

Fixed Income Markets : Current Environment and Outlook

Sujoy Das, Head of Fixed Income
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Macro Events

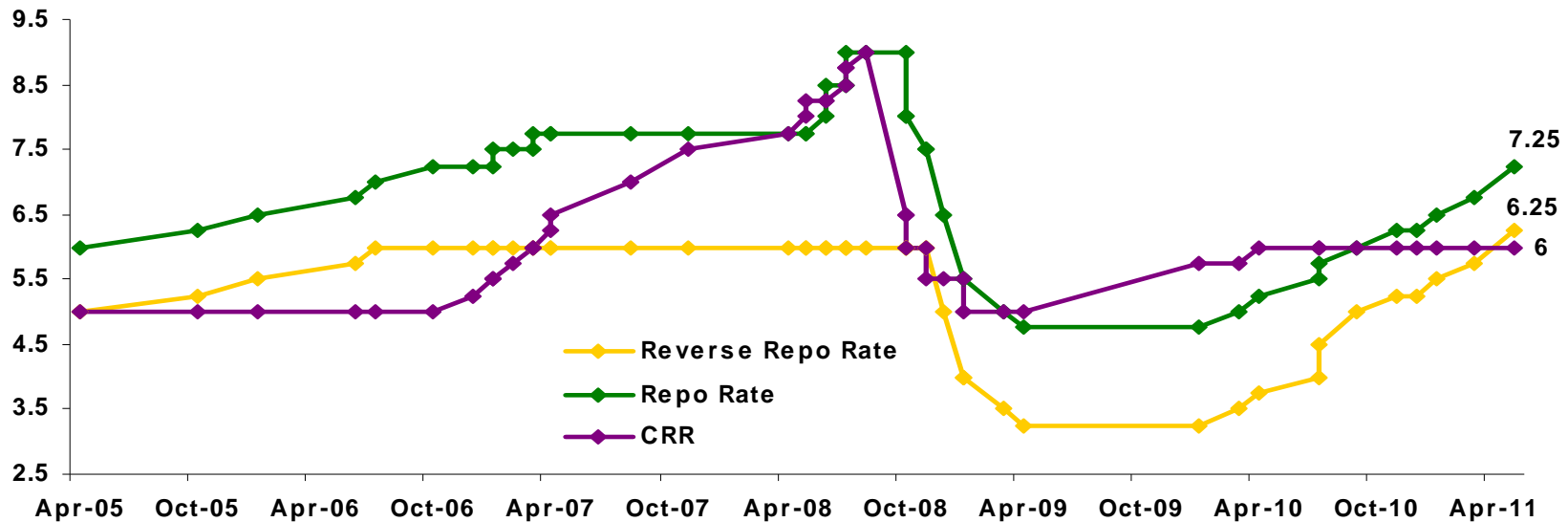
Domestic

- In the Annual Monetary Policy, RBI raised the repo rate - the key policy rate, and reverse repo rate by 50bps each to 7.25% and 6.25% 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 7.3% in Mar'11 having risen at just 3.7% YoY in the previous month (Feb'11). The cumulative growth for the financial year April- March, 2010-11 was at 8% over the corresponding period of the previous year
- Headline WPI inflation rate came at 8.66% YoY for the month of Apr' 2011 as compared to 9.02% for the previous month and 10.9% during the corresponding month of the previous year. The Feb'11 inflation was revised up to 9.5% YoY from a provisional 8.3% earlier.

International

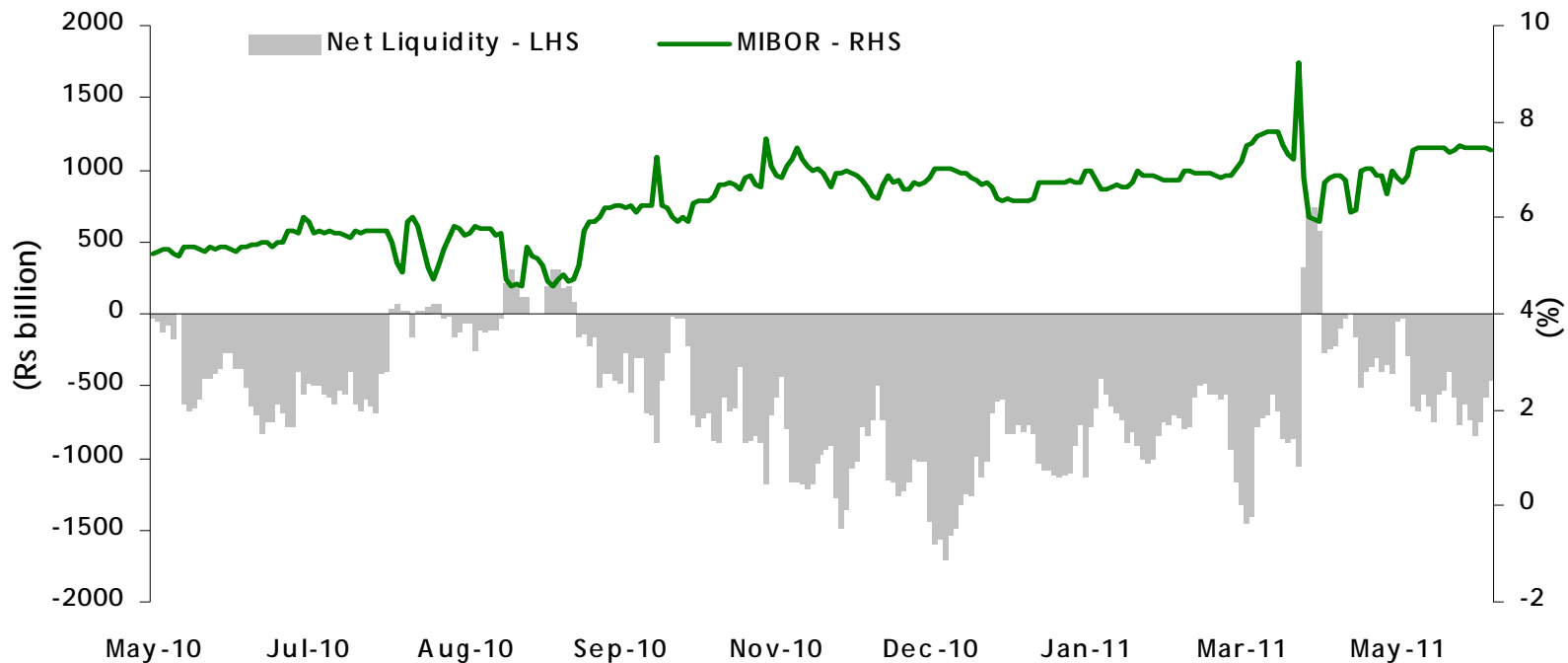
- Economic growth measured by GDP, has weakened from the post-crisis rebound in the US, UK and Euro zone . The unemployment rate in the developed economies, continues to improve slowly.
- US GDP growth rate softened to 1.8% QoQ in Q1'11 from 3.1% in the previous quarter. GDP in the UK rebounded in Q1'11 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%.

RBI tightens aggressively in it's Annual Monetary Policy



- The Reserve Bank of India (RBI) hiked the repo rate by 50 bps and the reverse repo rate by 50 bps. RBI's 50bps increase in repo and reverse repo rates was the ninth hike since Oct'09.
- This is a deviation from the calibrated tightening (baby steps) being followed since Jan'10
- The central bank also fixed the width of LAF corridor to 200 bps centered at Repo rate with Reverse repo pegged at 100 bps below Repo and newly introduced Marginal Standing Facility (MSF) at 100 bps above.

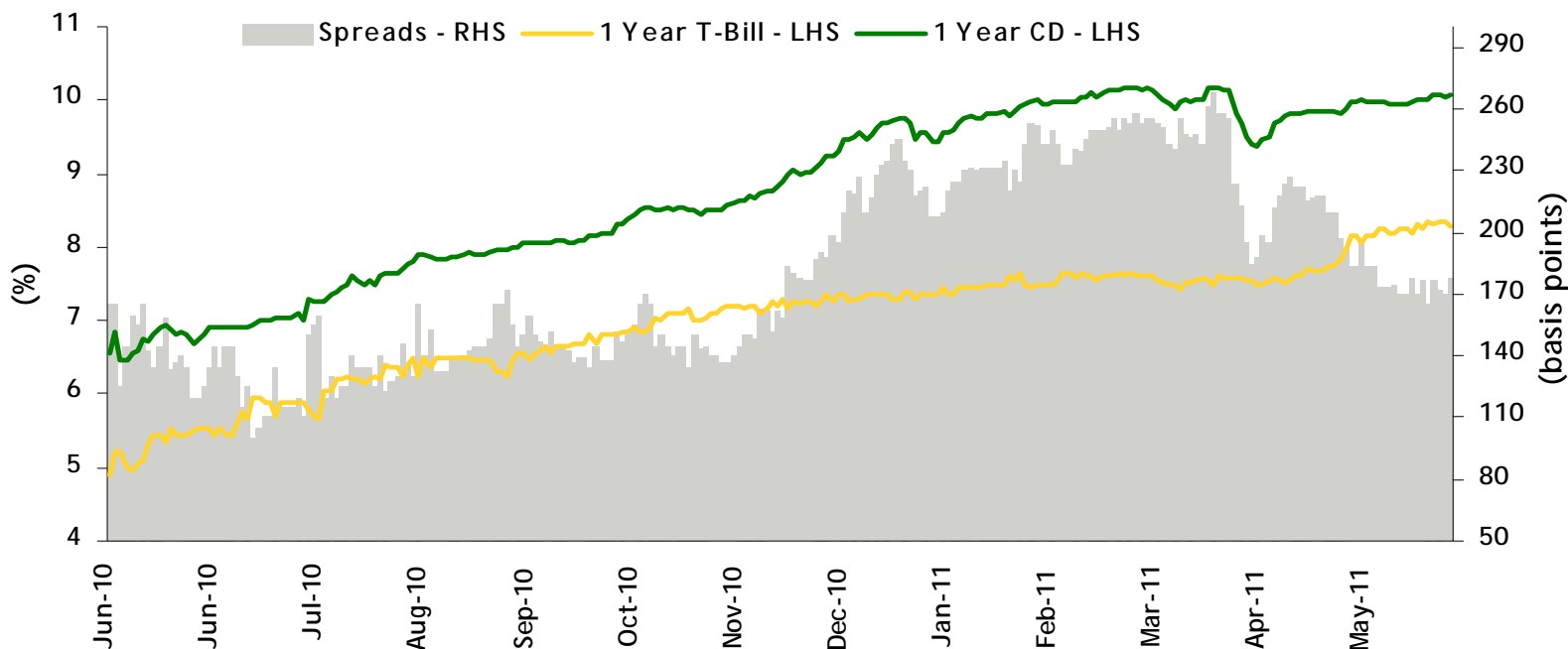
Liquidity - remains tight



- The daily average borrowings by all the banks from RBI under LAF in the month of May'11 was around Rs. 53,000 crore (Rs.10,000 crore previous month).
- The daily average MIBOR over the month of May'11 was at 7.29% (6.78% previous month)
- The average daily borrowings by banks from RBI moved higher compared to April'11

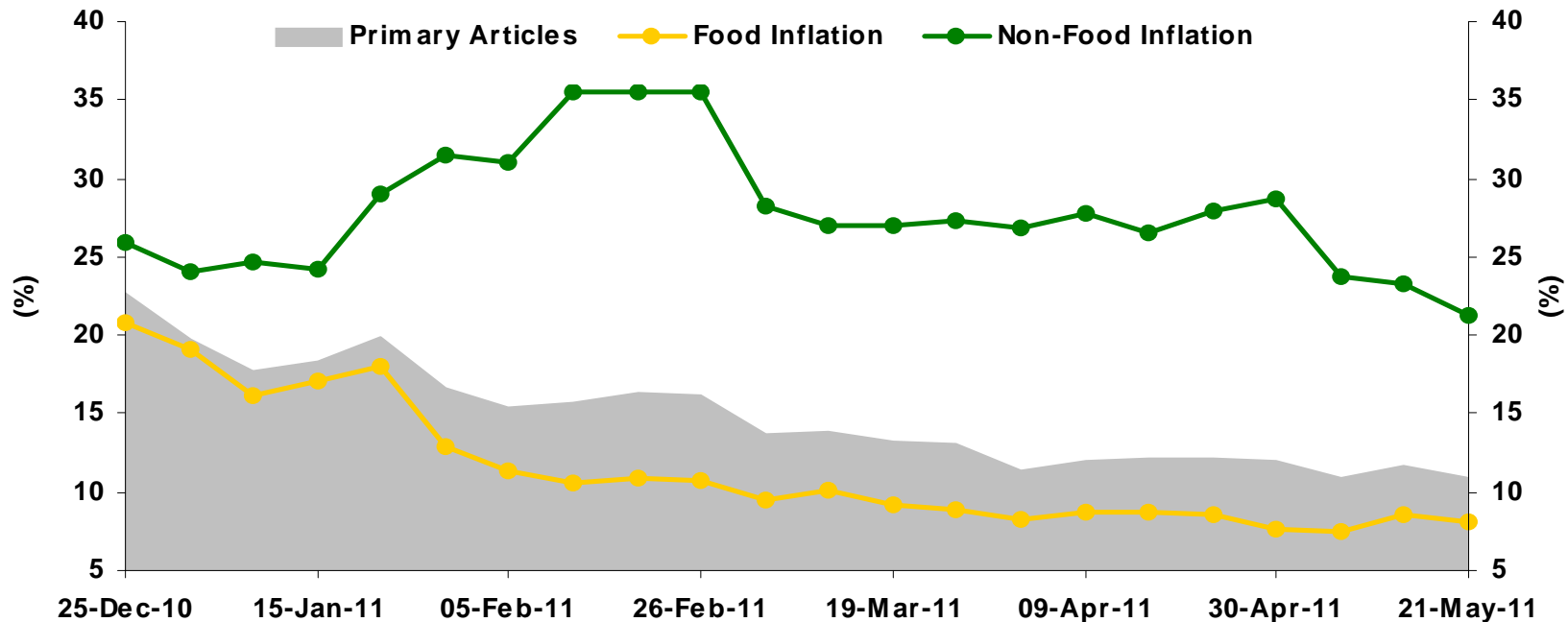


Money Market - rates remain high amidst tight liquidity



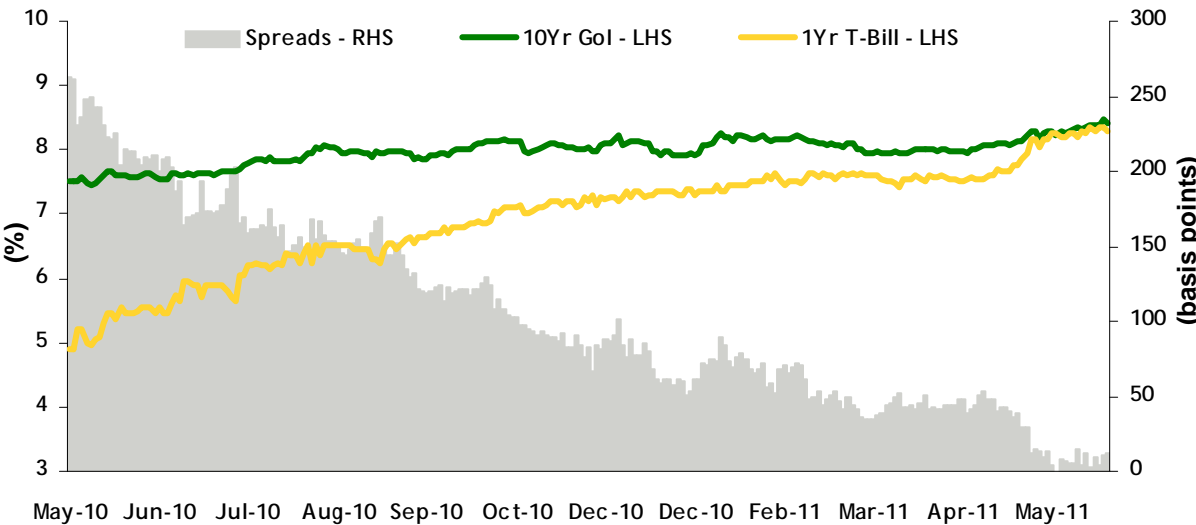
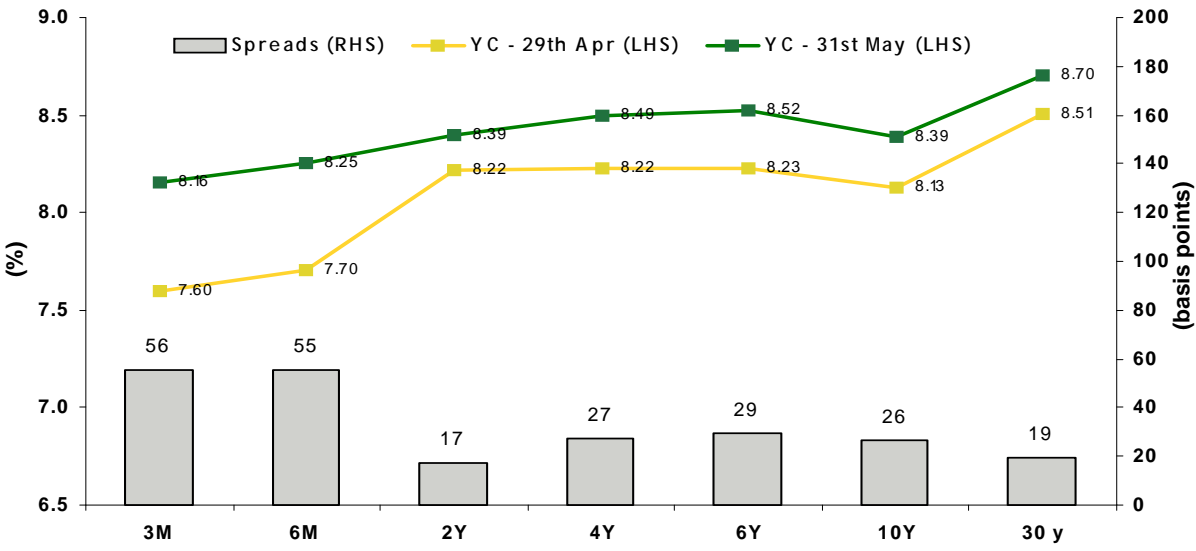
- The money market rates hardened over the month of May'11. The 50bp rate hike by RBI pushed the 3m CD yields by over 75bp. The 1 year CD yields moved up by about 25-30bp.
- The T-bill yields also moved northwards over the month of May'11. The 12m yields hardened by about 40-45 bp post the credit policy on 3rd May'11.

Inflation Dynamics - Non-Food Inflation starts to ease



- India's Food Inflation which had risen sharply, fell further to 8.1% in the week ending May 21, 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, has finally dropped in the month of May. Non-Food article Inflation fell to 21.3% for the week ended May 21, 2011 from 28.6% on Apr 30, 2011. It had been as high as 35.5% on Feb 26, 2011.

G-Sec Yield Curve - Upward Shift



- The G-Sec yield curve shifted upwards in the month of May, and turned flatter, with yields on the shorter segment of the curve rising more than yields on the longer end.
- The yield on the 10yr benchmark rose 26 bps over the month of May'11 to 8.39%.
- In the latest T-Bill Auction on May 18, 2011 the 91-day T-bill was issued at 8.1% and the 364-day paper yielded 8.29%.
- Current 10yr vs. 1yr GOI spread fell further to just 10 basis points during May. The spread has averaged 120 bps during the last year



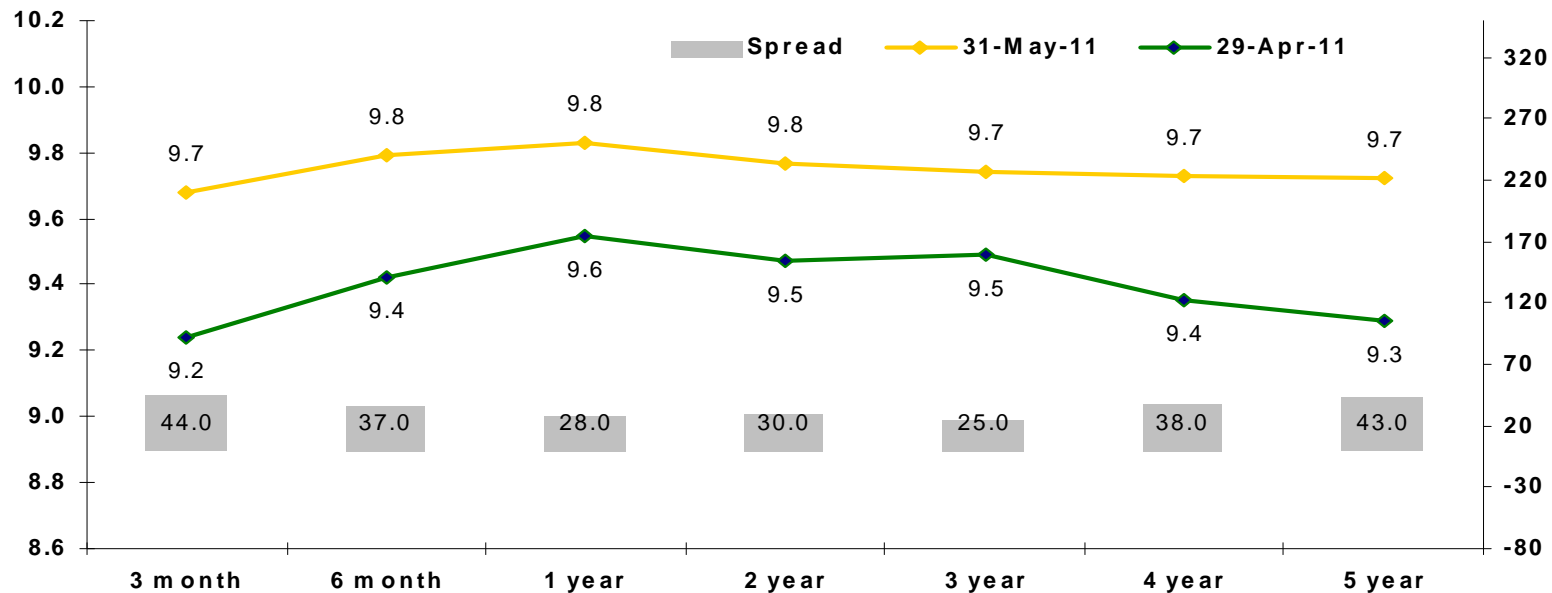
Corporate Bonds spread - Contracted



- The 5 year AAA spreads are currently at 130bp. About 30bp higher than the previous 1 year average of 101bp



Corporate Bond yield curve – shifts upward



Source: Bloomberg. Indian AAA Composite Curve.

- The 5 year AAA corporate bond yield curve moved northwards over the month of May'11. The yields hardened by over 40bp.
- The 5 year AAA corporate bonds averaged 9.66% during the month of May 2011

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- The liquidity situation in the current quarter, RBI's monetary policy on 16th June'11 and inflation targeting and on going policy actions will determine the yield movement over the quarter.
- The liquidity deficit situation within the banking system will be a function of the asset liability management. As discussed the liquidity situation in this quarter might average out at a better level than the previous month/quarter.
- The deteriorating inflation situation within food and non-food category is expected to temporarily improve over the months. This might be led by a favorable base and dropping commodity prices in the international market within both the food and non-food space.
- 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.
- RBI's anti-inflationary stance is expected to be hawkish amidst rising food and non-food articles and continue till the economic conditions change. The drop in international prices of several commodities might have some temporary relief on the inflationary conditions within the Indian economy.
- RBI might press the pause button on the rate hikes as some early signs of slow down in growth are visible and the inflationary conditions loosing steam in the near term.

Portfolio Actions during the month

- **Religare Liquid Fund**
 - High quality, very well diversified credit mix. 36 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. 30 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 further lowered duration to between 4-5 months. Post the rate hike of 50bp we have decided to run a duration of 4-6 months so as to capture the kink in the yield curve in the segment upto 1 year.

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.

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