Fixed Income Markets :
Current Environment and Outlook

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Macro Events

- Industrial Production (IIP) crossed the double-digit mark in Oct, up 10.3%YoY. Growth was supported by manufacturing (+11.1%) and mining, (+8.2%), while electricity was up 4.7%. On a cumulative basis, growth during Apr-Oct was 7.1% vs. 4.3% last year.

- Inflation rate, as measured by the WPI, rose to as high as 4.78% (YoY) in November from just 1.34% in the previous month. The spike was led primarily by Primary Articles (+11.8% YoY), with Food inflation being the major driver (+16.7%).

- While retaining India's local currency sovereign bond rating at Ba2, Moody's has revised the outlook from stable to positive. However, their ratings still remain below those of S&P/Fitch.

- Global Macro data continues to suggest a favorable turnaround in economic output but the path to a full recovery is likely to be slow and bumpy. Final revisions to GDP data showed that though the major economies are now in the positive territory the recovery will likely be weaker than what is typical coming out of a major recession.

- Recent data from the US has shown continuous strength. Manufacturing activity jumped in December, signaling growth in the sector for a fifth consecutive month. Jobless claims have fallen to a 17-month low.

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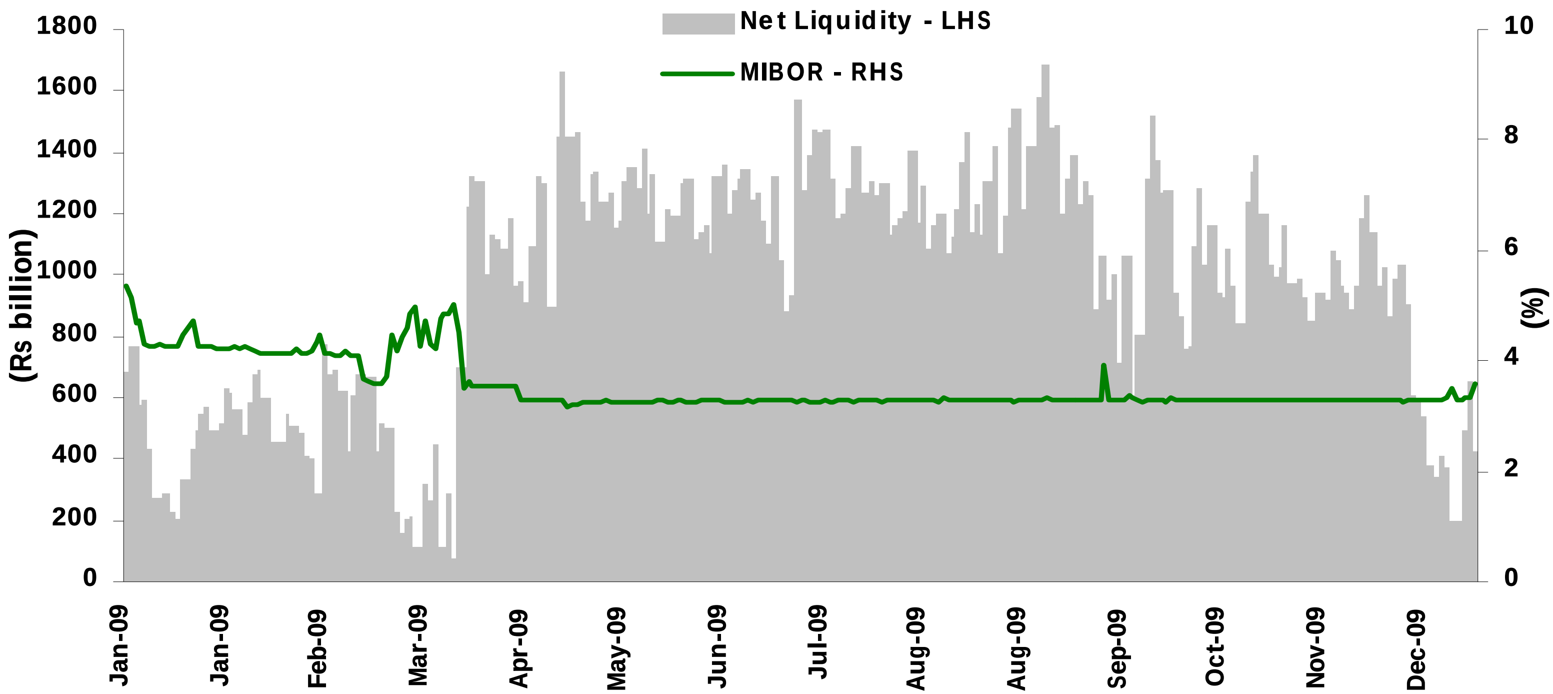
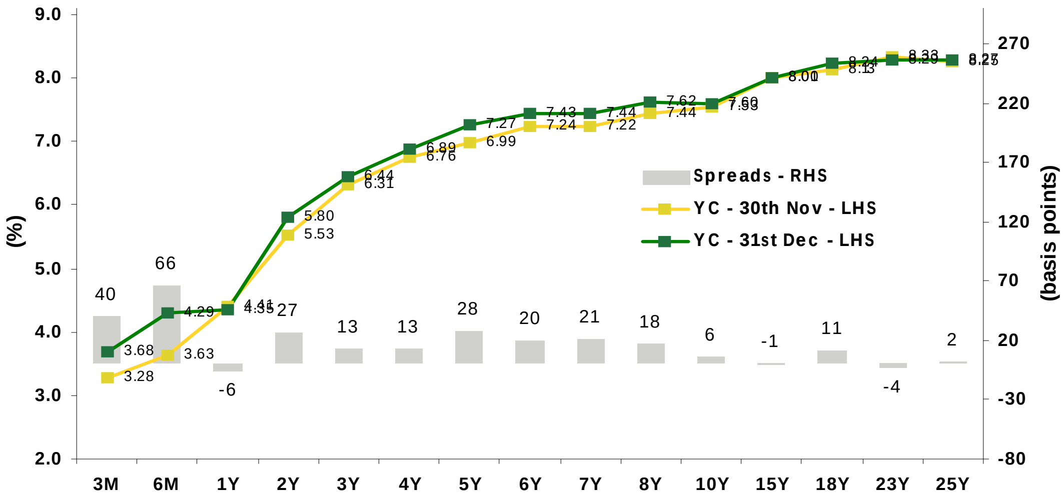
Liquidity – remains comfortable

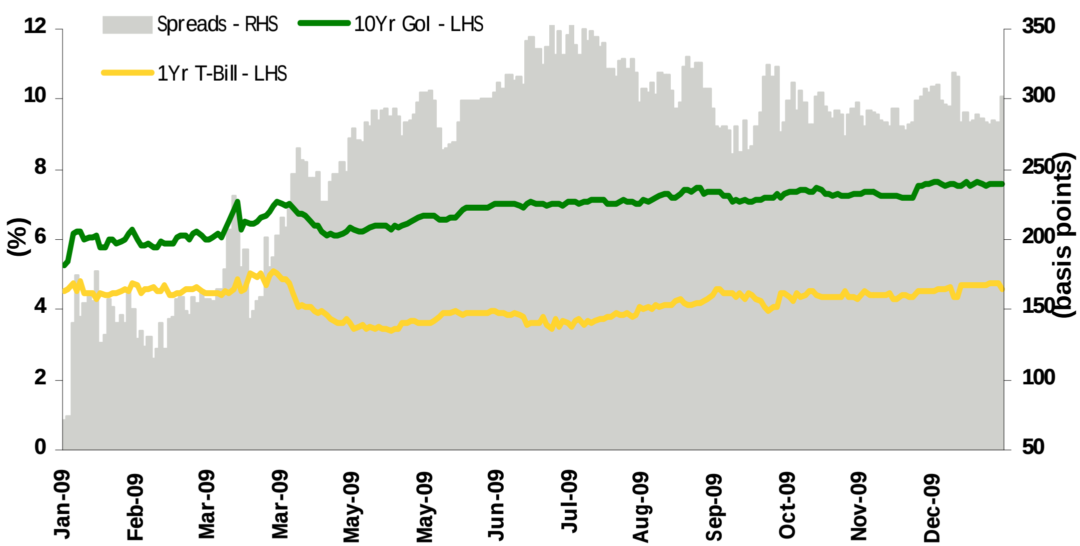


Source: Bloomberg

- Liquidity dipped temporarily in December taking the daily RBI LAF reverse repo average to around INR 73,000 crore during the month.
- MIBOR averaged around 3.25% during the month

G-Sec Yield Curve – steepening





- The G-Sec yield curve flattened with yields at the shorter end of the curve rising more than at the longer end.
- The yield on the 10yr benchmark closed the month at 7.6%, up from 7.55% at the end of the last month.
- In the T-Bill Auction held on Dec 30, the cut–off yields rose significantly, 91-day T-bill was issued at 3.68% and the 364-day paper yielded 4.72%.
- Current 1yr vs.10yr GOI spread was at 300 basis points as against the mean spread of 190 basis point over the last 1 year. We expect the current spread to compress and revert to the mean.

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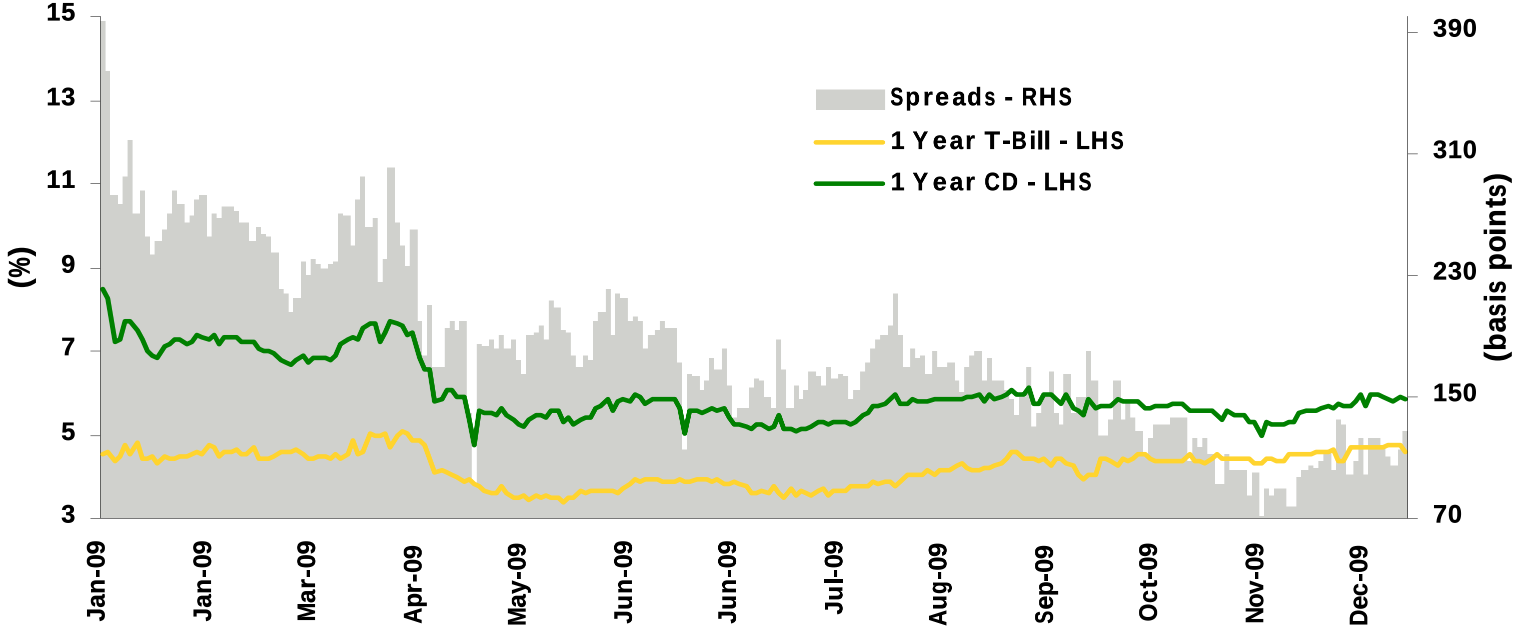
Source: Bloomberg

Money Market – low rates and 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 widened 45 bps during the month, while the spreads between CP's and CD's widened by 30-35 bps. Overall, 1 Year CP spreads over 1 Year T-Bills widened by 75-80 bps over the month.
- Spread compression indicates reduced risk aversion and demand for short-term assets.

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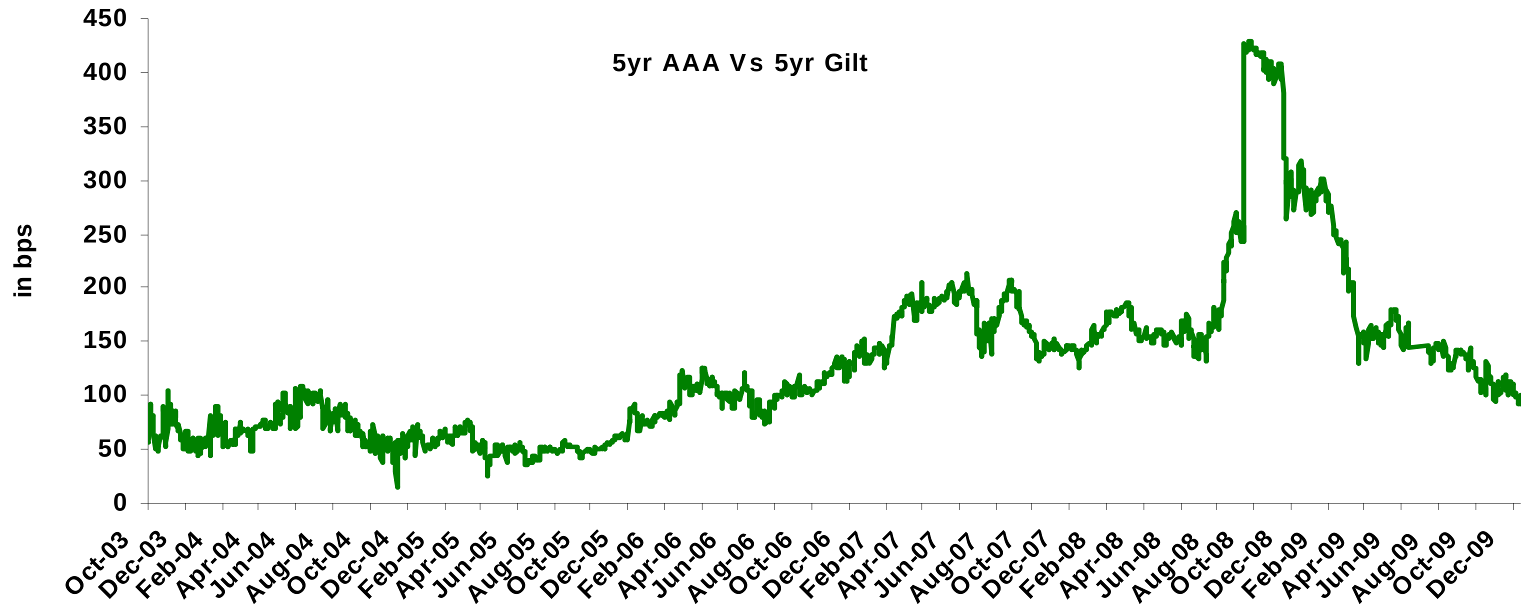
Corporate Bonds spread – slight compression



Source: Bloomberg

- Spreads of 5-Year AAA corporate bonds over their corresponding benchmark sovereigns, compressed further by 5 bps during the month to under 100 bps, with corporate bond rates climbing less than sovereign rates.
- The 5 year AAA corporate paper yield climbed 20bps to 8.25% during the month.

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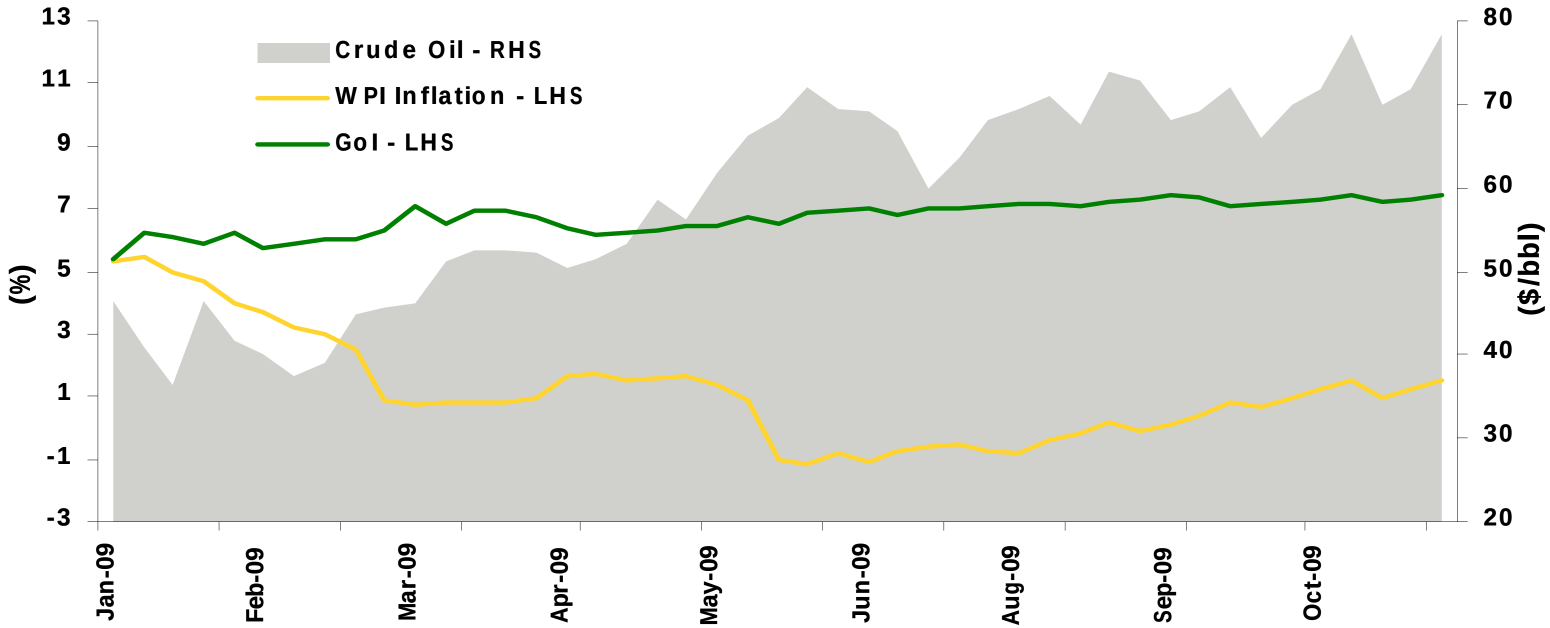
Crude and Inflation Dynamics



Source: Bloomberg

- Crude Oil prices (NYMEX Crude Oil Barrel) climbed back to the $80 levels at the end of December, after averaging around $75 during the month.

- WPI Inflation was higher at 4.78% (yoy) in November from 1.34% in the previous month. Rising prices of food articles remain the biggest threat to the overall inflation number.

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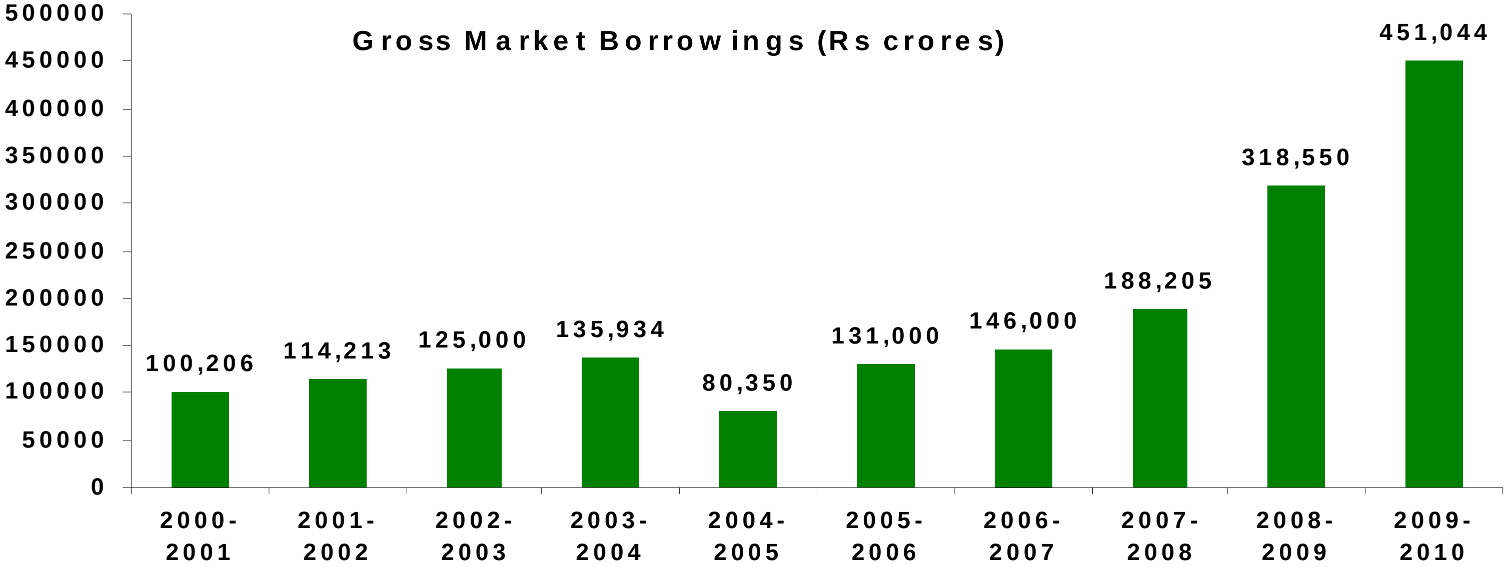
Government's borrowing program



Source: indiabudget.nic.in

- The market will continue to witness volatility though the RBI is to ensure "non-disruptive" borrowing program.
- OMO to be used only in case there is substantial hindrance in the auction process.

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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 continue to build in the coming months taking into account – a) pressure from global commodity price rise b) high food inflation and c) base effect of past year
- Liquidity conditions are likely to remain comfortable on
  - alternative sources of funding available to corporates (equity/ECBs)
  - weak credit pick up as corporates going slow on CAPEX plans and
  - RBI dollar intervention on FII/FDI inflows
- 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. It may also take steps to temper excess liquidity.

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Ideas for investors

- Risk-averse investors should continue to look at short end of the yield curve.

- Yields at the long end are likely to continue to be volatile ahead of the credit policy review due at the end of the month. The market would also be looking at the FY11 budget numbers to be presented by end February. Investors should take a call at that point in time regarding investments at the long end.

- 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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