

Fixed Income Markets : Current Environment and Outlook

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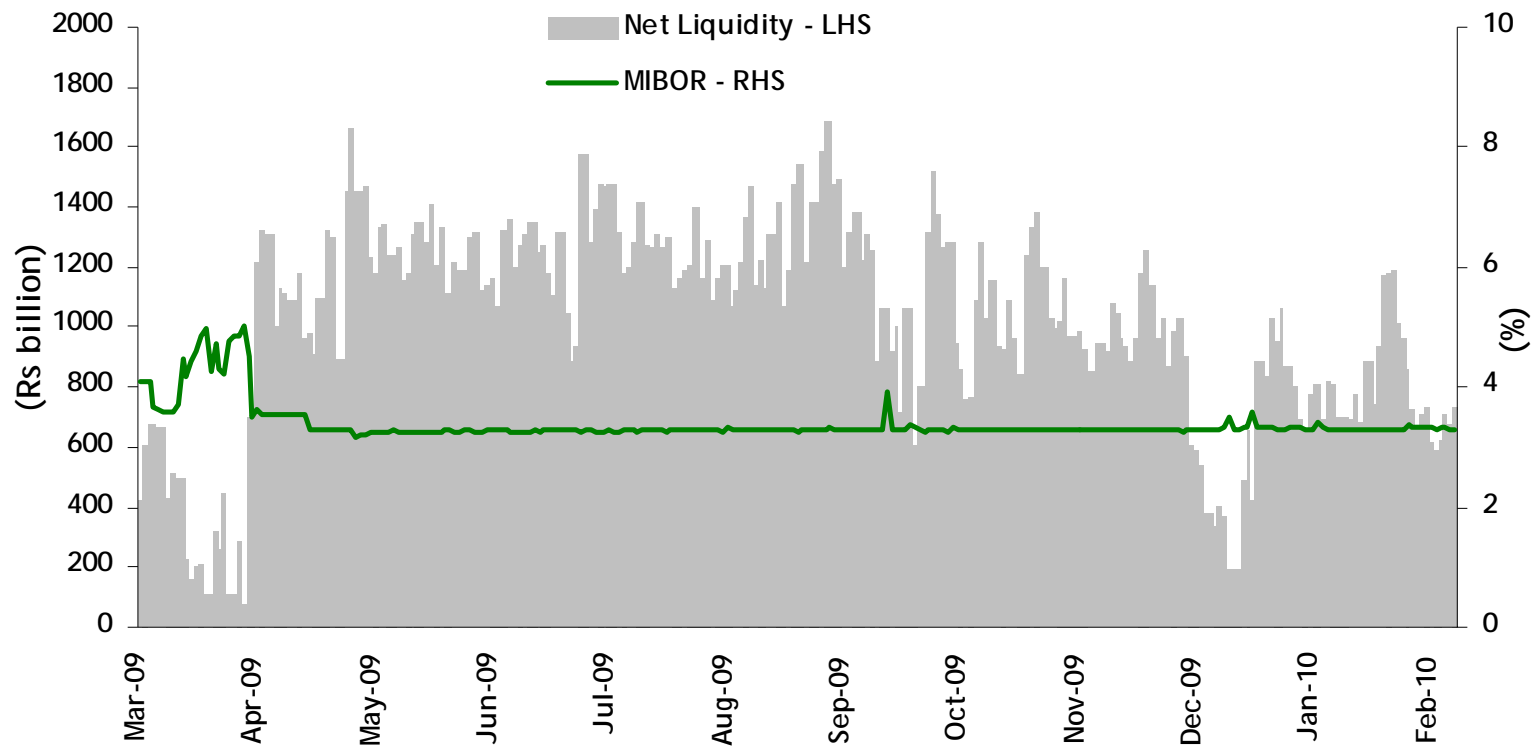
Macro Events

- The Union Budget 2010-11 was much in line with expectations as there was only partial rollback of certain stimulus. Net govt. borrowings is lower by Rs.52,000cr from previous fiscal.
- India's quarterly GDP growth rate dropped to 6% in Oct-Dec FY10. In the same period last fiscal the economy grew by 6.2%.
- The slowdown was primarily due to a 2.8% fall in agriculture production and 2.2% in community, social and personal services. The Manufacturing sector continued its upward march expanding by 14.3% against 1.3% in the same period last year.
- Industrial Production (IIP) in Dec rose 16.8% - the highest since FY95. Cumulatively, during Apr-Dec, output rose 8.6% v/s 3.6%. growth was led by an 18.5% rise in manufacturing – the highest since FY95 with growth led by transport equipment and machinery up 82% and 45%.
- Inflation rate, as measured by the WPI, rose further to 8.56% (YoY) in January from 7.31% in the previous month.
- Economic growth measured by GDP is now in the positive territory for the US, UK and the Euro zone. US GDP grew a strong 5.9% in Q4'09 helped mainly by the restocking of their inventory levels, by corporates, which were at historic lows. GDP growth in the UK moved into positive territory in Q4'09, following six consecutive quarters of contraction.

Union Budget 2010-11- Highlights

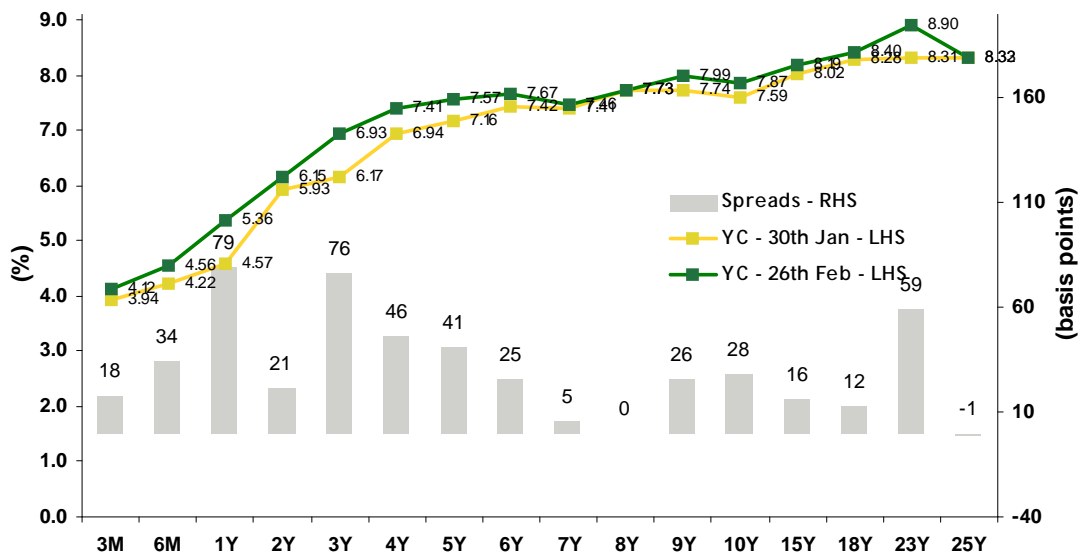
- The Union Budget 2010-11 was much in line with expectations as there was only partial rollback of certain stimulus.
- India's Fiscal Deficit target for next year is unchanged at 5.5% of GDP which aggregates around Rs.3.8 lakh crore.
- Net government borrowings is seen lower by Rs.52,000 crore compared to last fiscal at Rs.3.45 lakh crore against Rs.3.97 lakh crore.
- The Fiscal Deficit for FY12 was pegged at 4.8% while that for FY13 can be expected at 4.1%.
- The Fiscal Deficit for FY10 was revised to 6.9% of GDP from 6.5% in the initial Budget estimates.
- GDP growth in FY10 was expected to be 7.2% or higher despite negative growth in the Agricultural sector.
- GDP growth in FY11 was expected to be higher than 8% with the possibility of 10% plus growth in the not too distant future.
- Inflation led by a surge in Food prices due to supply-side bottlenecks caused by Drought, remained a major concern for the economy in the near-term.

Liquidity - remains comfortable

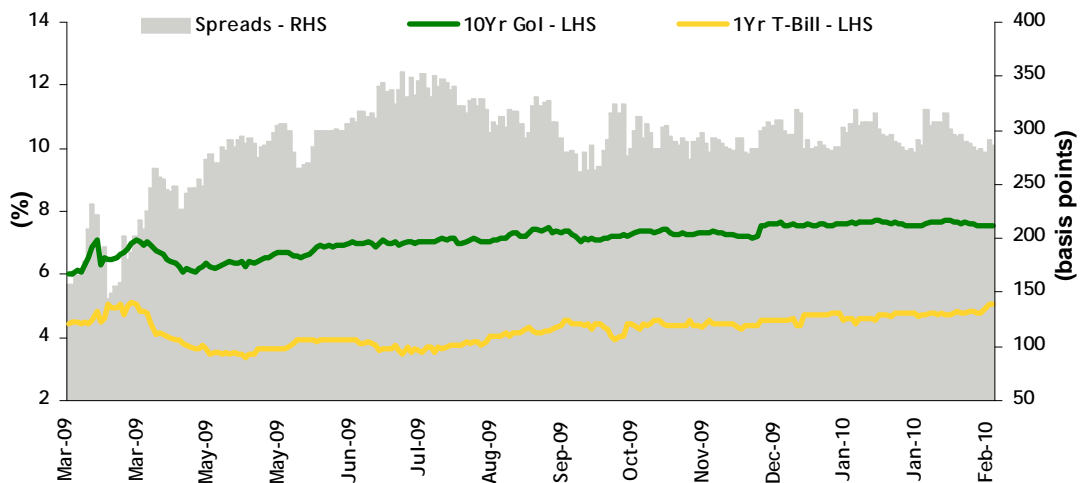


- Liquidity remained comfortable with the daily RBI LAF reverse repo average at around INR 80,000 crore during Feb 2010.
- MIBOR averaged around 3.3% during the month.

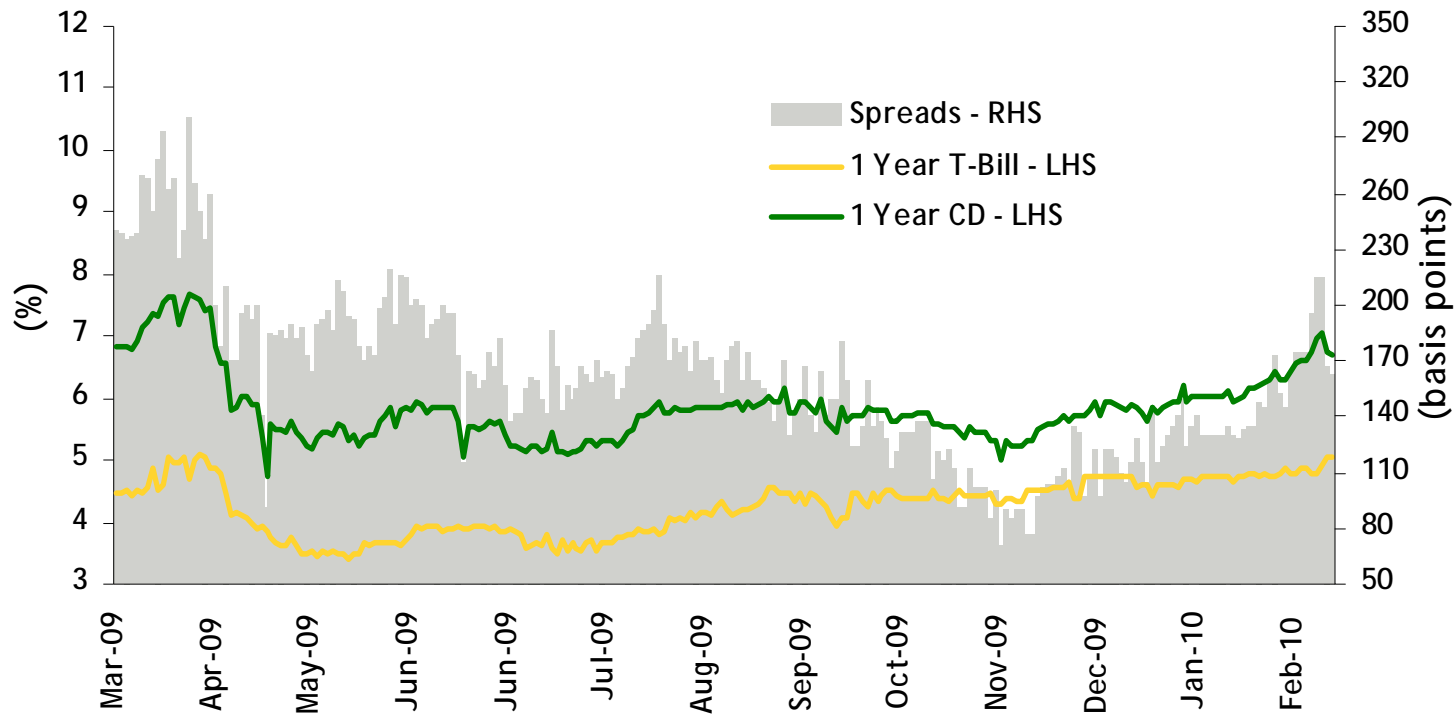
G-Sec Yield Curve - continued flattening



- The G-Sec yield curve flattened further with a relatively higher rise in yields at the short end of the curve.
- The yield on the 10yr benchmark rose 28 bps during the month closing at 7.87%.
- In the T-Bill Auction held on Feb 24, the 91-day T-bill was issued higher at 4.13% and the 364-day paper yielded 5.01%.
- Current 1yr vs.10yr GOI spread was at 250 basis points as against the mean spread of 200 basis point over the last 1 year. We expect the current spread to compress and revert to the mean.

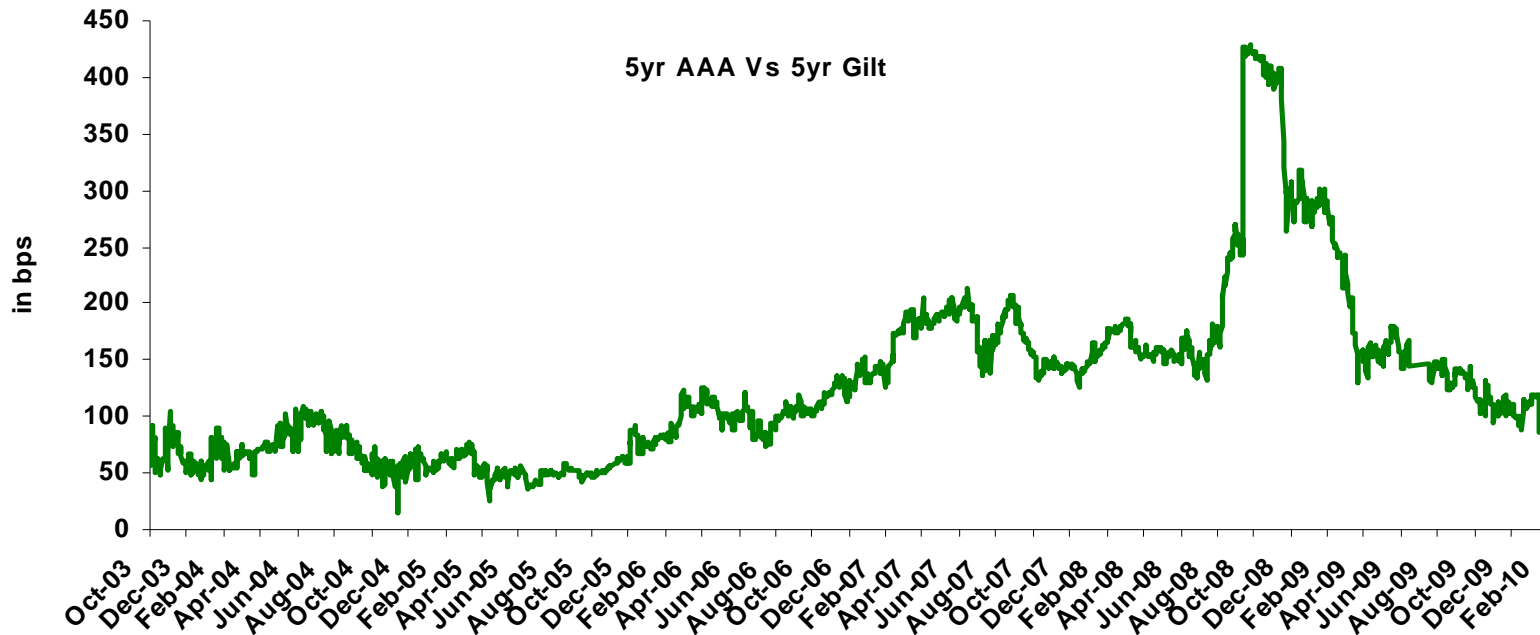


Money Market - higher rates amidst easy liquidity



- Money market rates continued to rise amidst comfortable liquidity in the market.
- Spreads between 1 Year CD's and T-Bill's widened 20 bps during the month, while the spreads between CP's and CD's widened by 15 bps. Overall, 1 Year CP spreads over 1 Year T-Bills widened by 35 bps over the month.

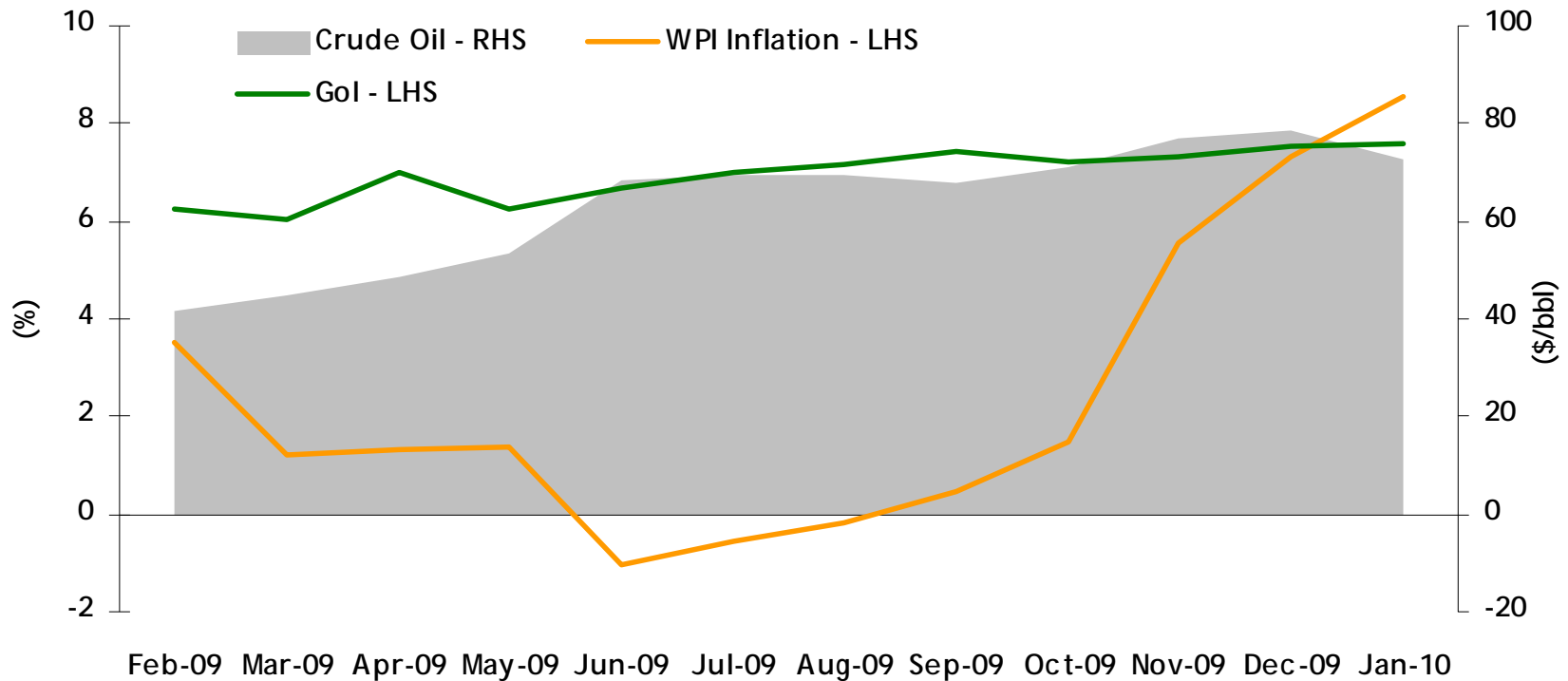
Corporate Bonds spread - contraction



Source: Bloomberg

- Spreads of 5-Year AAA corporate bonds over their corresponding benchmark sovereigns, contracted by 10 bps during the month to just under 110 bps, with sovereign rates rising even higher than the 30bps rise in corporate bond yields.
- The yield on the 5 year AAA corporate paper climbed to 8.6% from 8.3% during February.

Crude and Inflation Dynamics



- Crude Oil prices (NYMEX Crude Oil Barrel) drifted higher to \$78 at the end of February from \$74 at the start of the month.
- WPI Inflation climbed sharply to 8.56% in January from 7.31% in the previous month. The rise in Food prices moderated but inflation was seen spreading across the board.

Religare MF: Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

- Global economic data continues to point towards recovery gaining traction.
- Risk trades are back in favour with investors at the moment betting on an EU rescue of Greece.
- Euro is likely to remain range bound till clarity emerges on Greece rescue and this may have a bearing on risk trades globally.
- Domestically, 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 a) alternative sources of funding available to corporates (equity/ECBs) b) weak credit pick up as Corporates going slow on CAPEX plans and c) RBI dollar intervention on FII/FDI inflows.
- In the medium term, macro conditions are likely to lead RBI to hike interest rates. However, we believe that after raising the reserve requirement in January policy, the Central Bank may revisit policy rates only in April 2010.

Ideas for investors

- Risk-averse investors should continue to look at short end of the yield curve.
- Yields at the long end have increased post budget. Inflationary pressures are likely to remain a concern and yields are likely to continue to move higher targeting 8.25%-8.40% range on the 10 year benchmark. Investors with an investment horizon of >6 months can look to invest in long duration products at that time.
- 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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