

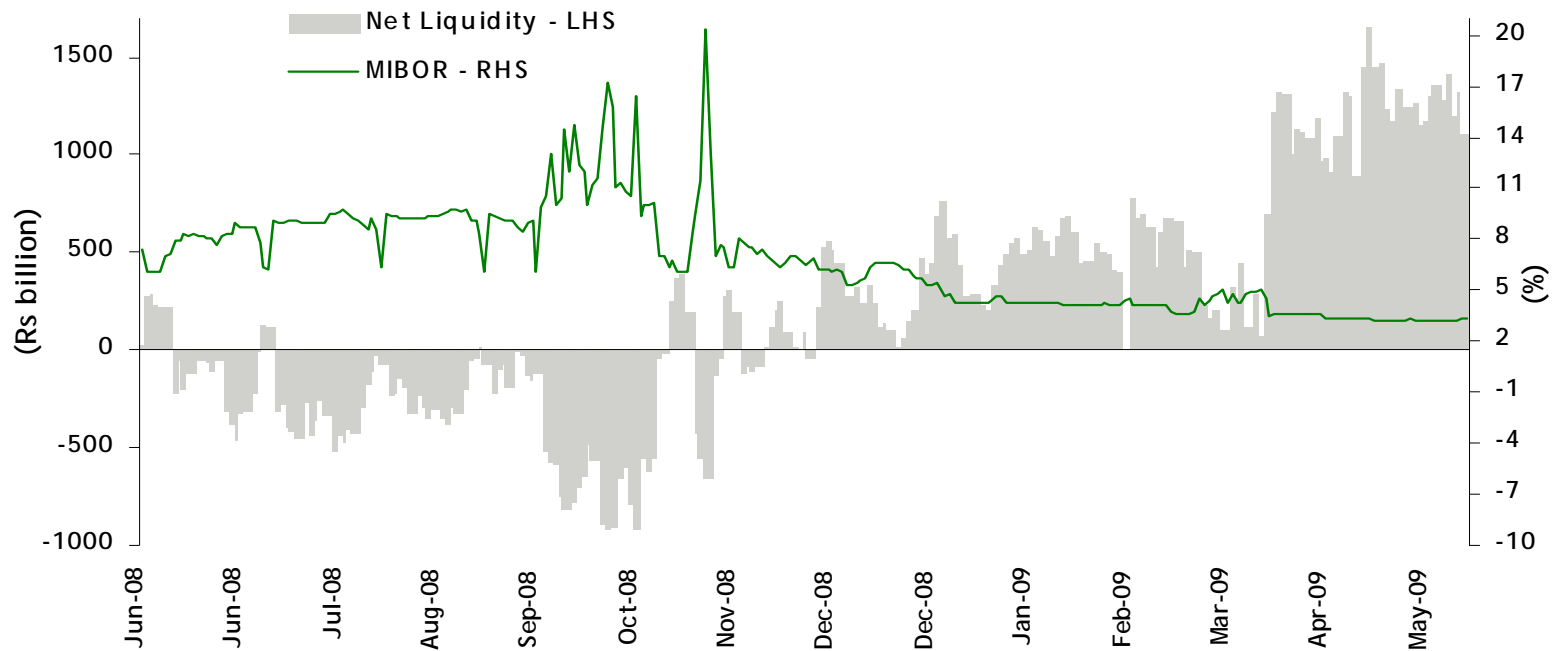
Fixed Income Markets : Current Environment and Outlook

Ashish Nigam, Head of Fixed Income
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Macro Events

- The results of the month-long general election in India saw The United Progressive Alliance (UPA), led by the Congress Party, retain power with the alliance finishing up just short of an absolute majority. The results defied many predictions and the markets reacted bullishly to the outcome
- The Indian economy logged a better-than-expected 6.7% growth in FY 2008-09 despite the global financial meltdown adversely impacting its output in the second-half of the fiscal year under review
- GDP grew a robust 5.8% in Q4 of 08-09. The Q3 GDP growth performance has now been revised upwards to 5.8% from 5.3%
- Across the globe: Japanese Factory Output expanded, Housing prices in Britain rose, German Retail Sales improved and the US GDP data for Q1 09 was revised upwards. All signs that the worst for the global economy might just be behind us

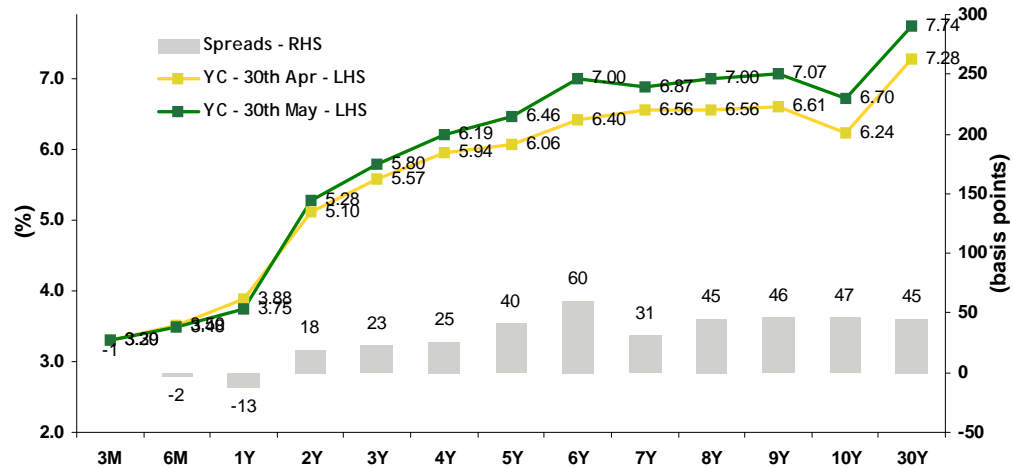
Liquidity - remains buoyant



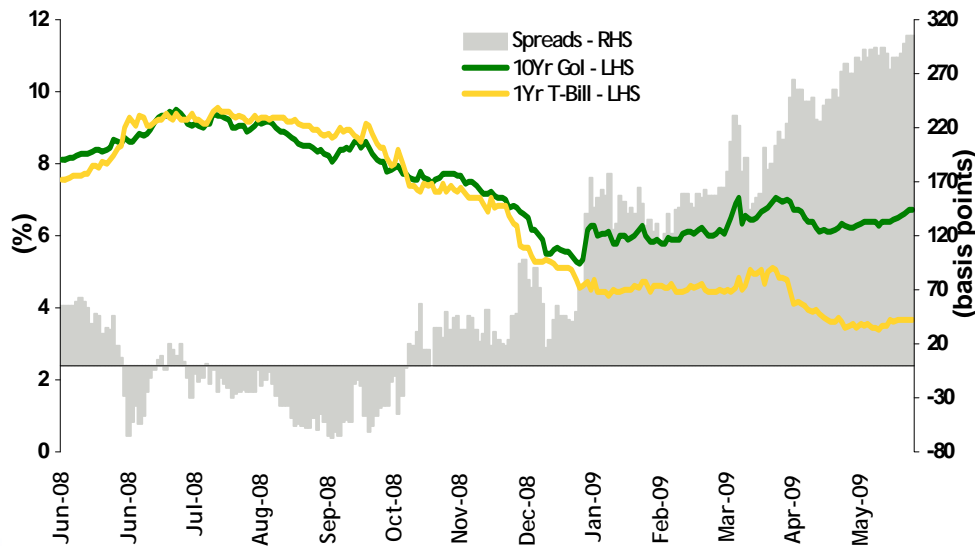
Source: Bloomberg

- The system remained flushed with liquidity during the month of May with the daily RBI LAF Reverse Repo averaging INR 132,000 crore during the month
- MIBOR rates traded lower in the 3-3.5% band, averaging 3.25% during the month

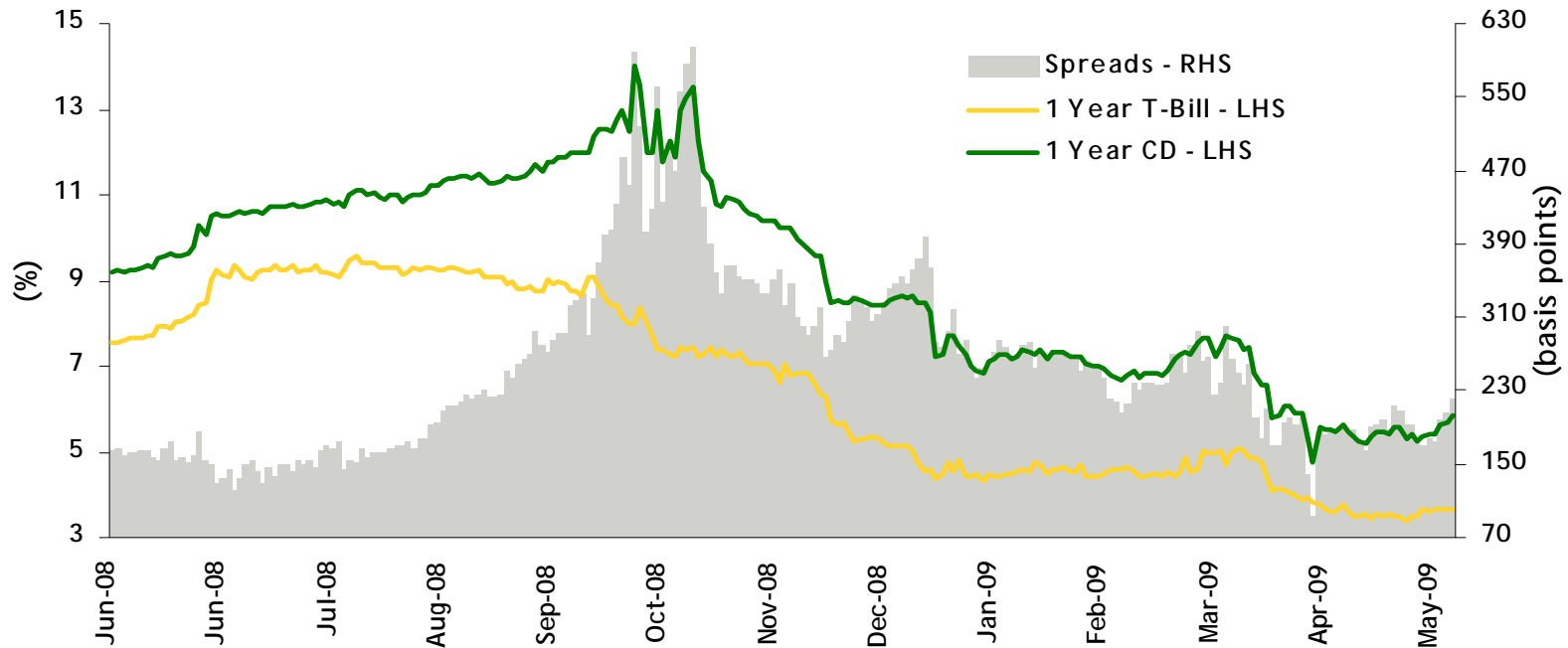
G-Sec Yield Curve - Steepening



- G-Sec yield curve shifted upwards and steepened as the rates at the long end rose and the rates below 1 year softened
- The 10yr benchmark yield rose to 6.7% from 6.24% at the start of this month
- In the T-Bill auction results on May 20' 09, 91-day bill issued at 3.28% and the 364-day paper yielded 3.68%, reporting marginal lower cut-offs
- Current 1yr vs 10yr Gol spread widened to 305 basis point as against the mean spread of 80 basis point over last 1 year. We expect the current spread to compress and revert to the mean



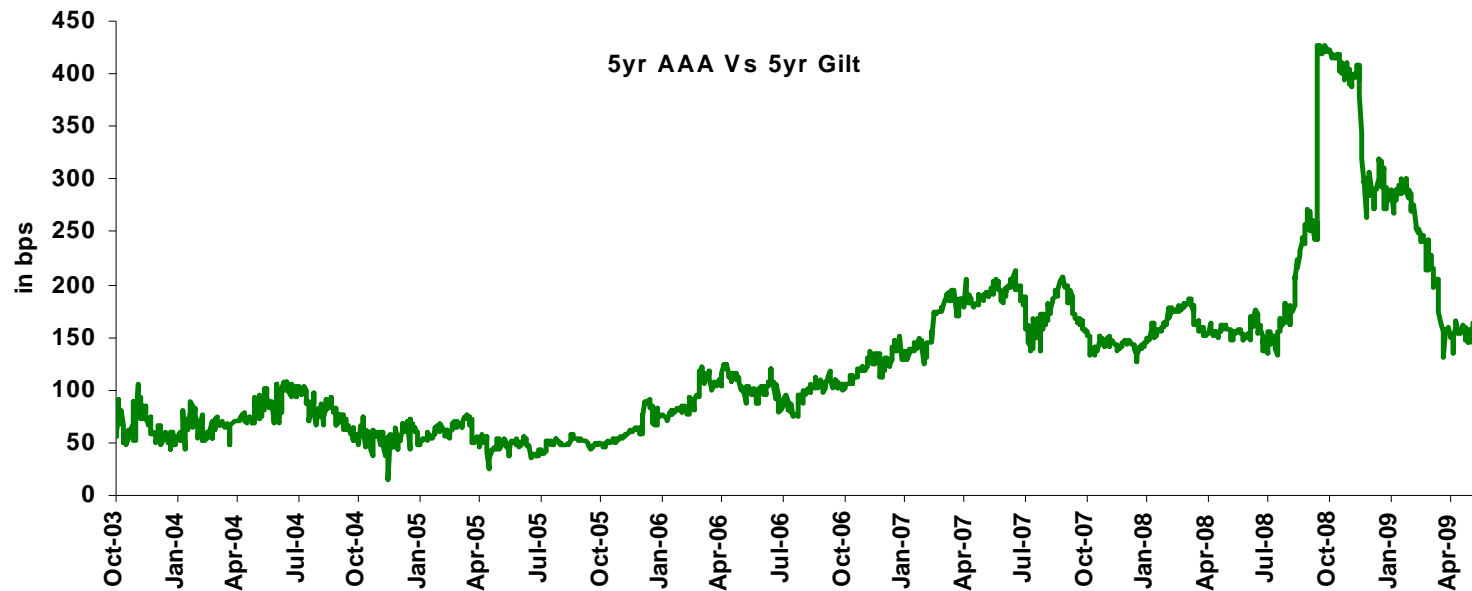
Money Market Yields-Low amidst easy liquidity



Source: Bloomberg

- Money market rates remained at low levels due to ample liquidity in the system
- Spreads between 1 year CD's and T-Bill's widened by 10-15 basis points, though CP's and CD's shortened by about 70-75 basis points.
- Spread compression indicates reduced risk aversion and demand for short-term assets

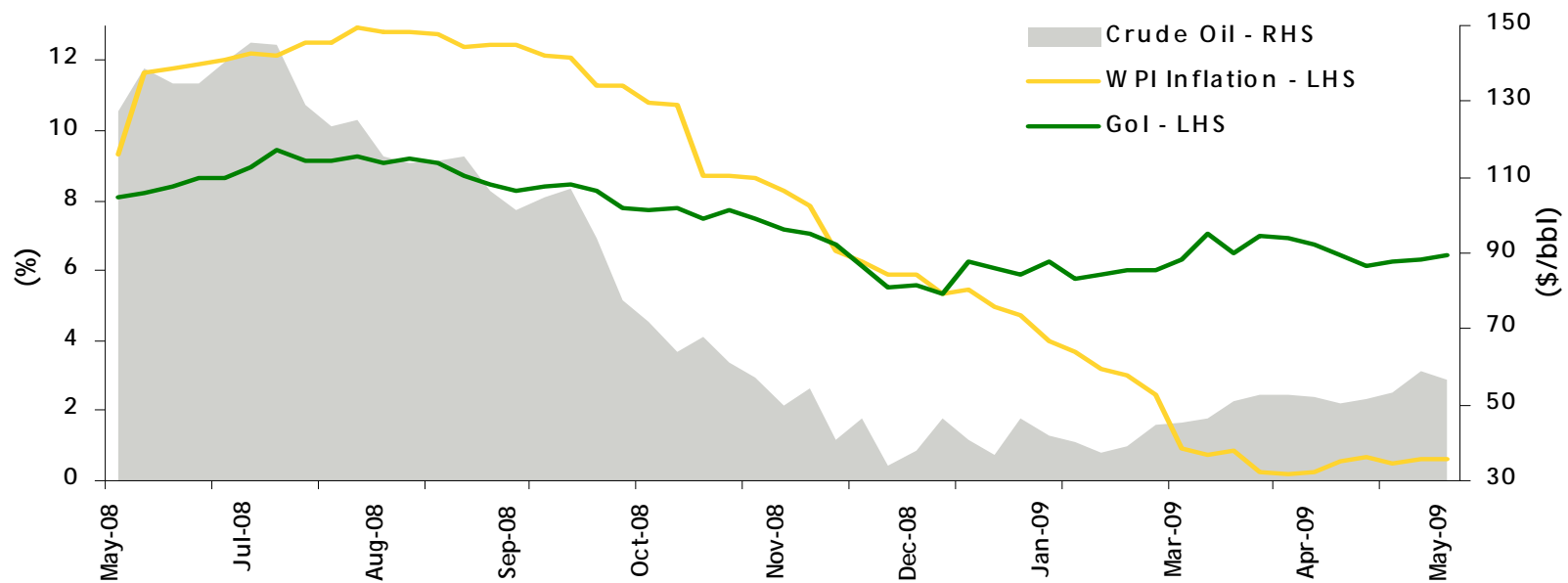
Corporate Bonds spread-Widens



Source: Bloomberg

- Spreads of corporate bonds over their corresponding benchmark sovereigns hardened by about 10-15 basis points
- The 5 year corporate paper yield was higher from 7.6% to 8.1% during the month

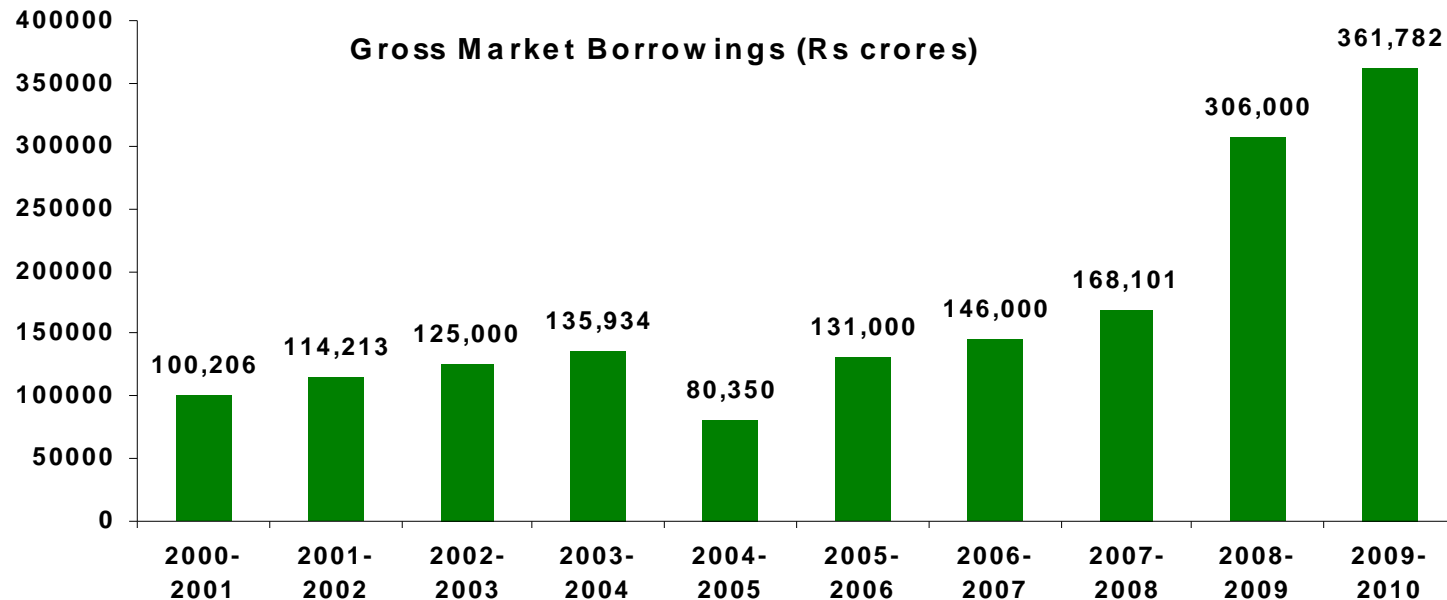
Crude and Inflation Dynamics



Source: Bloomberg

- Crude oil prices continued to rise on weakening US Dollar, with NYMEX crude closing May at \$66 a barrel from \$53 a barrel at the end of April
- WPI Inflation rose marginally during the month to 0.48% for the week ended May 23' 09 but remained well below 1% during the month, though the prices of Food Products and Articles rose at a worrying pace

Government's borrowing program



Source: indiabudget.nic.in

- Gov supply, net of OMO and maturity, was positive for the month of May by INR 39000 crores
- The market will continue to witness volatility though the RBI is to ensure “non-disruptive” borrowing program

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- Yield curve continued to steepen, with 1yr over 10yr spreads widening and currently trading at 245 basis points. Likely to steepen further
- Bond markets to remain uncertain and volatile, atleast till the Budget
- Global economic concerns to weigh on Indian markets, US treasury yields having jumped up by nearly 80 basis points over 1 month
- Corporate bond curve to move parallel to sovereign curve, with the downside risk of spreads widening
- RBI measures expected to ensure smooth government borrowing program
- Upward revision in the borrowing numbers, followed by higher OMO buy-back of securities
- Liquidity to remain easy
- Oil at over USD 65 could pose a threat and likely to track USD against major currencies
- Inflation not a worry for the bond market in near term
- Long-term expectation – bias towards soft interest rates

Ideas for investors

- Volatility to continue in bond market, investors could consider Short Term Plan to avail superior returns than Ultra Short Term, while looking to hedge on volatility
- Consider investing in portfolio with a mix of PSU corporate bonds and gilts
- Income Funds expected to deliver double digit returns over 1 year horizon

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