

Key Market Highlights

- India's IIP growth continued its robust performance with 10.3% in October v/s a rise of 9.6% in September 2009 (revised from 9.1%).
- Export growth turned positive after 13 consecutive months of negative growth and it grew by 18.2% in November vs -6.6% for October 2009.
- Import growth also improved substantially and was at -2.6% for November as against -15.0% for October 2009.
- Inflation came at 4.78% for November 2009 higher than expectation, which was led by primary articles 11.8% (food price inflation was 16.7%)
- Credit growth improved marginally to 10.5% in mid December as against 9.8% in mid November (lowest in last decade)
- Deposit was steady at 18.33% in mid December as against 18.6% in mid November
- M3 growth was flat at 17.7% at the end of December as against 18.4% at the end of November

Source: www.rbi.org.in

Market impact

- Government securities market was bearish during December 2009. Industrial production growth continued to post good performance at 10.3% y-o-y growth though it was marginally lower than market expectation. However, at the same time, inflation as measured by WPI came at 4.78%, which was higher than market expectation of around 4.2%. CPI Indices are already high, in double digits since last few months due to high food prices. Food inflation has been showing very high growth and the latest numbers indicate that it could be well over 18% for the month of December.
- At the same time, the officials of RBI made statements where they acknowledged that though food price inflation is more of a supply side problem and that monetary measures may not be a suitable solution in such a scenario, there was danger of price pressure spilling over to segments other than food articles through adverse inflationary expectations. This further added to the bearish sentiment in the market, as market started factoring in some monetary action in the near future as growth also seems to be on a firmer ground along with consistently good growth numbers. There is wide spread expectation in the market that in the January Quarterly policy, RBI would undertake steps for unwinding the accommodative monetary policy stance by reducing liquidity in the system by hiking the CRR rate and the it may also hike the Repo Rate / Reverse Repo Rate
- Yield on 6.90% 2019 maturity G-sec bond, which was the previous 10 year benchmark security spiked up from 7.26% at the end of November 2009 to 7.68% by the end of December 2009 as it was no longer the benchmark bond and as a result went out of favor with the market participants. The previous 11 yr benchmark bond was notified as the new 10 yr benchmark bond by FIMMDA and hence, it outperformed most of the other bonds and its yield hardened a bit from 7.52% at the end of November 2009 to 7.59% at the end of December 2009. Yield on 5 yr benchmark security hardened from 6.98% at the end of November 2009 to 7.25% by the end of December 2009.
- Corporate bond yields also hardened across the curve as there were renewed fears of exit from accommodative monetary policy stance. Yields on 3 year corporate bonds increased from 7.30-35% to 7.55-60%. Yields on 5 yr bonds also increased from around 8.05% to 8.35% and yield on 10 yr corporate bond increased from 8.55% to 8.65% during the month.
- INR Swap curve hardened significantly with 5 year swap rates going up from 6.53% to 6.91%. 2 year OIS rate also hardened by around 39 bps from 5.38% at end November 2009 to 5.77% at the end of December 2009.

Source: www.bloomberg.com

Our assessment

INR Yields were bearish during December on account of:

1. Higher than expected inflation at 4.78% and high food price inflation for November pushed yields up and reinforced fears of exit from an accommodative monetary policy stance through either a hike in repo / reverse repo rates or reduction in liquidity through a CRR hike.
2. RBI officials making statements that price pressure as seen in high food prices could spill over to other segments through inflationary expectations.
3. However, while industrial production numbers were strong, they were lower than expected. This along with reducing supply of Government securities going forward capped the upward movement of yields.

Going Forward

- 1 Markets are expected to remain bearish in the near term as we come closer to the quarterly monetary policy meeting where it is expected that RBI will take further steps of reversal of the accommodative monetary policy stance, which could push yields higher. However, reduced supply of Government securities and lower than expected growth and inflation numbers could result in the yields softening marginally.
- 2 The corporate bond curve could flatten, with the short end of the corporate curve expected to underperform the longer end as there are fears of RBI exiting the accommodative monetary policy stance in its quarterly policy. However, if RBI does not hike repo / reverse repo rates, then we could see the shorter end of the curve performing better.

Our Portfolio Strategy

Recap - December 2009

1. We managed duration actively as we were expecting volatility in rates. We increased duration of the Long term Bond and Gilt funds when yields were higher and exited after booking profits at lower yields.
2. In short term fund we reduced duration as we were expecting short term rates to increase, we exited our 2-3 years bonds exposure and reduced mark to market component to around 20%, while maintaining accrual assets at around 30% of the fund.
3. In Liquid and Treasury Advantage Fund, we have been maintaining a judicious mix of cash and very short term instruments. We expect rates of 1-3 months CDs and CPs to remain stable and hence would like to remain invested in upto 3 months CD's and good quality corporate CP's.

Strategy going forward

1. In Income fund and Gilt fund, we would look to actively manage duration to take advantage of any mispricing. As the market is expected to remain volatile, we would look to increase duration when rates are attractive and reduce duration at lower rates after booking some profits.
2. In Short Term fund we would continue to have lower exposure to mark to market assets as there is higher possibility of sharp increase in yields in shorter tenure corporate bonds. We would also increase accrual assets to get a decent accrual income.
3. In Liquid and Treasury Advantage Fund, we have been maintaining a judicious mix of cash and very short term instruments. We expect rates of 1-3 months CDs and CPs to remain stable and hence would like to remain invested in upto 3 months CD's and good quality corporate CP's.

Gilt Outlook Matrix

	Outlook	Key Drivers	Key Risks
Short Term	<ul style="list-style-type: none"> • Neutral 	<ul style="list-style-type: none"> • Reducing supply of G-sec as borrowing programme of Govt. comes to an end • Tepid global recovery • Easy liquidity 	<ul style="list-style-type: none"> • Possible reversal in accommodative monetary stance • Better domestic economic numbers • Increasing inflation due to higher food prices • Stronger rebound in the global economic growth
Long Term	<ul style="list-style-type: none"> • Negative 	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Neutral 	<ul style="list-style-type: none"> • Stability in the underlying G-sec base curve as incremental borrowing is lower • Easy liquidity • Good carry in 3-5 year bonds 	<ul style="list-style-type: none"> • High supply in terms of refinancing and reissuances by banks and corporates.
Long Term	<ul style="list-style-type: none"> • Negative 	<ul style="list-style-type: none"> • 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 ten year sovereign bond closed at 7.59%, 7 bps higher than the previous month closing level of 7.52%

Credits: The yield on the 1 year CDs increased from 5.35% in previous month to around 5.60%. During this month, the yield on a 10 yr AAA corporate bond hardened from 8.55% at the end of November to 8.65% at the end of December 2009.

OIS: 2 year OIS rate hardened significantly by around 39 bps from 5.38% at the end of November 2009 to 5.77% at the end of December 2009



Ramanathan K

Chief Investment Officer - Single Manager: ING Investment Management (I) Pvt. Ltd.

INVESTMENTS

www.ingim.co.in



Statutory Details: **Sponsor:** ING Group, **Trustee:** Board of Trustees of ING Mutual Fund, **Investment Manager:** ING Investment Management (India) Private Limited. **Risk Factors:** Mutual Funds and securities investment are subject to the market risks, and there is no assurance or guarantee that the objectives of the Schemes will be achieved. As with any investment in securities, the NAV of the units issued under the Scheme can go up or down depending on the factors and the forces affecting the capital markets. Past performance of the Sponsors/ Mutual Fund or their affiliates does not indicate the future performance of the Scheme. The Sponsors and associates are not responsible or liable for any loss resulting from the operation of the Scheme beyond the initial contribution of Rs. 1 lakh made by them towards setting of the Mutual Fund. The names of the Schemes do not in any manner indicate either the quality of the Scheme or its future prospects and returns. The Schemes do not guarantee or assure returns. **Please read the Scheme Information Document /Statement of Additional Information / Key Information Memorandum carefully before investing. Important Disclosure:** This Document and the Information contained herein do not constitute a distribution, an endorsement, an offer to buy or sell or the solicitation of an offer to buy or sell any securities or any other financial products / investment products (collectively "Products") mentioned in this Document or an attempt to influence the opinion or behavior of the Investors/Recipients. All such Information in the Document should not be relied upon and does not constitute any investment advice and any use of the Information / any investments and investment related decisions of the Investors/Recipients are at their sole discretion & risk. Investors/Recipients must make their own investment decisions based on their own specific investment objectives, their financial position and using such independent professional advisors, as they believe necessary, before investing in any Products. This Document has been prepared on the basis of information, which may be already available in publicly accessible media or developed through analysis of ING Investment Management (India) Private Limited. Under no circumstances should this Information or any part of it be copied, reproduced or redistributed. ING may or may not have a position in or with respect to the Products mentioned. ING Investment Management (India) Private Limited, its affiliates/associates (collectively "ING"), their directors, employees, representatives or agents shall not be liable or responsible, in any manner whatsoever, to any Investor/Recipient or any other person/entity, for the performance/profitability/operations of the Products, the contents of any document (including the Terms of Offer) or any investments in the Products including any and all direct, special, punitive, indirect, or consequential damages (including lost profits), even if notified of the possibility of such damages.

Except for the historical information contained herein, statements in this publication, which contain words or phrases such as 'will', 'would', etc., and similar expressions or variations of such expressions may constitute 'forward-looking statements'. These forward-looking statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements. ING Investment Management (I) Pvt. Ltd undertakes no obligation to update forward-looking statements to reflect events or circumstances after the date thereof. The words like believe/belief are independent perception of the Fund Manager and do not construe as opinion or advise.