

Key Market Highlights

- Q2 GDP growth came at 7.9%, beats market expectation (6.3%)
- India's IIP growth continued its robust performance with 9.1% in September v/s a rise of 11.0% in August 2009 (revised from 10.4%).
- Export growth improved to -6.6% for October v/s -13.8% for September 2009.
- Import growth was negative at -15.0% for October as against -31.3% for September 2009
- Credit growth fell to single digit at 9.8% in mid November (lowest in last decade) as against 10.8% in mid October
- Deposit growth also slowed down to 18.6% in mid November vs 19.9% in mid October
- M3 growth was flat at 17.8% at the end of November as against 18.9% at the end of October

Source: www.rbi.org.in

Market impact

- Government securities market was volatile during November. The sentiment in the fixed income markets was bullish initially as the fears of early exit from accommodative monetary stance were allayed by dovish statements from RBI saying that the growth was still 'fragile'. RBI officials also said that they wanted to be assured that the growth was stable, before undertaking an exit from accommodative monetary policy stance. This was further helped by lower supply of Government Securities remaining in the second half as majority of the government borrowing has already been absorbed. The yield on 10 yr benchmark security saw a low of 7.15%, however, by the end of the month the yield rose to 7.26%, as Q2 GDP growth came at a very healthy 7.9%, which brought back fears of exit from accommodative stance.
- Going forward we expect markets to remain volatile within a 25-30 bps range with a possibility of rates moving higher in the next 6-8 weeks as industrial production numbers are expected to post strong performance and inflation is expected to further move up driven by high food prices. The yields could remain supported at a higher level due to lower incremental supply of G-sec as borrowing programme of the government comes to an end in the next two months. However, if RBI continues to reiterate that there would not be an exit from accommodative stance till they are assured of stable recovery, we could see yields soften.
- Yield on the 10 year benchmark G-sec softened from 7.30% at the end of October 2009 to 7.26% by the end of November 2009. Yield on 5 yr benchmark security softened more than the 10 yr benchmark, from 7.11% at the end of October 2009 to 6.98% at the end of November 2009. However, 11 year benchmark security outperformed all other securities as its yield dropped from 7.76% at the end of October to 7.52% at the end of November 2009 as there were market expectations that the security could become the next 10 yr benchmark. The spread between the 10 yr and 11 yr benchmark reduced from 46 bps to 27 bps during the month.
- Corporate bond yields softened across the curve as there were reduced fear of any hike in interest rates. Also, the carry in 3-5 years bonds remains good with spreads of more than 100 bps in these segments. Yields on 3 year corporate bonds dropped sharply from 7.75-8.0% to 7.30-3.5%. Yields on 5 yr bonds decreased from around 5.45% to around 5.05% and yield on 10 yr corporate bond softened from 8.82% to 8.55% during the month.
- INR Swap curve has softened with 5 year swap rates coming down from 6.77% to 6.54%. 2 year OIS rate also came down from 5.58% at end of October 2009 to 5.37% at the end of October 2009

Source: www.bloomberg.com

Our assessment

INR Yields were volatile during November on account of:

1. Dovish comments from RBI officials stating that exit from accommodative stance would not happen till the time growth was on firm footing. This gave rise to expectations that RBI may not increase interest rates for another 3-6 months.
2. Reduced supply of Government securities going forward as a major portion of the borrowing by the government has been completed.
3. Strength of economic recovery continued to remain a concern for developed economies, and major central banks of the world stated that global economic growth was fragile and that interest rates may have to be kept at low levels for extended period.
4. However, better than expected GDP numbers and industrial production numbers pushed up the yields by the month end as expectations of a reversal of accommodative monetary policy re-emerged.

Going Forward

1. Markets are expected to remain range bound with a bearish undertone as there are renewed fears of an early reversal of the accommodative monetary policy stance, which could push yields higher. However, reduced supply of Government securities and dovish statements from RBI officials could cause the yields to soften a bit.
2. The corporate bond curve could flatten, with the short end of the corporate bond curve expected to underperform the longer end as any better than expected growth would result in heightened fears of reversal of accommodative stance, which in turn would impact the shorter end much more than the longer end of the curve.

Our portfolio strategy

Recap - November 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 increased mark to market component at around 35% and maintained accrual assets to around 35% of the fund, which would help in getting better carry with minimal impact of any increase in interest rates.
3. In Liquid funds, 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 the 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 range bound, we would look to increase duration when rates are attractive and reduce duration at lower rates after booking some profits.
2. In the Short Term fund we would reduce mark to market assets as there is higher possibility of sharp increase in yields in shorter tenure corporate bonds. We may also increase accrual assets to get a decent accrual income.

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 benchmark sovereign bond closed at 7.26%, 4 bps lower than the previous month closing level of 7.30%

Credits: The yield on the 1 year CDs decreased from 5.60% in previous month to around 5.35% during this month, the yield on a 10 yr AAA corporate bond softened significantly from 8.83% at the end of October to 8.57% at the end of November 2009.

OIS: 2 year OIS rate softened by around 20 bps from 5.58% at end of October 2009 to 5.38% at the end of November 2009



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INVESTMENTS

www.ingim.co.in



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