

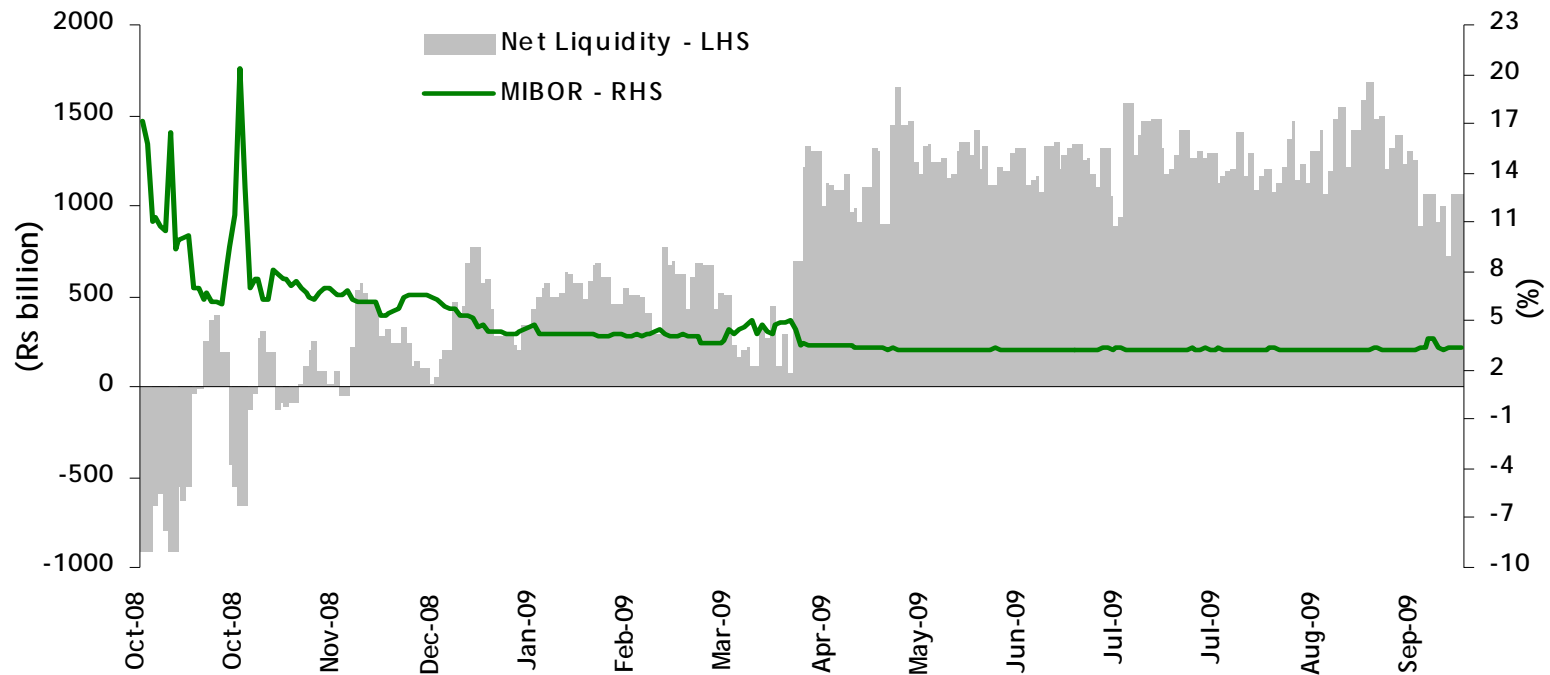
Fixed Income Markets : Current Environment and Outlook

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September 2009

Macro Events

- The buoyancy in Industrial production continued in July, growth was up 6.8% yoy, with the surprise being the very strong consumer goods numbers. On a cumulative basis, growth during Apr-July was at 4.6% v/s 5.6% last year
- The main stimulus for Industrial Production is coming from the Infrastructure (Core) Sector. Following the dismal 2.5% growth posted in July, the index for the six core infrastructure industries was up 7.1% in Aug – the highest growth since Feb 08. The index was up 4.8% during Apr-Aug FY10 vs. 3.3% last year
- The Inflation rate continued its sharp rise led by prices of primary food products. WPI Inflation climbed to 0.70% for the week ended Sep 26th from a negative (-)0.12% on Aug 29th. The base effect (from higher prices last year) too has been adding to this number
- Major economies around the world continue to recover slowly from a prolonged recession. Economic performance has been improving steadily though there are no signs yet of a V-Shaped recovery. The most recent Industrial activity numbers in both the US and the UK have disappointed from the month before
- September was the 21st consecutive month of shrinkage for the US workforce. The number of job losses accelerated sharply from a revised tally of 201,000 during August, and the rate of unemployment ticked up from 9.7% to 9.8

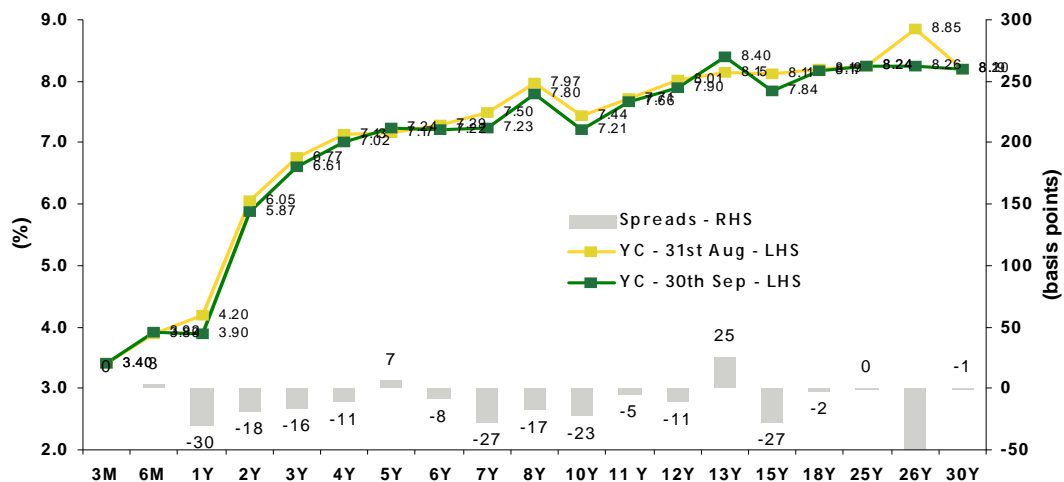
Liquidity - remains abundant



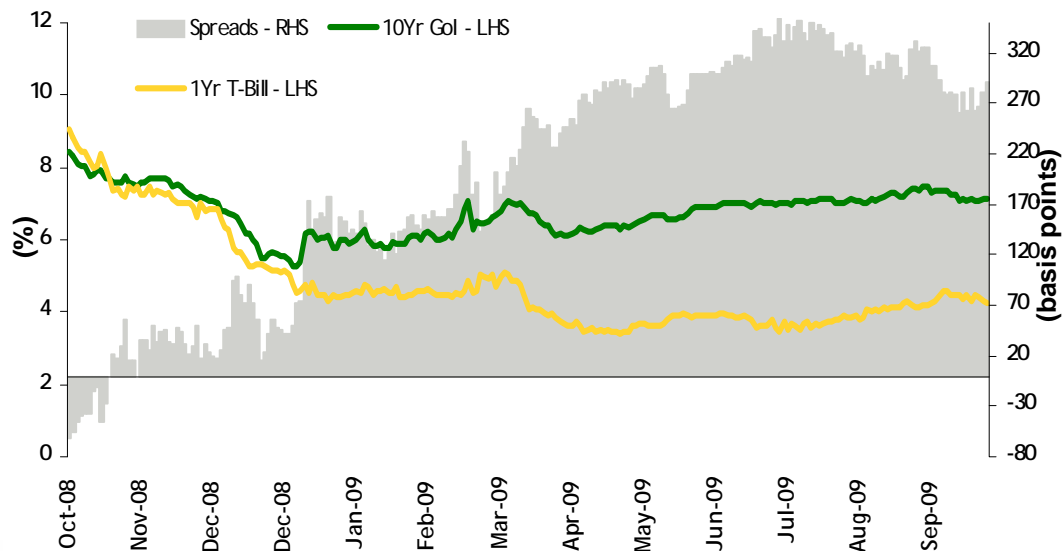
Source: Bloomberg

- The system remained flushed with liquidity in September with the daily RBI LAF reverse repo averaging INR 1,20,000 crore during the month
- MIBOR rates were marginally higher averaging just 3.35% during the month

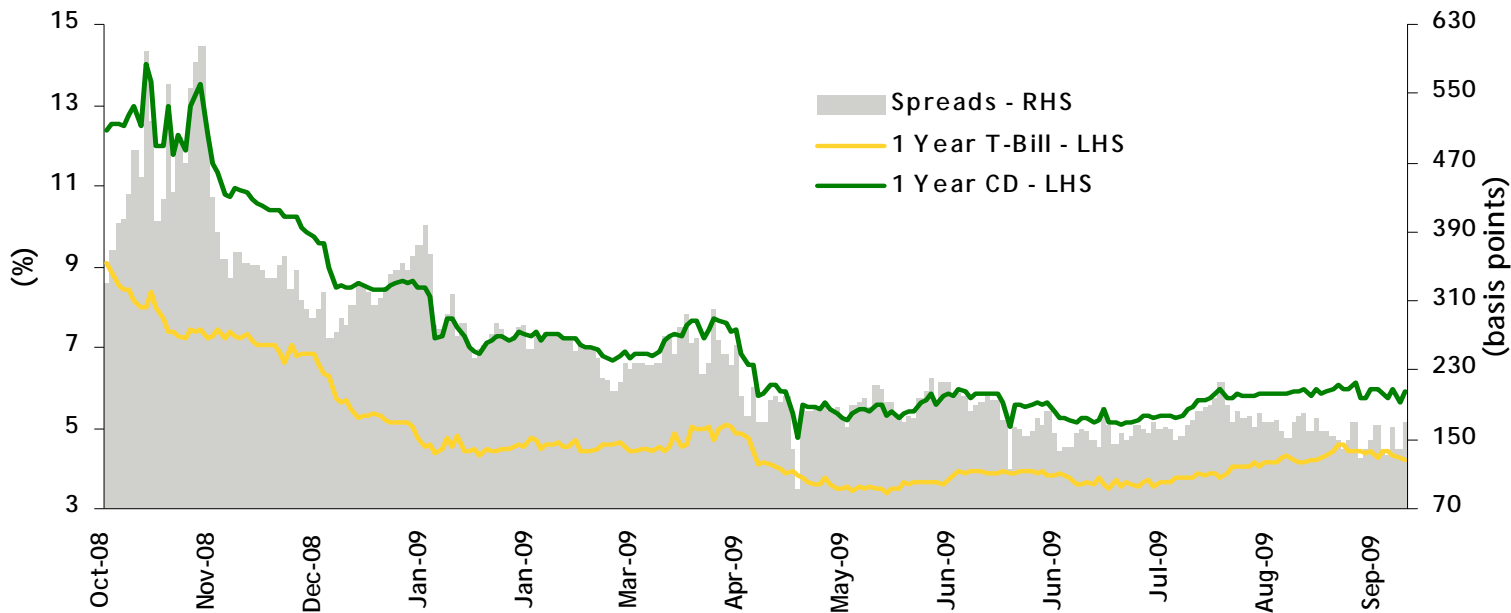
G-Sec Yield Curve - marginally lower



- G-Sec yield curve shifted marginally lower from the previous month as rates across the curve softened slightly
- The 10yr benchmark yield fell to 7.21% from 7.44% at the start of this month
- In the T-Bill Auction results on Oct 07, 91-day T-bill issued at 3.23% and the 364-day paper yielded 4.59%, reporting lower cut-offs on the short end and higher cut-offs on the long end as compared to the previous month
- Current 1yr vs.10yr GOI spread was at 275 basis points 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. Mean reversion is being witnessed since the last few months



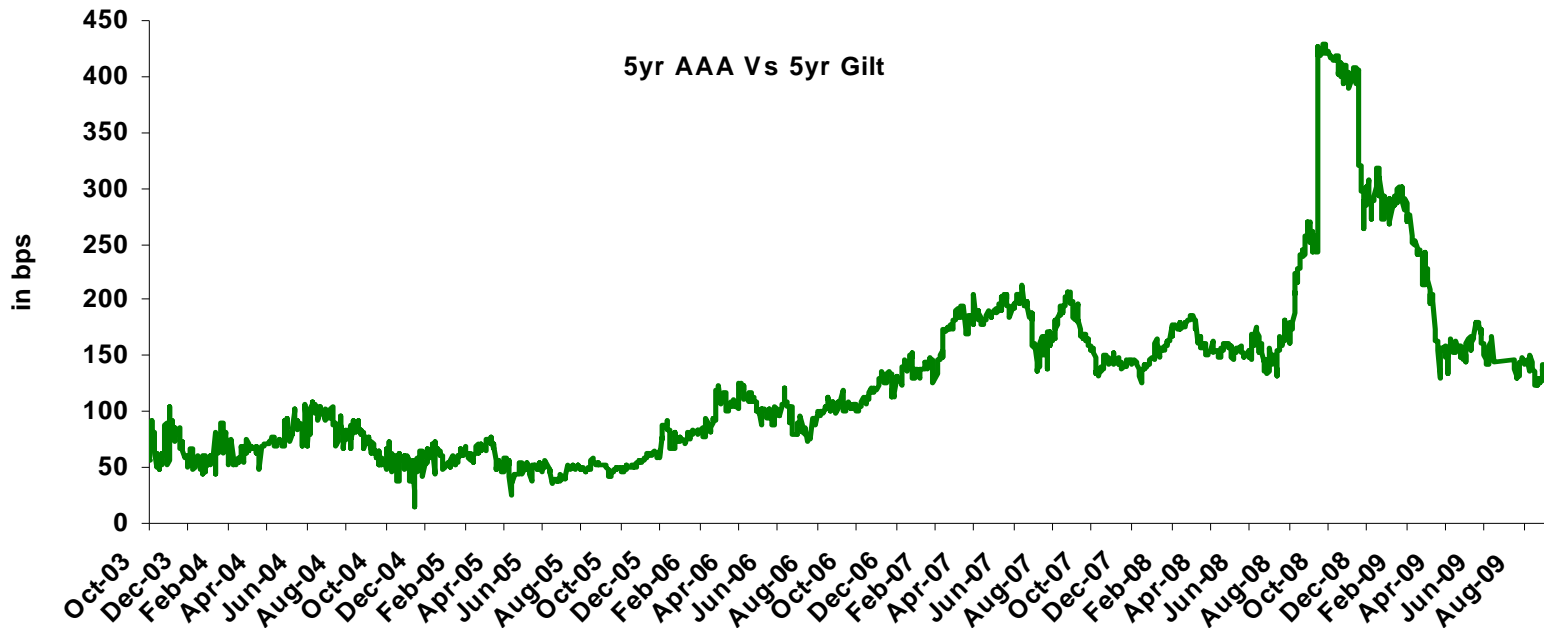
Money Market - low rates amidst easy liquidity



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, and spreads between CP's and CD's widened. Overall, 1 Year CP spreads over 1 Year T-Bills widened 20-25 bps over the month
- Spread compression indicates reduced risk aversion and demand for short-term assets

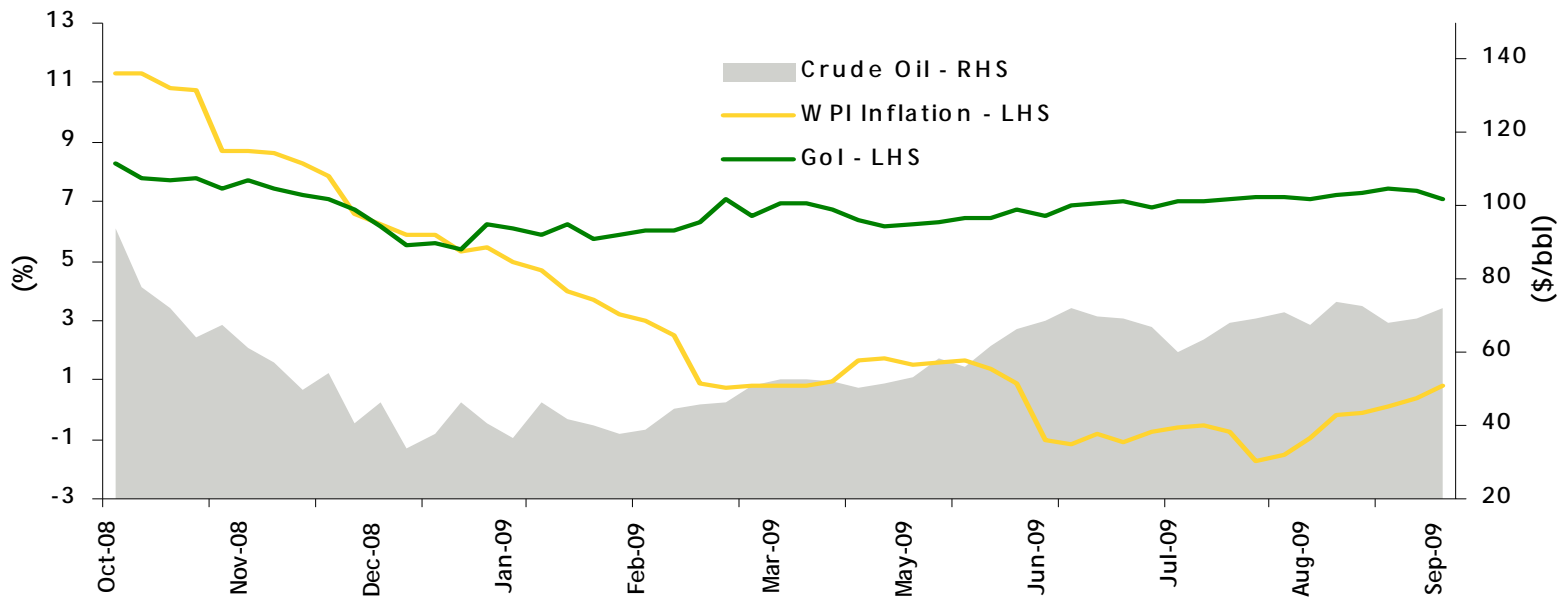
Corporate Bonds spread - unchanged this month



Source: Bloomberg

- Spreads of 5-Year AAA corporate bonds over their corresponding benchmark sovereigns, remained unchanged during the month and stood at about 140 bps
- The 5 year corporate paper yield compressed slightly to 8.45% at the end of September from 8.55% at the start of the month

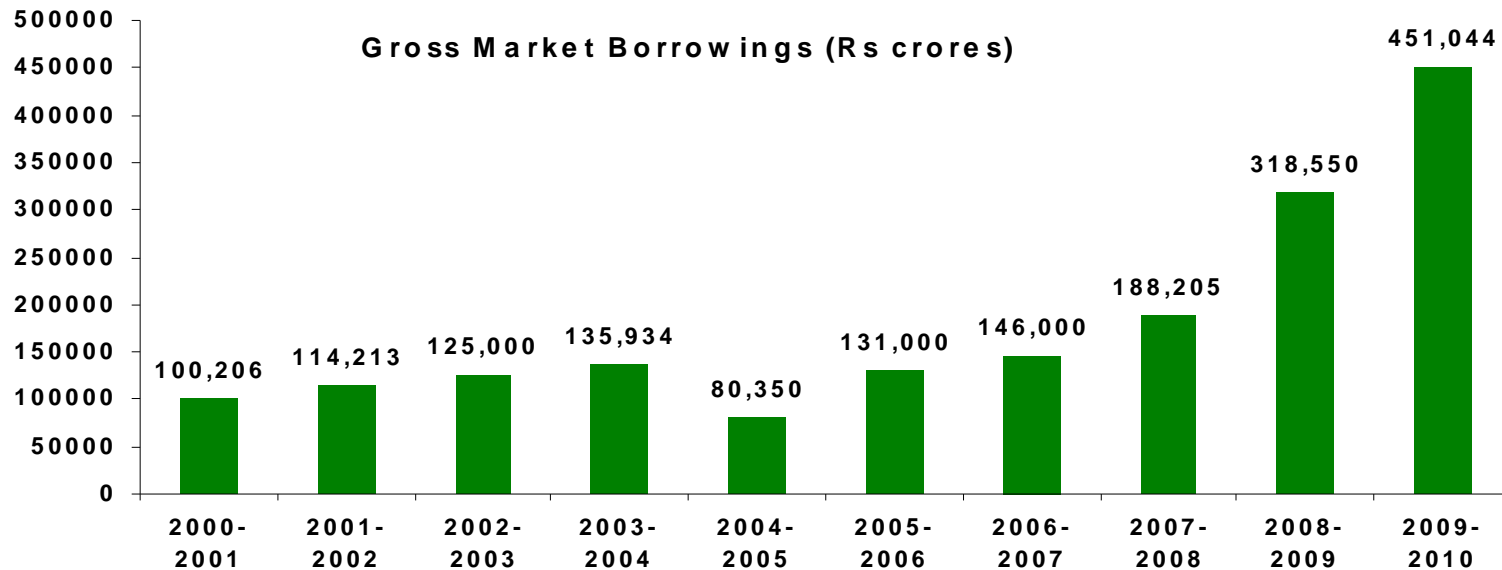
Crude and Inflation Dynamics



Source: Bloomberg

- Crude Oil prices remained in a range with the NYMEX Crude Oil Barrel averaging \$70 during September.
- The WPI Inflation Index rose to 0.70% for the week ended Sep26, 09 from negative (Deflation) of -0.12% on Aug29, 09. The prices in the current year (week on week) continue to rise 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
- With the 2nd half borrowing program being front loaded and RBI hinting at withdrawal of OMO program, all eyes would be on the monetary and credit policy review later in October. The market is likely to remain range bound in the meantime
- 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
- Volatility is likely to once again return at the long end of the yield curve with RBI policy review on the anvil. Investors who have entered at higher yields should take profits

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