

Fixed Income Markets : Current Environment and Outlook

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Macro Events

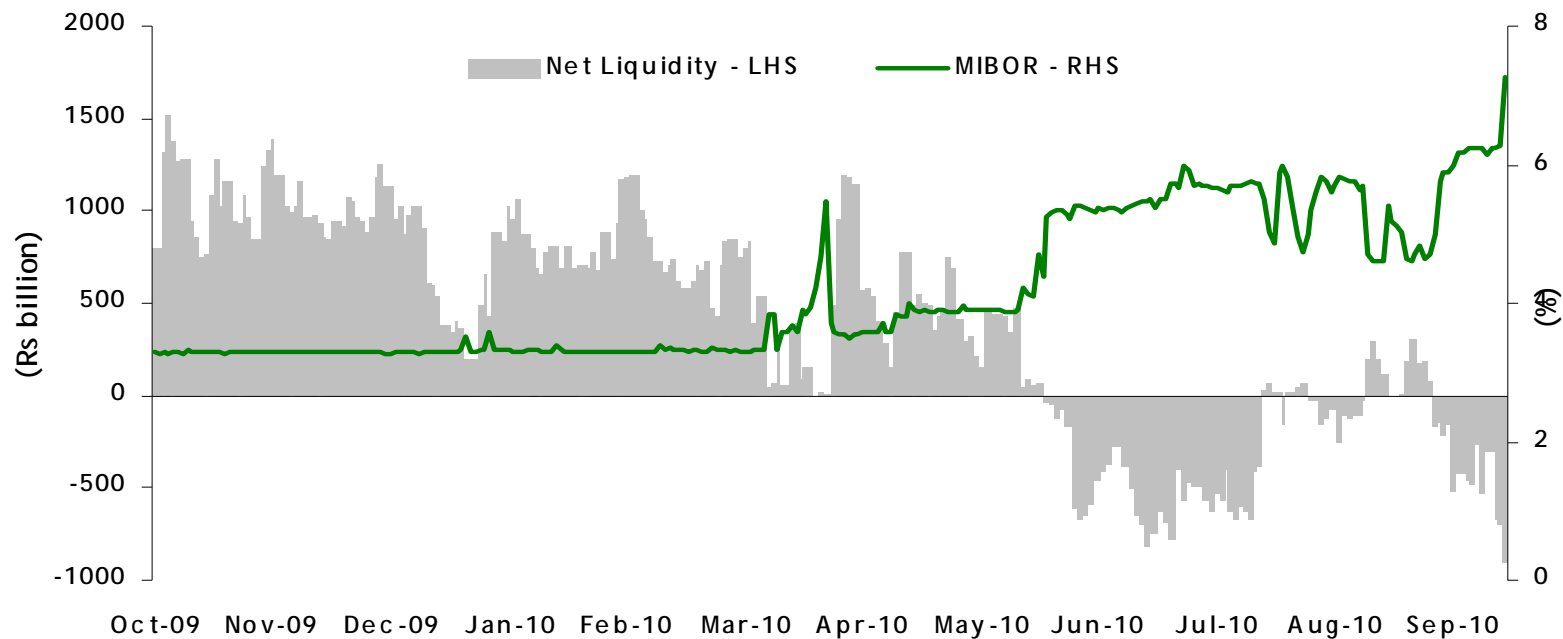
Domestic

- India's GDP grew 8.8% YoY in Q1FY11, its fastest pace in 3 years, on strong manufacturing growth and farm output.
- Industrial production (IIP) rose abruptly to 13.8% YoY in July '10 (7.2% in Jul '09) from 5.8% in Jun '10. The cumulative growth for the period April-July 2010-11 stands at 11.4% over the corresponding period of the previous year.
- Growth in the six major infrastructure industries, which constitute the core sector, fell to 3.7% in August from 4% in July. While cement and coal production remained flattish in August, crude oil output continued to grow near its highest level in over a decade.
- Inflation , as measured by the WPI Index, eased to 8.5% YoY in August, from 9.8% in July, according to a new WPI Index series with 2004-05 as the base year. Inflation was led by primary articles up 15.8%, fuel up 12.6% and manufactured products up 4.8%.

International

- Economic growth measured by GDP is now in the positive territory for the US, UK and the Euro zone, though the unemployment rate continues to remain high. US GDP growth was revised marginally higher to 1.7% QoQ in Q2'10 slowing down sharply from a 3.7% rate in Q1'10. GDP growth in the UK for Q2'10 rose by 1.7% on the year seeing a marginal upward revision.
- The global economic recovery is building steam led by strong growth in Asia although the sovereign debt crisis in Europe is presenting risks to the recovery.

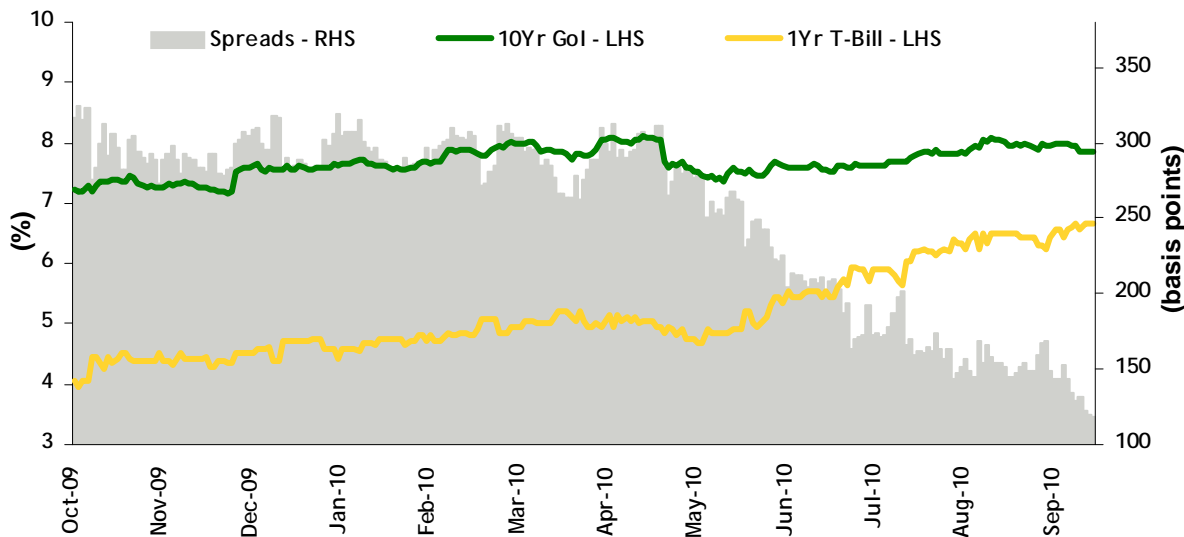
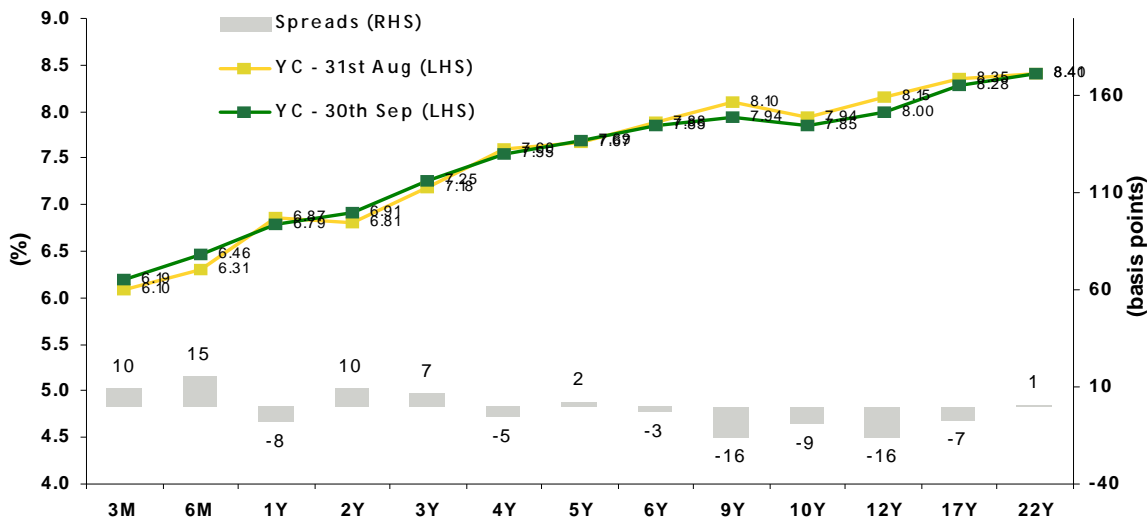
Liquidity - remains stubbornly tight



Source: Bloomberg

- Liquidity in the system remained tight during September '10. The daily average money borrowed by banks under LAF was Rs 25,000 crore (approx.)
- MIBOR rates went higher, averaging over 5.71% over September '10, from 5.38% over August '10 amidst continuing tight liquidity.

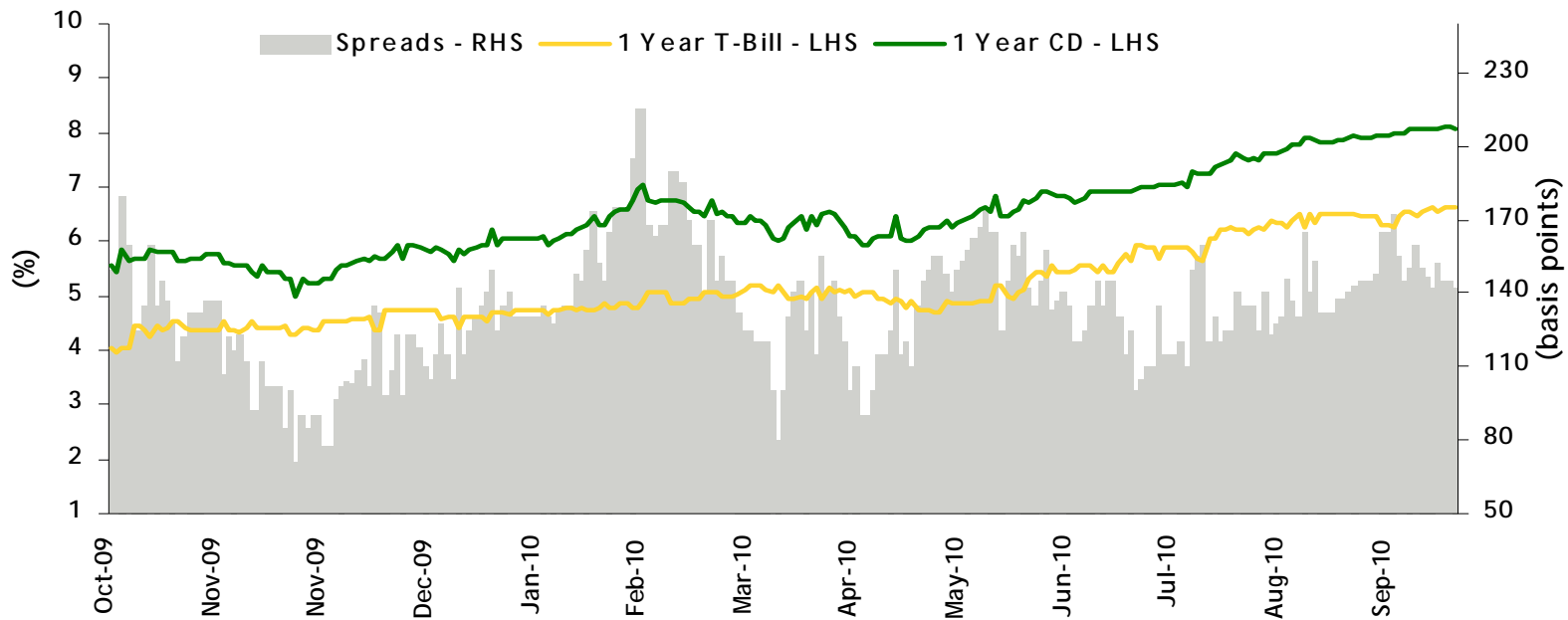
G-Sec Yield Curve - flattening



- The G-Sec yield curve flattened with yields on the short end of the curve moving higher as yields on the long end fell.
- The yield on the 10yr benchmark fell 9 bps in September to 7.85%.
- In the latest T-Bill Auction, the 91-day T-bill was issued at 6.19% (6.19% in Aug '10) and the 364-day paper yielded 6.70% (6.54% in Aug '10).
- Current 10yr vs. 1yr GOI term spread fell to 130 basis points during September. The spread has averaged 240 bps during the last year



Money Market -rates remain high amidst tight liquidity



Source: Bloomberg

- Money market rates rose in the month of September '10 amidst tighter liquidity in the market.
- Spreads between 1 Year CD's and T-Bill's ended September '10 at 150 bps while spreads between 1 Year CP's and CD's were 17.5bps. Overall, 1 Year CP's traded at a spread of 167.5 bps over 1 year T-Bills



Source: Bloomberg

Corporate Bonds spread - unchanged



Source: Bloomberg

- Spreads of 5-Year AAA corporate bonds over their corresponding benchmark sovereigns, contracted marginally by 5 bps during September '10 to 80 bps.
- The yield on the 5 year AAA corporate paper closed the month of September '10 at 8.5% remaining more or less unchanged from the end of August '10.

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- The yields of short term papers are expected to reflect the general level of liquidity scenario in the market.
- It is expected that the liquidity situation might improve quickly with the start of government expenditure in the new quarter. However, we expect the liquidity to be largely balanced to deficit for the larger part of the new quarter.
- The money in circulation is expected to build up as we get into the busy season. India's M3 growth at 15.20% for September'10 falls lower than the yearly average of 16.18%. However, we are seeing it recover from the lows seen in May 2010 of 14.50%.
- Small steps in fiscal consolidation and conforming within the budgeted estimates are expected to improve the positive sentiment towards sovereign assets.
- Its largely expected that the non-banking credit growth within the system is going to surpass the banking credit growth. Hence, we do not expect the credit spreads of papers in the medium segment to contract from the current levels. The spreads are expected to be within the current band with a widening bias.

Portfolio Actions during the month

- **Religare Liquid Fund**
The Fund maintained a low duration in anticipation of continued tight liquidity conditions going forward.
- **Religare Ultra Short Term Fund**
The Fund reduced duration in anticipation of tighter liquidity conditions. The fund also reduced its MTM asset allocation to below 10% to reduce the volatility in returns
- **Religare Short Term Plan**
The Fund maintained a duration of around 12 months. Incrementally, we are increasing exposure to liquid papers in the 3-6 month segment.
- **Religare Credit Opportunities Fund**
The Fund is a mix of CPs and NCDs and will continue to look at names available at attractive yields.
- **Religare Active Income**
The Fund continued to have a lower duration in line with the liability profile of the Fund.

Ideas for investors

- Risk-averse investors should continue to look at short end of the yield curve.
- Yields at the long end have risen in the past due to inflationary concerns and RBI's stance on the liquidity. The benchmark 10Y gilt is expected to trade in a range of 7.75%-8.25% for H2, but with fiscal position improving going forward and inflation expected to taper off due to base effect gilts may surprise on the positive side.
- Investors with an investment horizon of 3-6 months may also look at investment in Religare Short Term Fund and Religare Credit Opportunities Fund.

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