

## Key Market Highlights

- India's IIP growth continued its robust performance with 16.8% growth for December 2009 v/s 11.8% growth for November 2009.
- Export growth improved from 9.3% in December 2009 to 11.5% for January 2010.
- Import growth further improved and was at 35.5% for January 2010 as against 27.2% for December 2009.
- Inflation came at 8.56% for January 2010 v/s 7.31% for December 2009, which was led by primary articles 14.5% (food price inflation was high at 17.4%), fuel prices by 6.9% and manufactured products by 6.6%
- Credit growth further improved to 15.07% in mid February v/s 13.88% in mid January 2010
- Deposit growth was flat at 16.59% in mid February v/s 16.85% in mid January 2010
- M3 growth was flattish at 16.4% at the end of February 2010 as against 17% at the end of January 2010

[Source: www.rbi.org.in](http://www.rbi.org.in)

## Union Budget FY2010-11

- GDP growth for FY09-10 estimated at 7.2%. Targeting 9% GDP growth over the next few years
- Fiscal deficit for FY10-11 estimated at 5.5% of GDP. Rolling targets for Fiscal deficit for the forthcoming years are fiscal deficit of 4.8% of GDP for FY11-12 and 4.1% of GDP for FY12-13
- Net market borrowing estimated at Rs. 345,010 crs for FY10-11.
- Excise duty has been rolled back partially to 10% from 8% currently.
- Disinvestment revenue target for FY11 increased to Rs400 bn from Rs250 bn in FY10.
- Conscious effort not to issue bonds to meet oil/fertilizer subsidies – an effort towards making fiscal accounts more transparent

[Source: www.indiabudget.nic.in](http://www.indiabudget.nic.in)

## Market Impact

- Government securities market was bearish during February 2010. Immediately after the RBI quarterly policy at the end of the previous month, rates started hardening as market was expecting higher inflation and growth numbers. With industrial production number posting very strong performance at 16.8% for December 2009 and monthly WPI inflation coming at 8.56%, which is higher than RBI expectation of inflation by end of March 2010, rates kept moving up firmly. The 10 year benchmark bond touched a high of 7.89% before softening a bit to around 7.76% close to the Union Budget for FY10-11. Initial expectations on the fiscal deficit for FY10-11 were at 5.5%, which translated into net central government borrowing at around Rs. 350,000-360,000 crs. However, closer to budget a few market participants were expecting a lower number on borrowing, and hence, the rates softened to around 7.76%. However, the actual net borrowing number which was announced on February 26, 2010 was Rs. 345,000 only marginally better than the originally expected number. At the same time, there was additional excise duty levied on Petrol and Deisel, which would only exacerbate inflation problem going forward. Hence, interest rates resumed their journey upwards post budget.
- Yield on 6.35% 2020 maturity G-sec bond, which is the new 10 year benchmark security hardened significantly by 28 bps, from 7.58% at the end of January 2010 to 7.86% at the end of February 2010. Yield on 7.32% 2014 bond hardened by 17 bps, from 7.15% at the end of January 2010 to 7.32% at the end of February 2010
- Corporate bond yields also moved up sharply tracking the movement of the base G-sec curve. The yield on 3 year bonds hardened from 7.55% to 7.90%, whereas yield on 5 year bonds moved up from around 8.30-8.35% to around 8.60-8.65% and yield on 10 yr corporate bond moved up from 8.65-8.70% to 8.90-8.95% during the month.
- INR Swap curve also hardened though to a lesser extent with 5 year swap rates moving up from 6.88% to 7.02%. The 2 year OIS rate was flattish at around 5.67-5.77% during the month

## Our assessment

INR Yields were bearish during February on account of:

1. Robust Industrial production at 16.8% and a higher inflation at 8.56%, pushed up the yield of 10 year benchmark to a high of 7.89%. Expectation of a fast recovery and inflation kept the yields up for most of the month.
2. However, closer to budget, market was expecting a positive surprise on the borrowing number, because of which the 10 year yield softened to 7.76%
3. In the budget, while borrowing number was marginally better than expected, there was excise duty levied on Petrol and Diesel, which would have further inflationary impact and hence, the sentiment turned bearish once again

## Going Forward

1. Markets are expected to remain bearish in the near term as inflation, which is due to supply side constraints, may become a more general inflation if it is not tackled. RBI is expected to take further tightening steps like rate hikes or CRR hikes to counter inflation.
2. With almost Rs. 11,000-12,000 cr of borrowing estimated to hit the market on a weekly basis from April 2010 onwards, the yields are expected to harden further steadily.
3. The corporate bond curve is also expected to remain bearish and would track movement of the base G-sec curve.

## Our Portfolio Strategy

### Recap - February 2010

1. In the Income and Gilt fund, we reduced duration as we had a bearish view on the interest rates.
2. In short term fund we increased accrual assets to around 50% of the fund and we also increased our exposure to 2.5 year bonds to around 30% of the fund, as the spread of around 40 bps between 2 and 2.5 year bonds was attractive. However as short term rates hardened sharply, we reduced our bond exposure to reduce duration.
3. In Liquid and Treasury Advantage Fund, we maintained judicious mix of cash and very short term instruments.

### Strategy going forward

1. In the Income fund and Gilt fund, 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 overreacts and yields are at a very attractive level, we would look to increase duration.
2. In the Short Term fund we would have 70-75% exposure to accrual assets for steady income and have very low mark to market component as our view on short term rates is bearish.
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 increase during March 2010 as there is possibility of the system liquidity on an overnight basis to become negative, which would provide good buying opportunity at that time. Hence, we would look to take advantage of such opportunities in March 2010.

## Gilt Outlook Matrix

	Outlook	Key Drivers	Key Risks
<b>Short Term</b>	➤ Negative	<ul style="list-style-type: none"> <li>➤ Expectation of a front loaded borrowing programme starting from April 2010.</li> <li>➤ Liquidity tightening measures taken by RBI and expectation of further hikes</li> <li>➤ Concerns on high inflation</li> </ul>	<ul style="list-style-type: none"> <li>➤ Lower than expected inflation number</li> <li>➤ Weak growth numbers</li> </ul>
<b>Long Term</b>	➤ Negative	<ul style="list-style-type: none"> <li>➤ Rise in central bank policy rates</li> </ul>	<ul style="list-style-type: none"> <li>➤ A possible “U” shaped recovery scenario for the world economy</li> </ul>

## Corporate Bond Outlook Matrix

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

## Month end levels

**Sovereign:** The yield on the ten year sovereign bond hardened from 7.58% to 7.86% during the month of February 2010

**Credits:** The yield on the 1 year CDs increased sharply from 6.00% in previous month to around 6.80%. During this month, the yield on a 10 yr AAA corporate bond hardened from 8.69% at the end of January 2010 to around 8.90% at the end of February 2010.

**OIS:** 2 year rate was flat from 5.68% at the end of January 2010 to 5.69% at the end of February 2010.



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INVESTMENTS

[www.ingim.co.in](http://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 PF 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:** 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 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.

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