

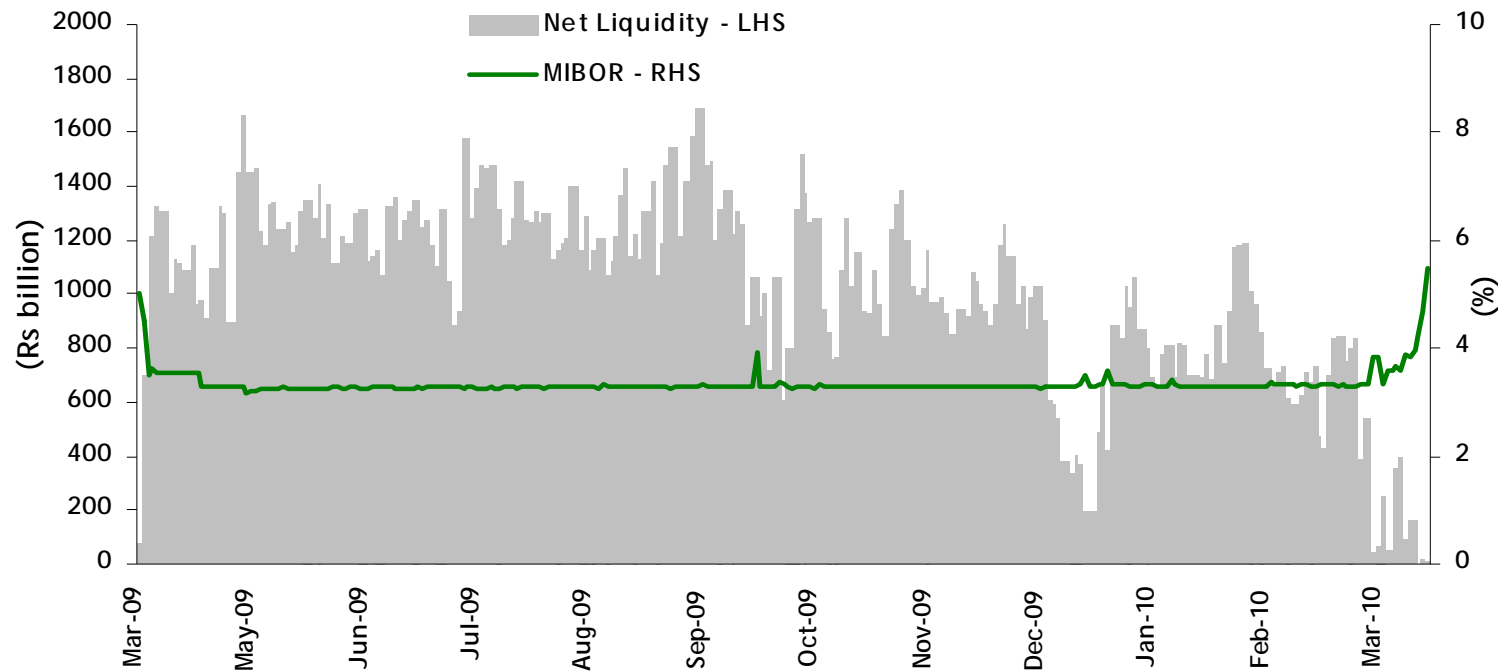
Fixed Income Markets : Current Environment and Outlook

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March 2010

Macro Events

- RBI surprised the markets by raising key policy rates by 25 bps. The move, aimed at taming inflation and anchoring inflationary expectations, marks a reversal in the easy monetary policy regime amid signs of strong economic revival
- Industrial Production (IIP) surprised again, rising 16.7% in Jan. Cumulatively, during Apr-Jan, output expanded 9.6% vs. 3.3%, growth was led by an 17.9% rise in manufacturing due to a continued surge in capital goods of 56.2% and a 31.6% rise in consumer durables — the main focus of fiscal and monetary stimulus packages
- Growth of the six key infrastructure (core) sectors moderated to 4.5% in Feb from 9.4% in Jan, The growth rate had stood at a meager 1.9% in Feb 09.
- Inflation rate, as measured by the WPI, rose further to 9.89% (YoY) in February from 8.56% in the previous month.
- Economic growth measured by GDP is now in the positive territory for the US, UK and the Euro zone. US GDP grew a strong 5.6% (YoY) in Q4'09. GDP growth in the UK moved into positive territory in Q4'09, following six consecutive quarters of contraction and GDP in the European region too was positive in Q4'09 (QoQ)
- The slow but steady U.S. economic recovery appears set to continue, with underlying indicators signaling a growing strength

Liquidity - remains comfortable



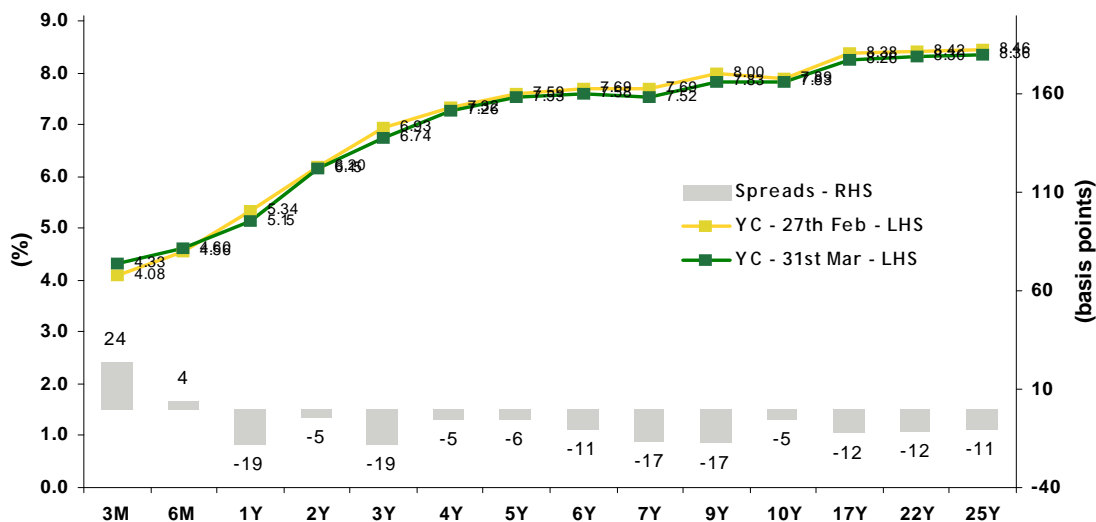
Source: Bloomberg

- Liquidity dipped due to financial year-end, with the daily RBI LAF reverse repo average at around INR 40,000 crore in March. It was however back to comfortable levels soon after
- MIBOR moved higher, averaging around 3.75% during the month

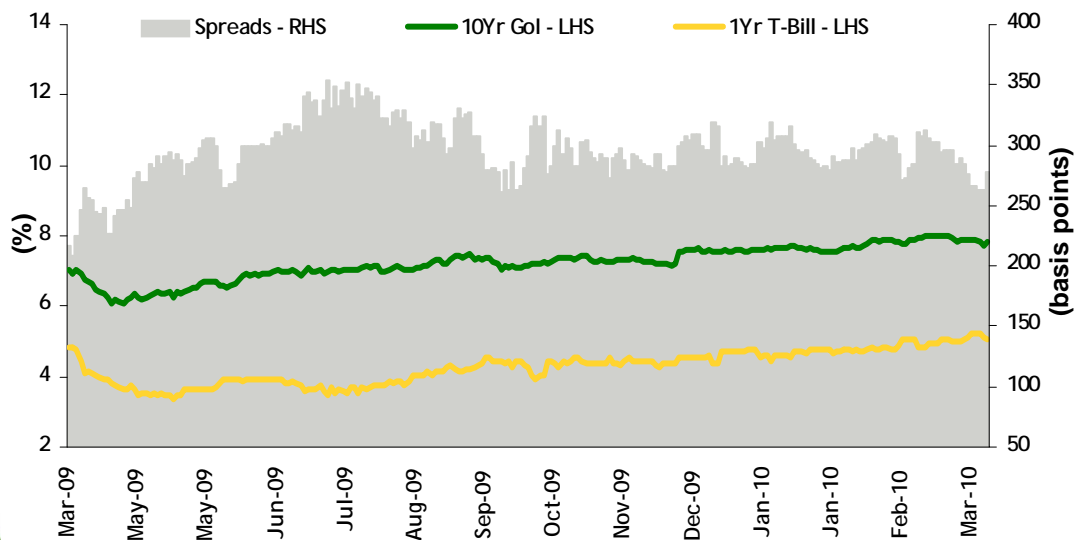


Source: Bloomberg

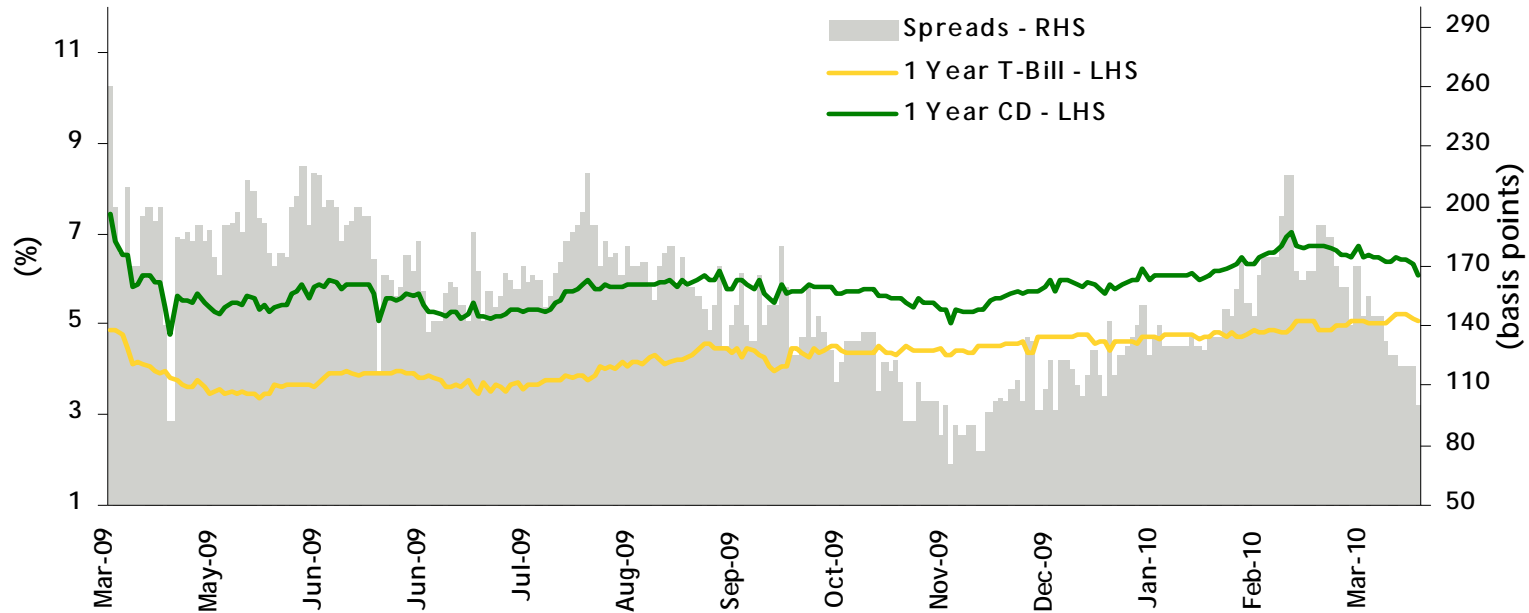
G-Sec Yield Curve - further flattening



- The G-Sec yield curve flattened further with a rise in yields at the short end of the curve while yields on the medium and long end fell
- The yield on the 10yr benchmark fell during the month closing at 7.8%
- In the T-Bill Auction held on Mar 23, the 91-day T-bill was issued at 4.42% and the 364-day paper yielded 5.15%
- Current 1yr vs.10yr GOI spread was at 250 basis points as against the mean spread of 215 basis point over the last 1 year. We expect the current spread to revert to the mean



Money Market - rising rates amidst easy liquidity



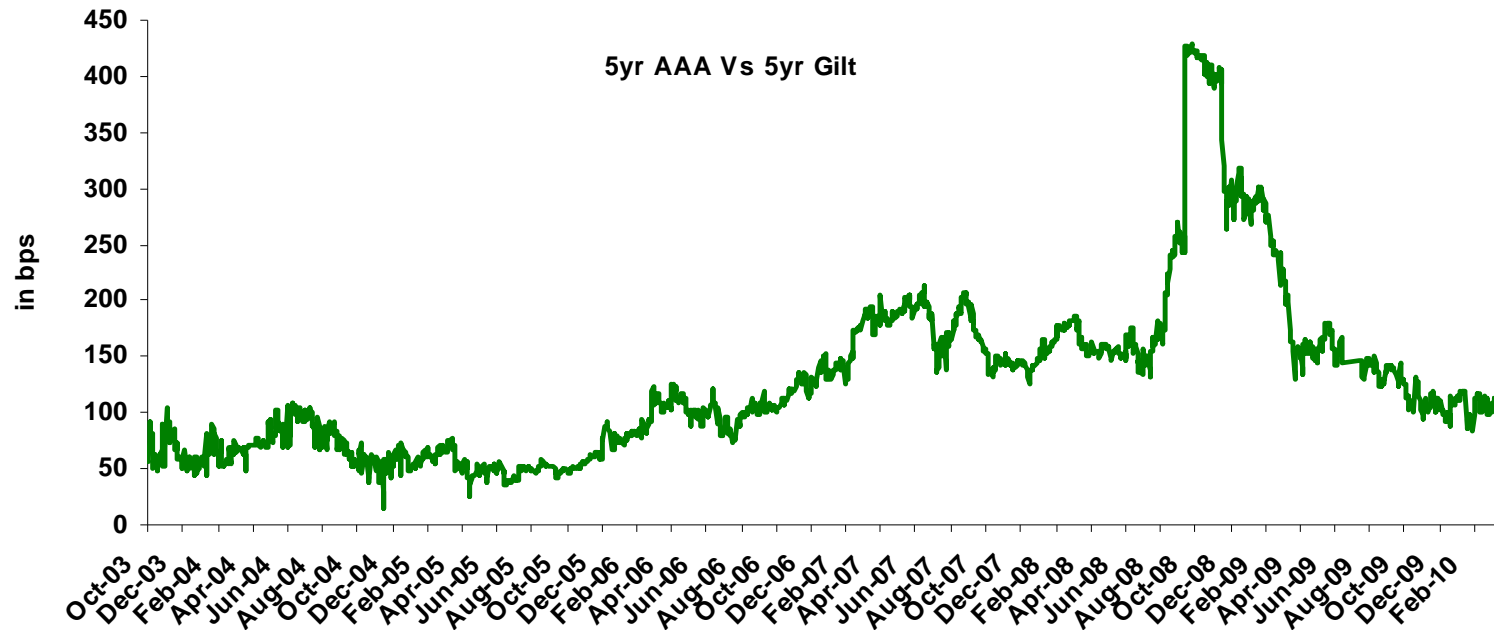
Source: Bloomberg

- Money market rates continued to rise amidst comfortable liquidity in the market
- Spreads between 1 Year CD's and 1 Year CP's over T-Bill's narrowed during the month.



Source: Bloomberg

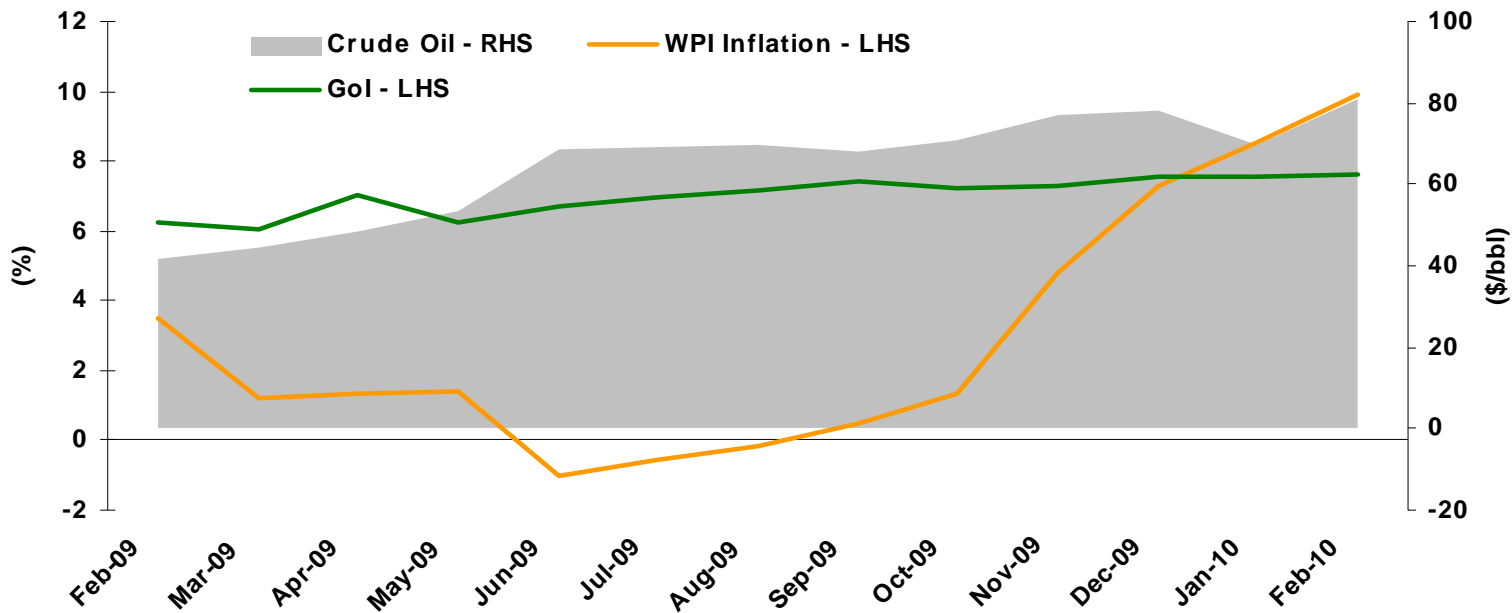
Corporate Bonds spread - unchanged



Source: Bloomberg

- Spreads of 5-Year AAA corporate bonds over their corresponding benchmark sovereigns, remained unchanged during the month at 100 bps, with both the sovereign and the corporate rates rising 5bps rise each
- The yield on the 5 year AAA corporate paper dropped to 8.54% from 8.6% during the month

Crude and Inflation Dynamics



Source: Bloomberg

- Crude Oil prices (NYMEX Crude Oil Barrel) drifted higher towards \$84 at the end of March from just above \$78 at the start of the month.
- WPI Inflation climbed sharply to 9.89% in February from 8.56% in the previous month. The rise in the prices of manufactured goods remains a worry

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- Global economic data continues to point towards recovery gaining traction
- Problems of deficit ridden economies led by Greece continues to be a sore point and has the attention of “bond vigilantes”
- Euro is likely to remain under pressure as there are differences of opinion regarding rescue packages for debt ridden economies
- Domestically, inflationary pressures likely to continue to build in the coming months taking into account – a) pressure from global commodity price rise b) high albeit moderating food inflation and c) base effect of past year. It is likely to moderate from second half of FY11 as base effect reverses course.
- Liquidity conditions are likely to remain comfortable on a) alternative sources of funding available to corporates (equity/ECBs) b) slack season for credit-pickup and c) RBI dollar intervention on FII/FDI inflows
- RBI has now embarked upon its rate hiking cycle and it is likely to increase the policy rates once again in its April 20 annual monetary policy.

Ideas for investors

- Risk-averse investors should continue to look at short end of the yield curve
- Yields at the long end have declines in the recent past on account of less than expected 1H borrowing numbers. However, inflationary pressures are likely to remain a concern and with continues supply yields are likely to continue to move higher targeting 8.25%-8.40% range on the 10 year benchmark. Investors with an investment horizon of >6 months can look to invest in long duration products at that time
- Investors with an investment horizon of 3-6 months may also look at investment in Short Term Fund and Credit Opportunities Fund

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