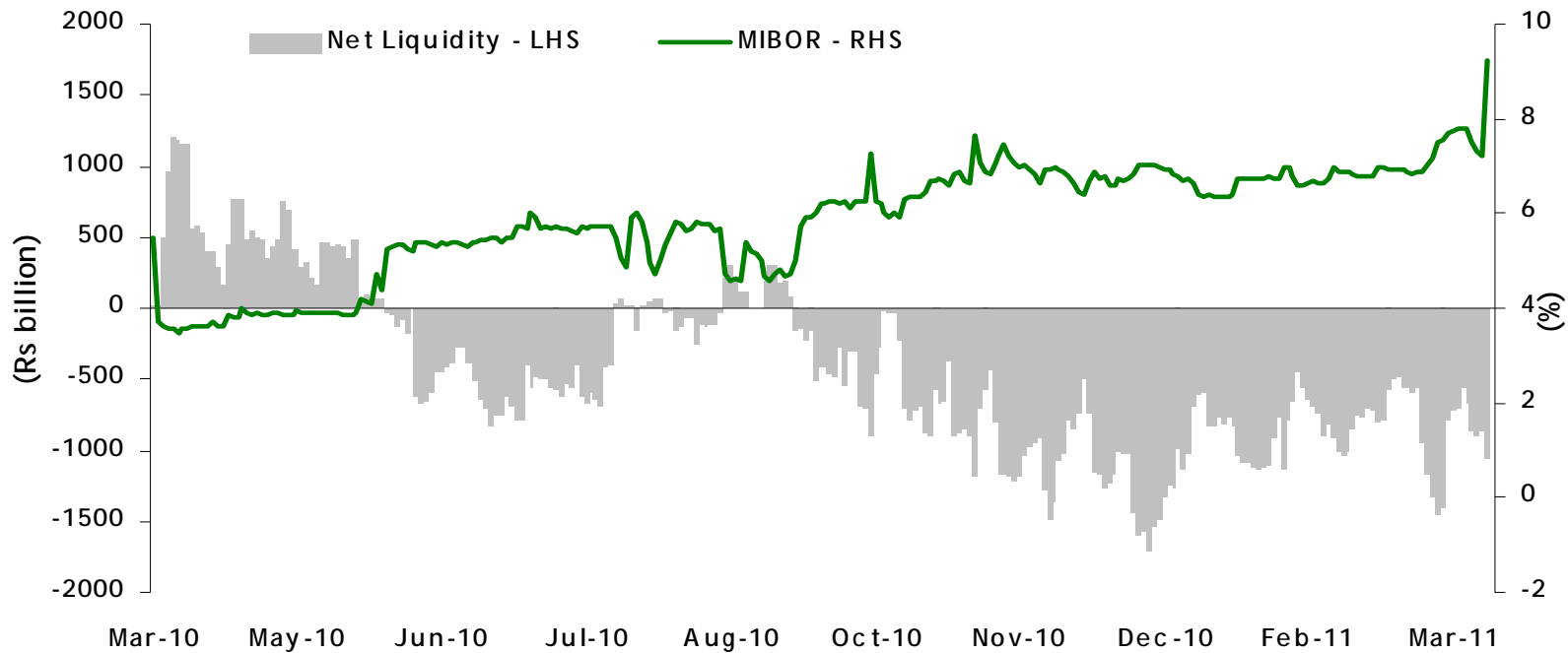
- Economic growth measured by GDP, continued its steady rise in the US, UK and Euro zone . The unemployment rate in the developed economies, continues to improve slowly.
- US GDP growth rate was revised higher to 3.1% QoQ in Q4'10 from 2.8% reported last month. GDP in the UK fell into negative territory for the first time since the 2001 recession, owing to adverse weather conditions. Growth for Q4'10 was upwardly revised to a negative 0.5% QoQ lower than a 0.7% rise witnessed in the previous quarter (Q3'10).

RBI Credit Policy – Mid Quarter Review (Highlights)



- Repo rate under the liquidity adjustment facility (LAF) hiked by 25 basis points, The rate now stands at 6.75 per cent from 6.50 per cent earlier. Hike in Reverse Repo rate too by 25 basis points from 5.50 per cent to 5.75 per cent.
- Cash Reserve Ratio (CRR) has been retained at 6.0 per cent.
- Baseline projection for WPI inflation for March 2011 is revised upwards to 8.00 percent from 7 per cent.

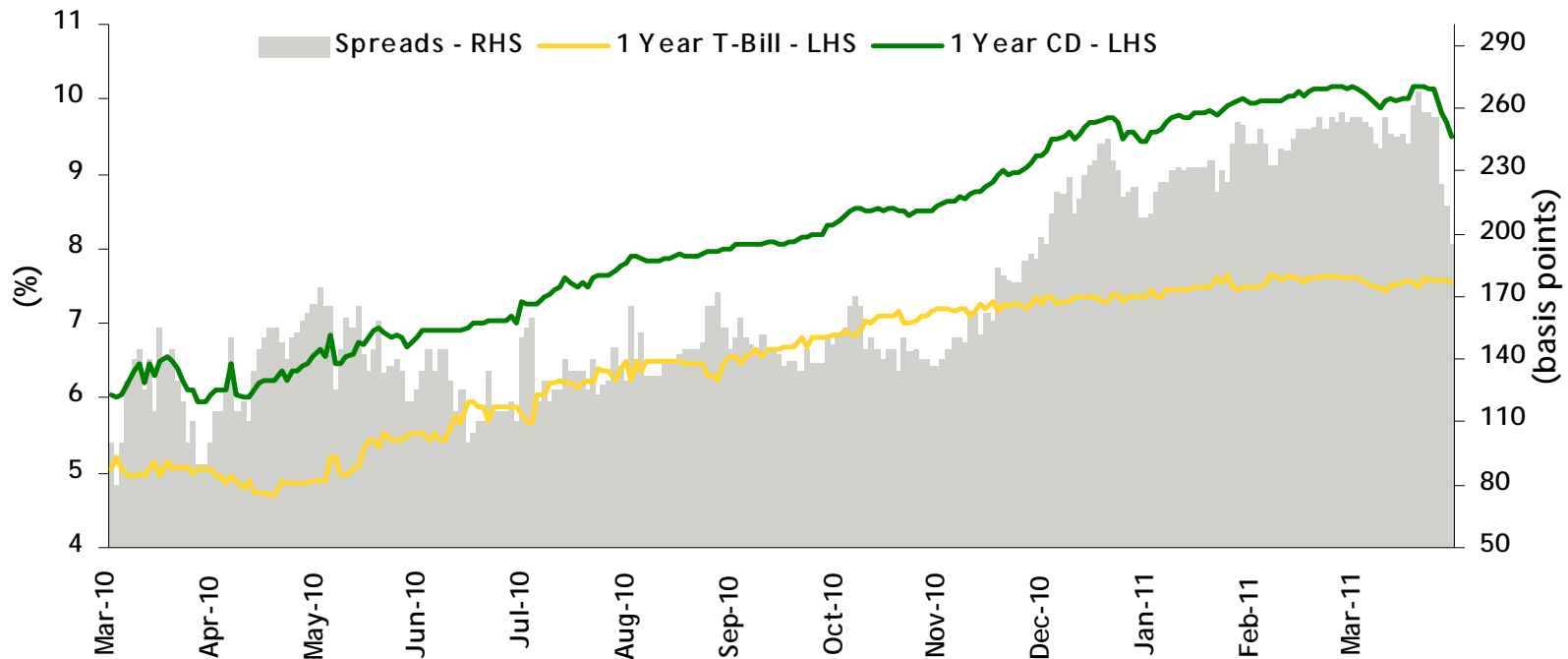
Liquidity - remains tight



- The daily average borrowings by all the banks from RBI under LAF in the month of March'11 was around Rs 82,000 crore (Rs 78,000 crore previous month).
- The daily average MIBOR over the month of March'11 rose to 7.34% from 6.78% previous month.
- Both the MIBOR rates and the average daily borrowings by banks from RBI moved higher from the previous month



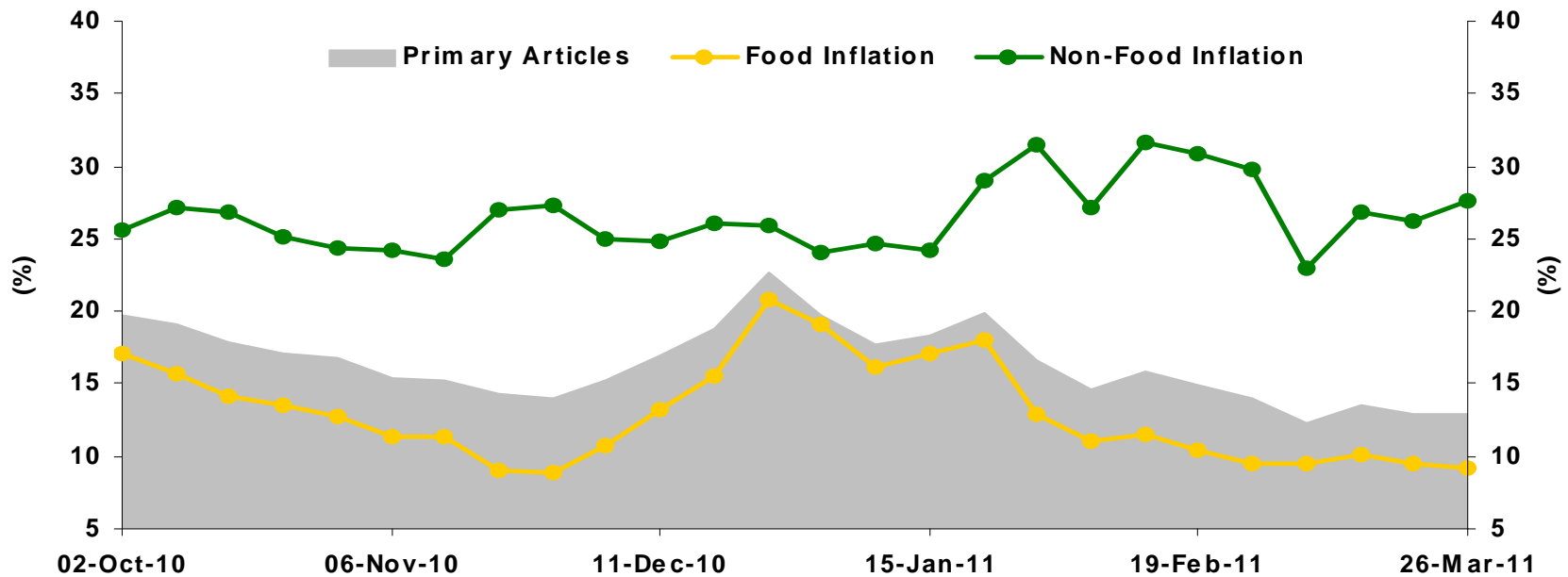
Money Market - rates remain high amidst tight liquidity



- The money market rates were flat in the first half of March 2011, before falling off by close to 50 bps before month end.
- The credit spreads of very short papers moved close to 300bp before ending closer to 225bp.

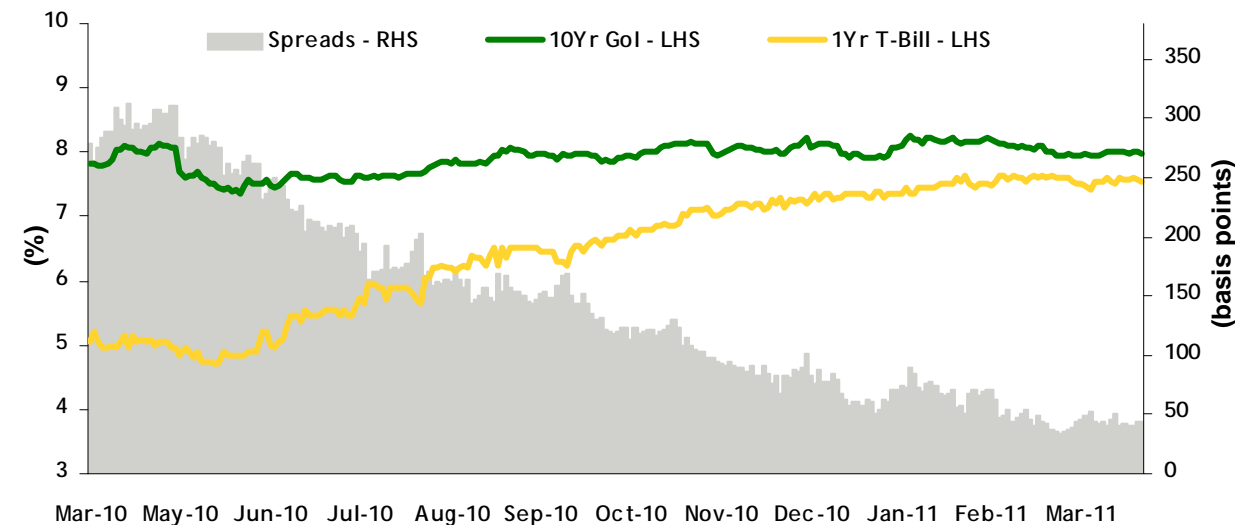
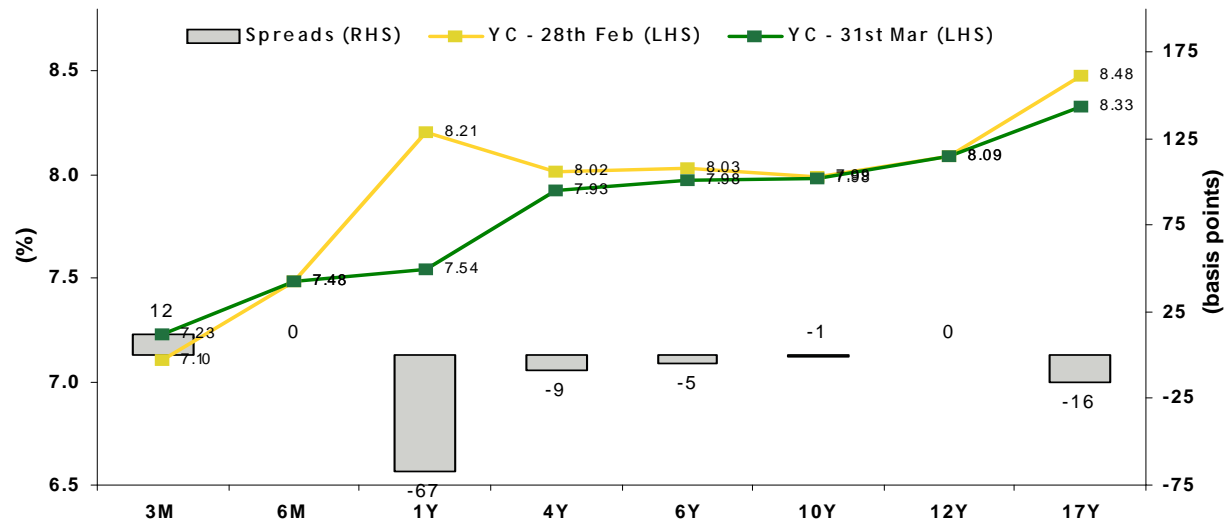


Inflation Dynamics - Food Inflation falls but Non-Food Inflation rises



- India's Food Inflation which had witnessed an upward shock from the month of November has now eased considerably to 9.2% in the week to Mar 26, 2011 from a high of 20.8% in the week ending Dec 25, 2010. Prices of essential commodities like fruits and vegetables have fallen back to 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 27.6% in the week to Mar 26, 2011.

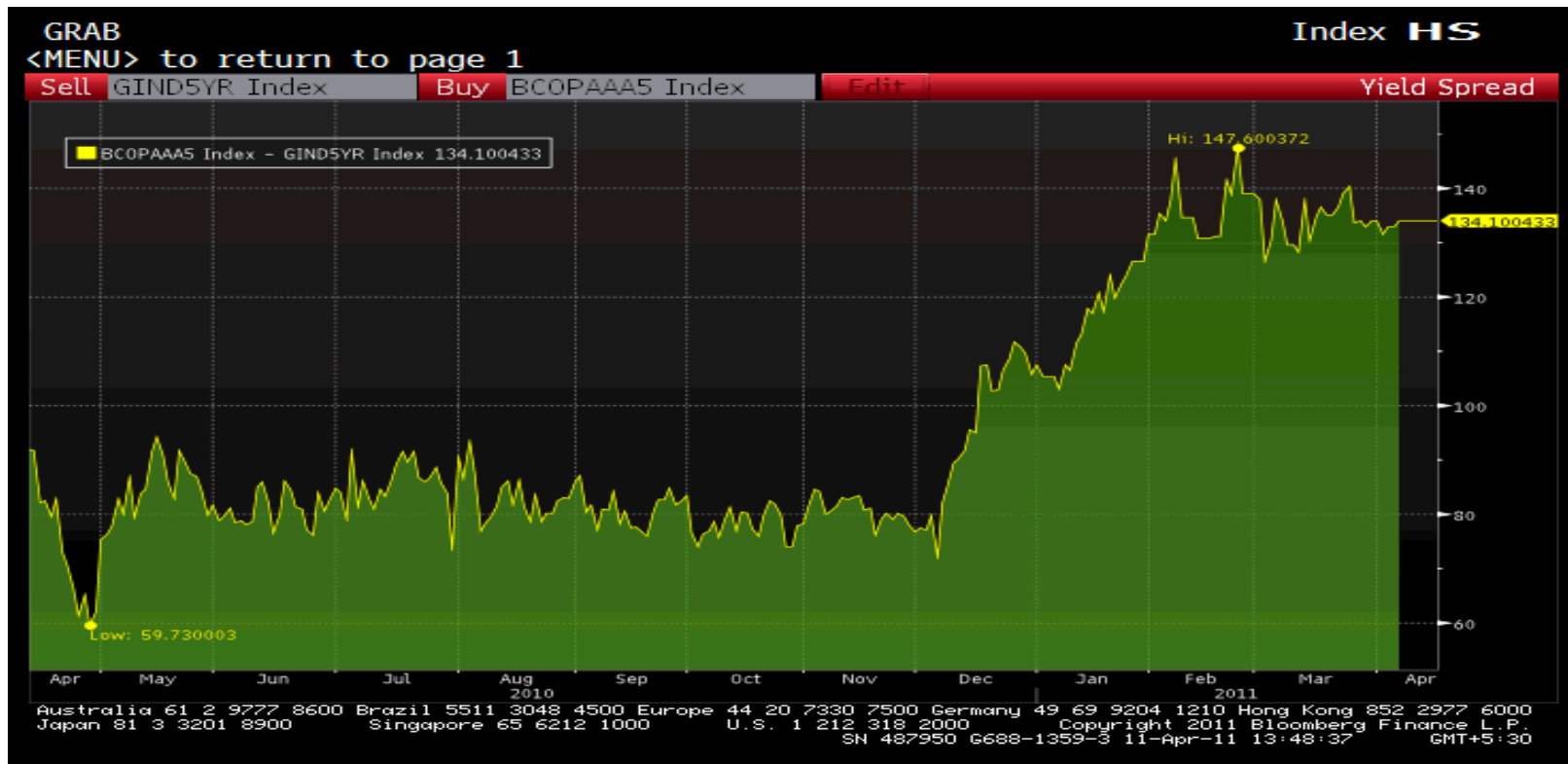
G-Sec Yield Curve - normalized it's Inversion



- The G-Sec yield curve normalized its inversion in the month of March with yields on the 1-Yr segment of the curve falling sharply.
- The yield on the 10yr benchmark was flat falling just 1 bps over the month of March'11 to 7.98%.
- In the latest T-Bill Auction on Mar 23, the 91-day T-bill was issued at 7.31% and the 364-day paper yielded 7.64%.
- Current 10yr vs.1yr GOI spread was at 45 basis points during March. The spread has averaged 160 bps during the last year.



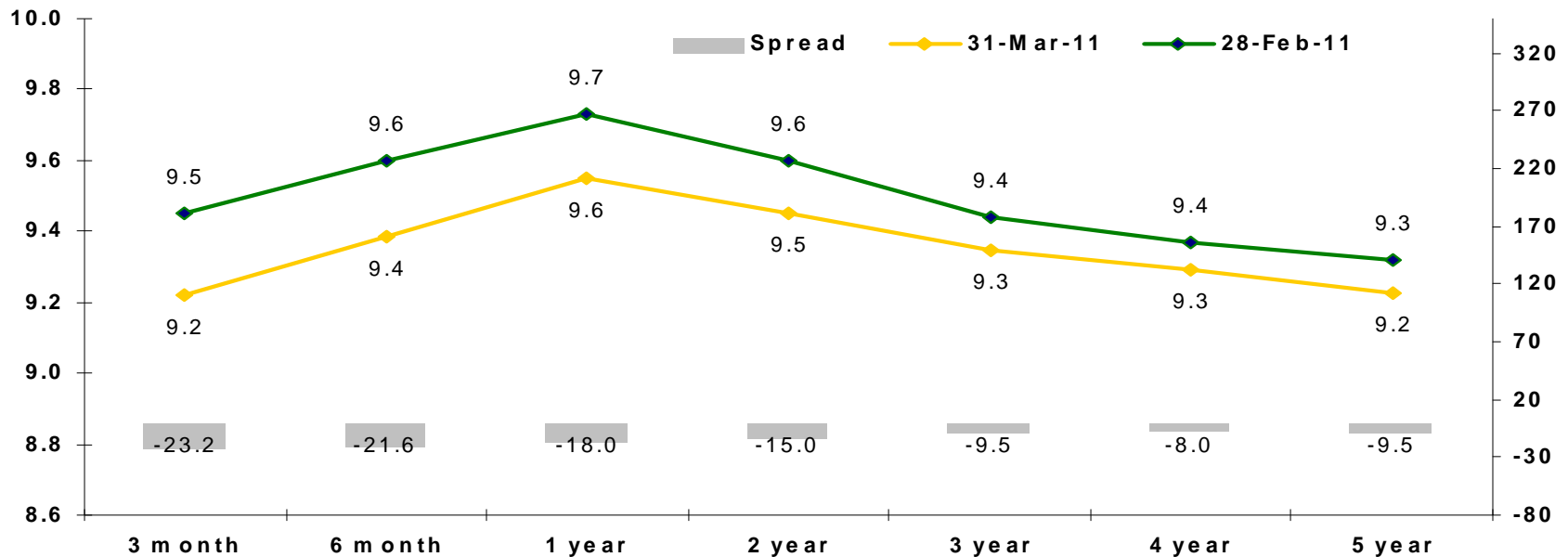
Corporate Bonds spread - unchanged



- The liquidity deficit scenario pushed the yield curve higher.
- The yield curve saw further inversion with yields on the shorter end rising more than the yields on the longer end of the curve
- The 5 year AAA spreads are currently at 135bp about 40bp higher than the previous 1 year average.



Corporate Bond yield curve – Downward Shift



Source: Bloomberg. Indian AAA Composite Curve.

- The 5 year AAA corporate bond credit spread over corresponding 5-year gilt moved lower over the month of March'11
- The 5 year AAA corporate bonds averaged 9.22% during the month of March 2011

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- The liquidity situation over the next few weeks is expected to be drastically different from the previous 3 quarters. The situation might change sharply and positive post high volume government expenditure.
- The liquidity situation in this quarter might average out at a better level than the previous month. In addition as the banking sector hikes their deposit rates, deposit mobilization is expected to continue to 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.
- The temporary build up of liquidity is expected to drop with government securities auction over the weeks. However, the slower credit growth in the initial months of the new financial year is expected to keep the situation better than previous month.
- 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 and rising food and non-food articles will keep the stance hawkish till economic conditions change.

Portfolio Actions during the month

- **Religare Liquid Fund**
 - High quality, very well diversified credit mix. 35 separate credit exposures
 - Managing a liquid low duration portfolio
- **Religare Ultra Short Term Fund**
 - Managing a low duration in line with the current liquidity conditions and rising yields.
 - Very well diversified portfolio. 29 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 1.5 months so as to reduce interest rate risk and maintain a high accrual
- **Religare Active Income**
 - The portfolio has extended duration to little 1.1 years, this is in line with our expectation of a improvement in liquidity situation and hence the yield curve might steepen out.

Ideas for investors

- The current attractive yield in the market and the inverse shape of the yield curve opens up several opportunities for the fixed income investor.
- 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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