

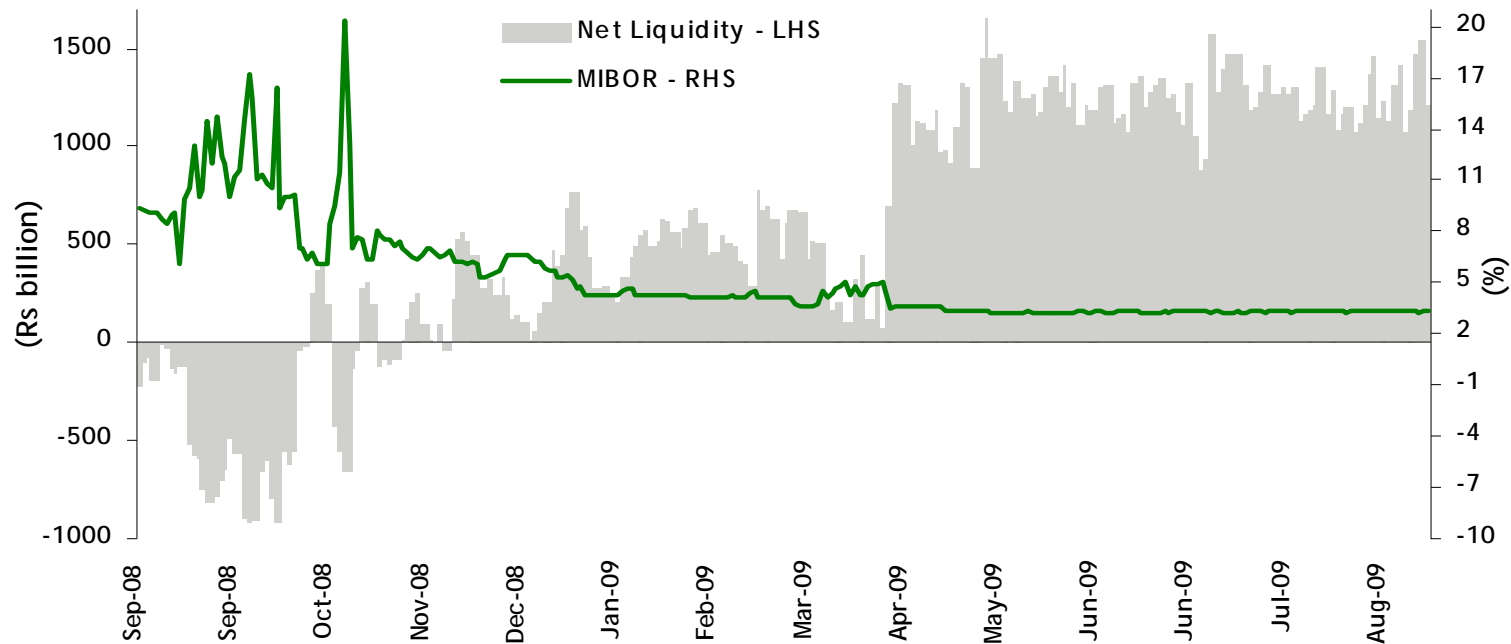
Fixed Income Markets : Current Environment and Outlook

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Macro Events

- India's economy (GDP) grew 6.1% in the June quarter from a year earlier as government stimulus measures helped spur demand, although a poor monsoon threatens to crimp growth later in the year even as it drives inflation. This was the first rise in quarterly GDP growth since the quarter ended Dec 07 indicating that the economy is on its way to a recovery
- Weak monsoon is expected to lead to a drop in farm output and more importantly put a dampener on India's rural demand hurting growth in the second and third quarter of this year. The Inflation rate has already started its acceleration being led by sharp rises in the prices of Primary Articles
- The main stimulus for the economy this year seems to be coming from the Industrial Sector. Industrial production measured by the IIP Index rose sharply to 7.8% in June from just 2.2% in the previous month
- Major economies around the world continue their slow progress towards a recovery. Economic output improved substantially from previous quarters. The Euro Zone posted a surprisingly stronger performance in the most recent quarter. The US and the UK economies are also believed to have now come out of a contraction

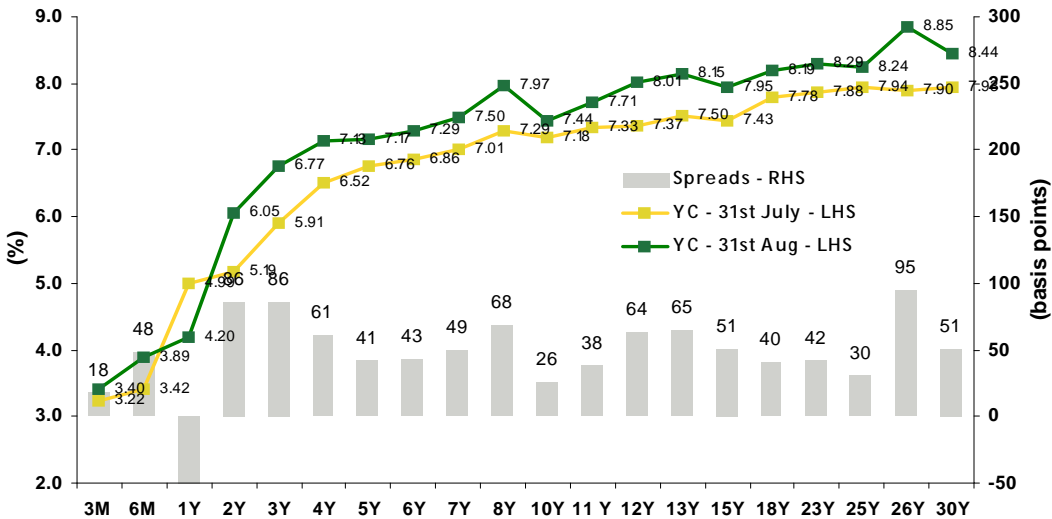
Liquidity - remains abundant



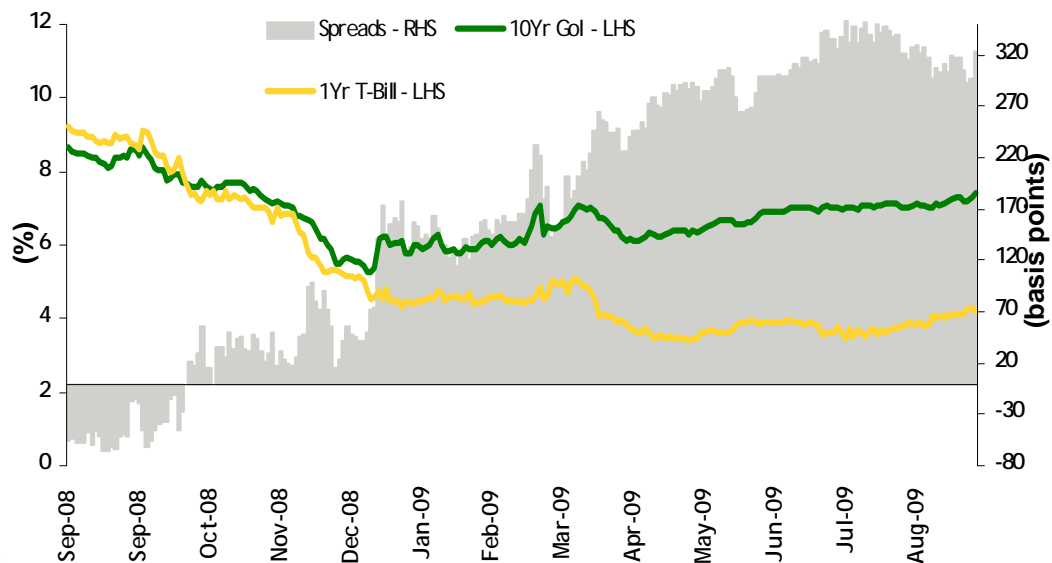
Source: Bloomberg

- The system remained flushed with liquidity in August with the daily RBI LAF reverse repo averaging INR 1,25,000 crore during the month
- MIBOR rates remained flat, traded in a very thin band of 10 bps, averaging just 3.2% during the month

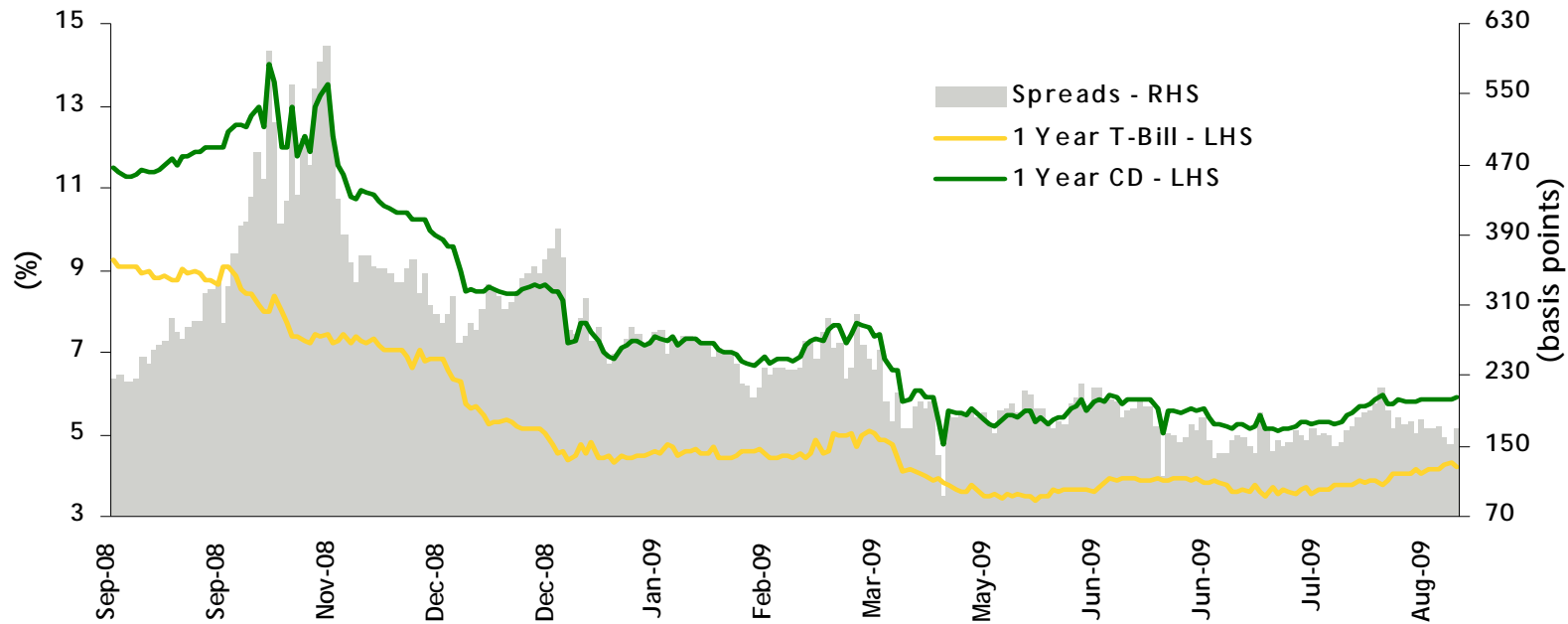
G-Sec Yield Curve - upward shift



- G-Sec yield curve witnessed an upward shift during the month as rates across the segments closed higher
- The 10yr benchmark yield rose further to 7.44% from 7.18% at the start of this month
- In the T-Bill Auction results on Aug 26, 91-day T-bill issued at 3.40% and the 364-day paper yielded 4.34%, reporting higher cut-offs on the short end as compared to the previous month
- Current 1yr vs. 10yr GOI spread was at 320 basis point as against the mean spread of 170 basis point over the last 1 year. We expect the current spread to compress and revert to the mean



Money Market - low rates amidst easy liquidity

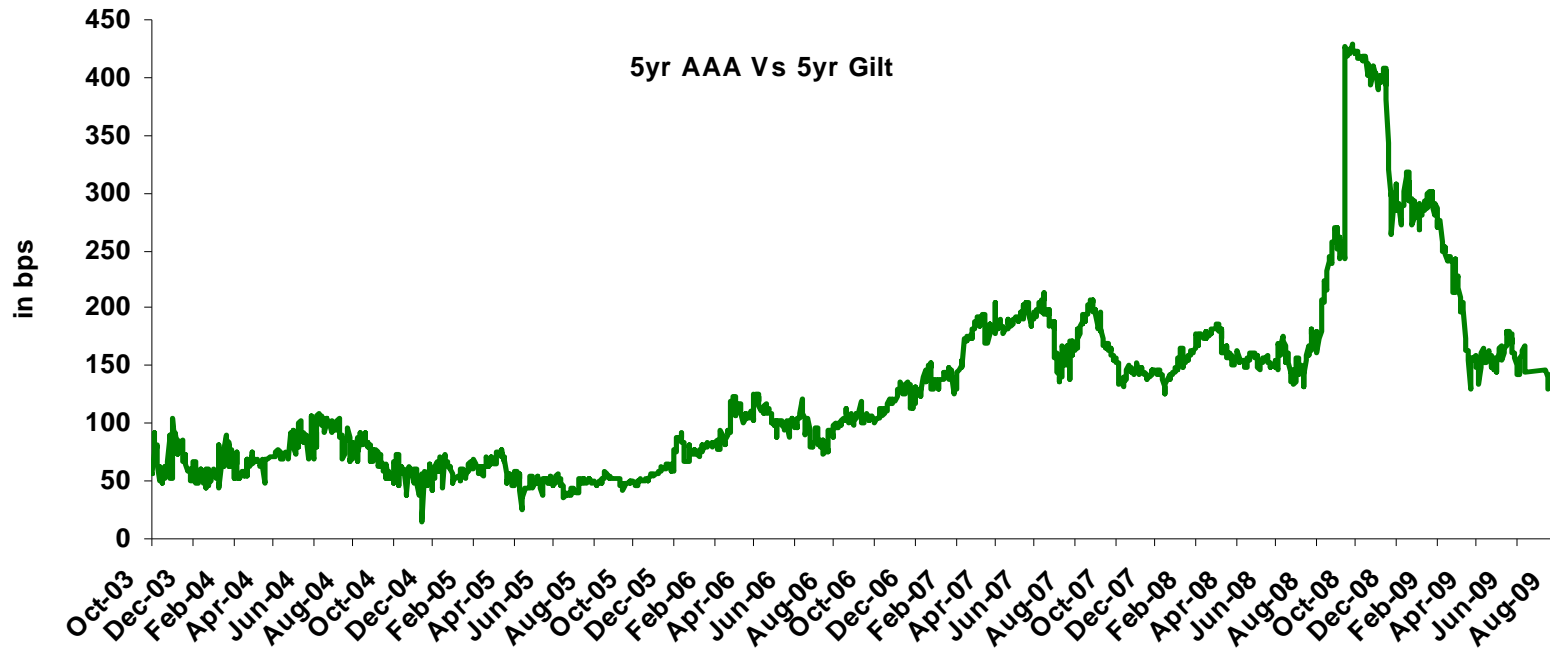


Source: Bloomberg

- Money market rates traded at extremely low levels due to ample liquidity in the system
- Spreads between 1 Year CD's and T-Bill's compressed marginally from the previous month, though spreads between CP's and CD's narrowed once again by as much as 45-50 basis points. Overall, 1 Year CP spreads over 1 Year T-Bills compressed 50 bps over the month.
- Spread compression indicates reduced risk aversion and demand for short-term assets



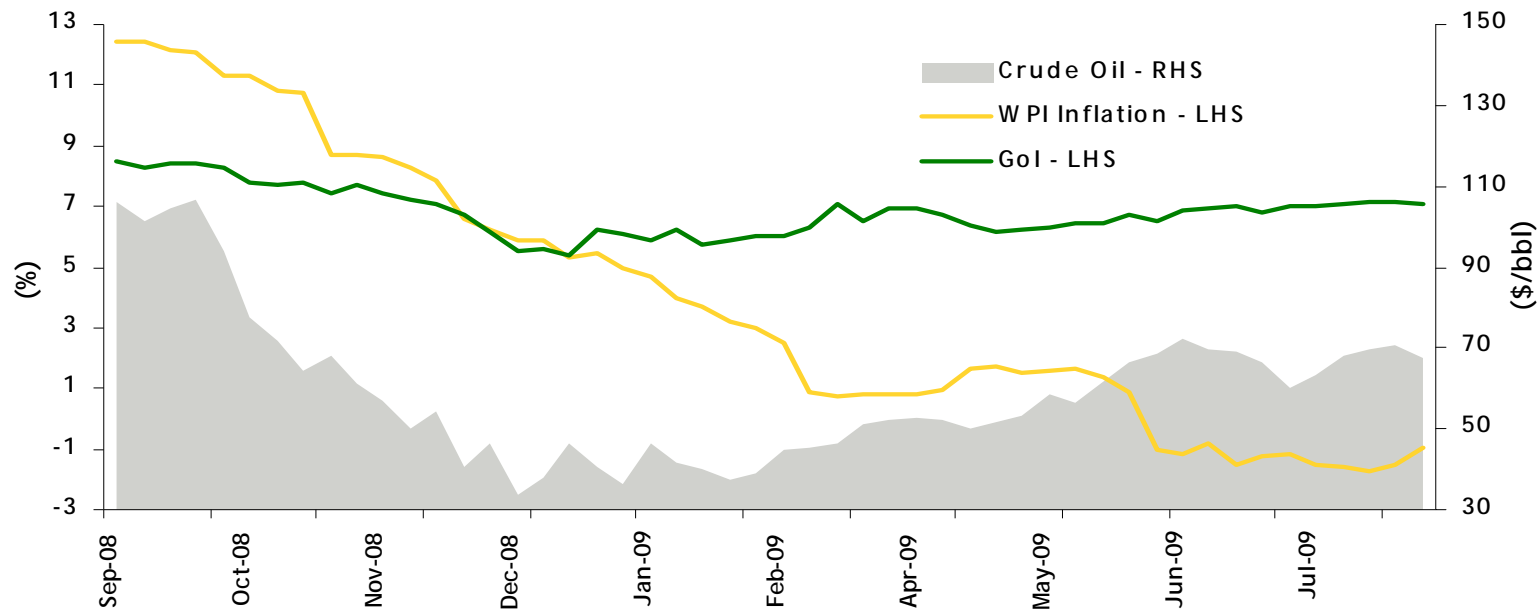
Corporate Bonds spread - slight compression



Source: Bloomberg

- Spreads of 5-Year AAA corporate bonds over their corresponding benchmark sovereigns, compressed slightly during the month, by about 7 basis points from the start of the month to 140 bps
- The 5 year corporate paper yield rose to 8.6% at the end of August from 8.2% at the start of the month

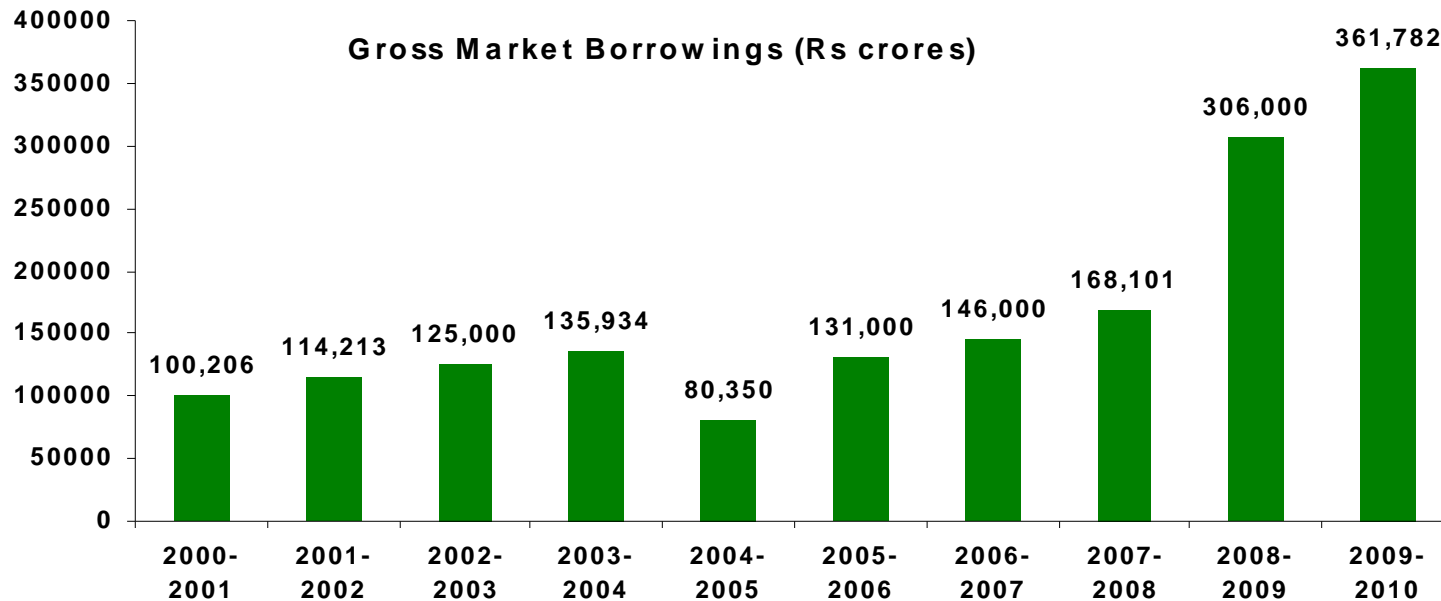
Crude and Inflation Dynamics



Source: Bloomberg

- Crude Oil prices remained in a range with the NYMEX Crude Oil Barrel averaging \$70 during August
- The WPI Inflation Index has risen as much as 1.6% during this month alone, though the headline number remained in the negative (Deflation) and was at -0.21% for the week ended Aug 22, 09. The prices in the current year (week on week) are rising sharply on the back of very steep rises in the prices of Primary Articles (Food Prices) and some other commodities

Government's borrowing program



Source: indiabudget.nic.in

- 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

- Global economic data continues to surprise positively
- Risk trades continue to be in favor leading to increase in global stocks and commodities
- Inflationary pressures likely to build in the coming months taking into account – a) pressure from global commodity price rise b) faltering monsoon situation and c) dwindling base effect of past year
- Liquidity conditions are likely to remain comfortable on a) RBI maintaining status quo on policy rates in calendar 09 b) weak credit pick up as Corporates going slow on CAPEX plans and c) RBI dollar intervention on FII/FDI inflows
- In the short term, risk-aversion may make a comeback leading to strength for the USD and weakness in equities and commodities. Also, longer duration products look oversold. With auction supply coming at the short end, yield curve may flatten
- In the medium term, macro conditions are likely to lead RBI to hike interest rates. We believe RBI may deliver a rate hike in the first quarter of calendar 2010

Ideas for investors

- Risk-averse investors should continue to look at short end of the yield curve
- Investors with a higher risk appetite could look at entering the longer duration products for trading gains as market looks oversold and global risk aversion trades may find favour with investors

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