

Key Market Highlights

- India's IIP growth continued its strong performance with 15.1% growth in February 2010 and 16.7% growth for January 2010.
- Export growth improved from 11.5% for January 2010 to 34.8% for February 2010.
- Import growth improved from 35.5% for January 2010 to 66.4% for February 2010.
- Inflation numbers were flattish compared to last month with WPI inflation coming at 9.90% for March 2010 v/s 9.89% February 2010, which was led by primary articles 14.1% (food price inflation was high at 16.7%), fuel prices by 12.7% and manufactured products by 7.1%. Inflation is expected to plateau from here and slowly move lower as higher base effect kicks in
- Credit growth further improved to 17.05% in beginning of April 2010 v/s 16.05% in beginning of March 2010
- Deposit growth dropped to 15.98% in beginning of April 2010 v/s 18.14% in beginning of March 2010

Source: www.rbi.org.in, Bloomberg

RBI Quarterly Credit Policy – April 2010

- RBI hiked Repo rate and Reverse Repo rate by 25 bps each to 5.25% and 3.75% respectively. Bank rate unchanged at 6%
- RBI also hiked CRR by 25 bps from 5.75% to 6%, effective from April 24, 2010. This has drained around Rs. 12,500 crs of liquidity from the system.
- April 2010 policy is guided by three major considerations:
 - Lower policy rates can give rise to inflationary expectations. Also, even after 25 bps rate hike in March 2010, the real policy rates (policy rates minus inflation) are still negative.
 - Inflationary pressures are very strong with evidence from a specific food price inflation & it is now transforming into general inflation which would give rise to further inflationary expectations.
 - Managing government borrowing program for FY2010-11 is seen as a bigger challenge compared to last year as the previous year's borrowing program was supported by MSS unwinding as well as open market operations by RBI. Since, such support would not be available in any significant way for FY2010-11, RBI would have to ensure that the liquidity in the system is not too low for the government as well as private sector borrowing requirement.
- RBI would respond to inflationary situation swiftly and effectively to ensure that inflationary expectations are anchored.

Source: www.indiabudget.nic.in

Market Impact

- Government securities market was volatile during the month of April 2010. With IIP growth for February coming strong once again at 15.1% and inflation being very close to the double digit mark at 9.90% for March, the sentiment turned bearish and the yield on 10 yr benchmark bond breached 8.00% mark and went upto 8.08%.
- With credit policy from RBI slated on April 20, 2010, the market was equally divided between a 25 bps rate hike and a more aggressive 50 bps hike in rates from RBI along with a 25 bps hike in CRR. However, RBI did only a 25 bps rate hike along with a 25 bps CRR hike. Also, the RBI officials assured the market that it would prefer to hike rates in smaller doses of 25 bps each as it did not want to shock the market and jeopardize the recovery which is still in its early stage. At the same time, while the problem of continuous supply remains, there was no data point release slated for the next couple of weeks and as a result the yields softened across the curve. This changed the sentiment of the market and a lot of buying interest was seen from market participants.
- However, the 10 yr benchmark bond i.e. 6.35% bond maturing in 2020 underperformed other bonds as there was expectation that there could be a new 10 yr benchmark bond announced and the existing 10 yr benchmark bond would become "off the run" security. Therefore, the buying interest was seen more in 12 year bond i.e. 8.20% bond maturing in 2022. This bond outperformed all other bonds in the market and softened from 8.33% in the middle of April to around 8.00% by the end of the month.
- For the last auction of the month, RBI announced auction of a new 10 yr benchmark bond, and while market was expecting the cut off to be announced around 7.85%, it actually came at a more aggressive level of 7.80%. With lower outstanding of this bond, and relatively higher demand seen in the new 10 yr benchmark bond, the yield softened further and ended at 7.74% on the last day of the month.
- Corporate bond yields significantly softened especially in 1 yr – 3yr bond segment due to high demand coming from FIIs, as the differential between interest rates of developed economies and that of emerging markets is attractive. The three year corporate bond yield softened from around 7.65% to 7.20% and the two year bond yields softened from 7.30% to 6.85% during the month. 10 yr corporate bond yield softened relatively lesser extent from 8.85% to 8.70% as FII demand is not seen at the longer end of the corporate bond curve.
- INR Swap curve was flattish with 5 year swap rates closing at 6.88%, two bps lower than previous month's closing at 6.90%. The 2 year OIS rate softened from 5.68% at the end of previous month to around 5.57% at the end of April 2010

Source: www.bloomberg.com

Our assessment

INR Yields were volatile during April on account of:

1. Continuing strong performance of Industrial production growth at 15.1% and a higher inflation at 9.90% which pushed up the yield of 10 year benchmark up to more than 8.08% mark.
2. Fear of an aggressive hike in Repo / Reverse Repo rate by RBI kept the sentiment bearish for the first half of the month.
3. RBI hiked both Repo rate and Reverse Repo rate by 25 bps in its credit policy meeting, which was on the lower end of the range expected by market. As market was equally divided between 25 and 50 bps rate hike, the sentiment turned bullish. At the same time, RBI officials assuaged fears of market participants by saying that they preferred to hike rates in smaller doses of 25 bps each.
4. With very few data releases slated in the next couple of weeks, there was a lot of buying interest seen, which caused the yields to soften further.

Going Forward

1. Markets are expected to remain volatile in the near term as on the one hand there is continuous supply of bonds of around Rs 11,000-15,000 crs per week, which would push the yields upwards.
2. Also, the growth numbers are expected to remain strong and inflation is also expected to remain in high single digit for the month of April 2010.
3. On the other hand, with RBI officials assuaging fears of the market regarding its intent of hiking rates in small doses of 25 bps, yields could be capped at higher levels.
4. The corporate bond curve is also expected to remain volatile and is expected to track movement of the base G-sec curve. The 1-3 year bond segment is expected to remain stable as there is sustained demand seen from FIIs in this segment.

Our Portfolio Strategy

Recap - April 2010

1. In the ING Income Fund and ING Gilt Fund Provident Fund Dynamic Plan, we managed duration actively. We had very low duration in the beginning as we had a bearish view on the interest rates. However, around the RBI policy, we increased duration as the yields were attractive. By the end of the month, when yields had softened we reduced duration.
2. In the ING Short Term Income Fund we increased 1-2 year bonds exposure to around 35% of the fund as there is sustained demand from FIIs. We also exited 3-6 months of CDs at the yields had softened significantly.
3. In the ING Liquid Fund and ING Treasury Advantage Fund, we maintained a judicious mix of cash and very short term instruments.

Strategy going forward

1. In the ING Income Fund and ING Gilt Fund Provident Fund Dynamic Plan, we would look to actively manage duration to take advantage of any mispricing. We would continue to keep lower duration as markets are expected to remain bearish. However, if the market over reacts and yields are at a very attractive level, we would look to increase duration.
2. In the ING Short Term Income Fund we would have around 30-35% exposure to 1-2 year bonds as there is strong buying interest in such assets. We would also keep around 50-55% exposure to accrual assets for steady income.
3. In the ING Liquid Fund and ING Treasury Advantage Fund, we would continue to maintain a judicious mix of cash and very short term instruments.

Gilt Outlook Matrix

	Outlook	Key Drivers	Key Risks
Short Term	➤ Negative	<ul style="list-style-type: none"> ➤ Continuing supply of Govt bonds with 10-15k cr of weekly borrowing by government ➤ Expectation of further tightening measures by RBI in the form of rate hikes along with CRR hikes 	<ul style="list-style-type: none"> ➤ Lower than expected inflation number ➤ Weak growth numbers ➤ Less than expected tightening by RBI of policy rates
Long Term	➤ Negative	<ul style="list-style-type: none"> ➤ Continuous supply of G-sec bonds ➤ Rise in central bank policy rates 	<ul style="list-style-type: none"> ➤ A possible “U” shaped recovery scenario for the world economy

Corporate Bond Outlook Matrix

	Outlook	Key Drivers	Key Risks
Short Term	➤ Negative	<ul style="list-style-type: none"> ➤ Bearishness in the underlying G-sec base curve as there are concerns on continuing high govt borrowing ➤ Expectation of tightening measures by RBI including rate hike and / or CRR hike 	<ul style="list-style-type: none"> ➤ Stability in inflation numbers ➤ Weak growth numbers
Long Term	➤ Negative	<ul style="list-style-type: none"> ➤ Continuous supply of G-sec bonds ➤ Rise in central bank policy rates ➤ Large investors in fixed income mutual funds can exit in one day notice 	<ul style="list-style-type: none"> ➤ Lower pick up in credit growth ➤ A possible “U” shaped recovery scenario for the world economy

Month end levels

Sovereign: The yield on the previous ten year benchmark Government security (6.35% bond maturity in 2020) firmed up from 7.85% to 8.05% as it became an 'off the run' security due to introduction of a new 10 year benchmark G-sec during the month. The new 10 year benchmark bond i.e 7.80% Govt bond maturing in 2020 closed at 7.74% by end of April 2010

Credits: The yield on the 1 year CDs softened from 6.35% in previous month to around 6.10%. During the month, the yield on a 10 yr AAA corporate bond softened from 8.85% at the end of previous month to around 8.70% at the end of April 2010.

OIS: The 2 year OIS rate softened from 5.68% at the end of previous month to around 5.57% at the end of April 2010.



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INVESTMENTS

www.ingim.co.in



Investment Objective: ING Income Fund: To generate attractive income by investing in a diversified portfolio of debt and money market instruments of varying maturities, and at the same time provide continuous liquidity along with adequate safety. **ING Gilt Fund Provident Fund Dynamic Plan:** The primary objective of the scheme is to generate relatively risk free return by investing in sovereign instruments issued by the central/state government as defined under section 2 of Public Debt Act, 1944. The scheme will not make investments in any other type of security such as shares, debentures etc. **ING Short Term Income Fund:** An open ended income Scheme which seeks to generate an attractive return for its investors consistent with capital preservation and liquidity by investing in portfolio of quality debt securities, money market instruments and structured obligation.. **ING Treasury Advantage Fund:** The scheme would aim to provide an investment avenue for investors preferring good liquidity and an investment horizon of 2 – 6 months. The scheme would be able to achieve its objectives by investing in a portfolio of money market and debt instruments. **ING Liquid Fund:** To provide reasonable returns while providing a high level of liquidity and low risk by investing primarily in money market and debt securities. The aim is to optimize returns while providing liquidity.

Statutory Details: Sponsor: ING Group, **Trustee:** Board of Trustees of ING Mutual Fund, **Investment Manager:** ING Investment Management (India) Private Limited.

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