

Key Market Highlights

- Q1 FY2010-11 GDP growth came at 8.8%, which was in line with market expectations.
- India's IIP growth moderated to single digit (after 8 months of double digit growth) with 7.1% for June 2010 as against 11.5% for May 2010. With the benefit of low base effect reducing, the IIP growth numbers are expected to remain in mid to high single digit numbers for the next few months.
- Inflation numbers moderated to just below the double digit at 9.97% for July 2010 as against 10.6% for June 2010, which was led by primary articles by 14.9%, fuel index by 14.3% and manufactured products by 6.2%. However, revision to past data continued with May numbers getting revised upwards substantially to 11.14% from 10.16% reported earlier.
- Export growth fell sharply to 13.2% for July 2010 as against 30.4% for June 2010.
- Import growth increased from 23.0% for June 2010 to 34.3% for July 2010.
- Credit growth remained high at 19.84% in mid August 2010 as against 19.90% for mid July 2010.
- Deposit growth was flattish at 13.79% for mid August as against 13.91% for mid July 2010.

Source: www.rbi.org.in, Bloomberg

Market impact

Government securities market was bearish during the month of August 2010. During the month, IIP data came at 7.1%, which was much lower than expectation, which led to marginal softening of yields. Also, WPI inflation came in at single digit at 9.97% after 5 consecutive months of double digit growth, which had a moderately positive effect on the market. However, since the May 2010 WPI data was revised upwards significantly from 10.16% to 11.14%, the market participants were very cautious. At the same time, market participants were getting wary of the continuous supply of G sec of around INR 11,000-13,000 cr per week. Also, the outstanding of the benchmark 10 year bond had crossed INR 40,000 crs. during the month and there were rumours of a new 10 year benchmark being announced due to high outstanding of the existing 10 year benchmark bond. This had a very negative impact on the market sentiment and the yield on the 10 year benchmark bond shot up and breached 8.00% level as there was a fear of this security becoming "off the run security". It touched a high of 8.08% during the month, before RBI officials making statement that there would not be a new 10 year benchmark bond in immediate future. After these statements, the yield on the 10 year bond softened to 7.93%.

During the month, 8.13% Government Security maturing in 2022 was very volatile. While initially it outperformed all other securities as there was rumour of a new 10 year benchmark security being announced and the market participants were exiting their positions of the 10 year bond and building positions on 2022 bond, later on with RBI assuring market that the current 10 year benchmark bond would continue to be the benchmark bond for some more time, the 2022 maturity bond underperformed most other bonds. The spread between the two securities was 10-12 bps at the beginning of the month, which inverted to almost 5 bps during the month before correcting and becoming 6 bps in favour of the 10 year benchmark bond again by the month end.

The short end of the curve has seen increase in rates due to expectation of system liquidity continuing to be negative in September due to advance tax outflows. 1 yr CD rates moved up from around 7.50% to 7.85%. Similarly corporate bond yields in 2-3 year bonds segment increased with yield on 2 year bonds rising from 7.75-8.00% to around 7.85-9.00% during the month.

INR Swap curve softened due to marginally better liquidity during second half of the month with 5 year swap rates closing at 6.94% as against 7.35% a month ago. The 1 year OIS rate also moderated to 6.13% from around 6.37% at the end of previous month.

Our assessment

INR Yields were bearish during August on account of:

1. While WPI inflation numbers came at single digit at 9.97% as against 10.6% for June 2010, the revision to May inflation number from a previously announced number of 10.16% to 11.14% kept sentiment bearish.
2. The outstanding of the 10 year benchmark bond crossed INR 40,000 crs and there were fears of this bond becoming "off the run" as there were rumours of a new 10 year benchmark bond being announced.
3. Expectation of another 25-50 bps rate hike by RBI in mid quarter review in September 2010.

Going Forward

1. G-sec market is expected to remain volatile in the near term as higher inflation and better macroeconomic conditions could continue to keep yields at higher level.
2. There is widespread expectation that RBI would hike policy rates by another 25-50 bps in its mid quarter policy review on September 12, 2010. This could continue to keep yields at higher level.
3. However, with the first half of the financial year FY10-11 close to an end, there could be softening of yields during the next month due to expectation of lower borrowing during second half of FY2010-11.
4. Also, if there is announcement of a new 10 year benchmark bond by RBI, there could be improvement in sentiment as there would be a lot of buying interest for a benchmark bond.

Our portfolio strategy

Recap –August 2010

1. In the ING Income Fund and ING Gilt Fund Provident Fund Dynamic Plan, we managed duration actively. We had moderate to low duration in the beginning of the month as we believed that yields could harden due to higher inflation. However, by end of the month, with 10 year yields close to 8%, we added duration, as we feel that a lot of negative factors are already priced in at these levels.
2. In ING Short Term Income Fund we continued with higher exposure to 3-6 months money market papers as the yields were attractive in that segment due to strained liquidity.
3. In 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. Yields look attractive at the current levels, hence would continue to have medium duration. However, if there is substantial softening of yields, we may reduce duration.
2. In the ING Short Term Income Fund we would continue have around 20-25% exposure to 1-2 year bonds as there is good carry in these assets. We would continue to have 50-55% exposure to accrual assets, which are being traded at higher rates currently due to tight liquidity situation currently.
3. In ING Liquid Fund and ING Treasury Advantage Fund, we would continue to maintain a judicious mix of cash and very short term instruments. However, we would continue to give higher importance to Asset Liability Management (ALM) for these funds.

Gilt Outlook Matrix

| | Outlook | Key Drivers | Key Risks |
|-------------------|------------|---|--|
| Short Term | ➤ Neutral | <ul style="list-style-type: none"> ➤ Fears of high inflation sustaining ➤ Expectation of further rate hikes in mid quarter review could keep yields high ➤ Fear of weaker growth in developed economies may induce softening bias ➤ Expectation of reduction in Govt borrowing in the second half of FY11 may lead to softer rates | <ul style="list-style-type: none"> ➤ Inflation continues to be high single digit to double digit for a longer period of time ➤ Higher than expected borrowing by govt for second half of FY11 ➤ Stronger than expected global / domestic growth numbers |
| Long Term | ➤ Positive | <ul style="list-style-type: none"> ➤ Moderation in inflation due to higher base effect and a good monsoon ➤ Reduction in Fiscal deficit due to higher collection in 3G auction and possibility of good mobilization due to disinvestment ➤ Expectation of faltering growth in developed economies ➤ Possibility of a new 10 year benchmark bond being issued by RBI | <ul style="list-style-type: none"> ➤ Inflation continues to be high single digit to double digit for a longer period of time ➤ Higher than expected borrowing by govt for second half of FY11 ➤ Stronger than expected global / domestic growth numbers |

Corporate bond outlook matrix

| | Outlook | Key Drivers | Key Risks |
|-------------------|------------|--|---|
| Short Term | ➤ Neutral | <ul style="list-style-type: none"> ➤ Expectation of range bound movement in the base G-sec Curve ➤ Reduction in Fiscal deficit due to higher collection in 3G auction and possibility of good mobilization due to disinvestment | <ul style="list-style-type: none"> ➤ Stronger than expected global / domestic growth numbers ➤ Higher than expected borrowing by Government for second half of FY11 |
| Long Term | ➤ Positive | <ul style="list-style-type: none"> ➤ Expectation of positive bias in the base G-sec Curve ➤ Reduction in Fiscal deficit due to good response to 3G auction and possibility of good mobilization due to disinvestment ➤ Expectation of faltering growth in developed economies | <ul style="list-style-type: none"> ➤ Stronger than expected global / domestic growth numbers ➤ Higher than expected borrowing by Govt. for second half of FY11 ➤ Higher supply of bonds due to higher issuance by PSU / Pvt sector issuers |

Month end levels

Sovereign: The 10 year benchmark bond i.e 7.80% Govt bond maturing in 2020 closed at 7.93% by end of August as against 7.80% at the end of July 2010

Credits: The yield on the 1 year CDs hardened from 7.50% in previous month to around 7.85%. During the month, the yield on a 10 yr AAA corporate bond increased from 8.80% at the end of previous month to around 8.85% at the end of August 2010.

OIS: The 5 year swap rates closed at 6.94% as against 7.35% a month ago. The 1 year OIS rate also moderated to 6.13% from around 6.37% at the end of previous month.



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INVESTMENT MANAGEMENT



www.ingim.co.in

Nature & Investment Objective: **ING Income Fund:** An open ended income scheme which seeks 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:** An open ended gilt scheme which seeks 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:** An open ended income scheme which seeks 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:** An open ended liquid income scheme which seeks 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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