

Key Market Highlights

- Reserve Bank of India (RBI) raised the Repo Rate and the Reverse Repo Rate by 25 bps each in to 6.25% and 5.25% respectively in its quarterly monetary policy review on November 2, 2010
- RBI stated that growth continues to be on strong footing. It has retained its year end projection of growth at 8.5% for FY11.
- RBI stated that inflation remains well above the comfort zone of RBI. It is now driven more by food price inflation, which is becoming a structural issue due to change in consumption patterns.
- RBI also stated that looking at the current macro economic scenario and current expectations, likelihood of another rate hike in immediate future looks low.
- India's IIP growth fell sharply to 5.6% for the month of August 2010 as against 15.2% for the month of July (revised from 13.8%). The manufacturing growth fell to 5.9% from 16.7% for July and capital goods fell to a -2.6% from 70% growth for July. With the advantage 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 for the month of September 2010 came at 8.62% (marginally higher than expectation of 8.50%) as compared to 8.5% for August 2010. This was led by primary articles 17.5%, fuel index 11.1% and manufactured products by 4.6%. Also July inflation was revised upwards from 9.8% to 10.3%.
- Export growth improved to 23.2% for September 2010 from 22.5% for August 2010.
- Import growth reduced to 26.1% for September 2010 from 32.2% for August 2010.
- Credit growth improved substantially to 20.93% in mid October compared to 17.68% in mid September.
- Deposit growth also improved to 16.26% in mid October as against 14.95% in mid September.

Market impact

Government securities market was bearish during the month of October 2010.

With auction hitting the markets to the extent of around INR 11,000 crs every week, the supply pressure pushed the interest rates higher throughout the month. While interest rates got some support as IIP growth came lower at 5.6%, with WPI inflation coming at 8.62% (higher than market expectations of 8.50%) the sentiment turned bearish once again. The trend of revision to previous months' readings continued with July inflation being revised upwards from 9.8% to 10.3%. Also, RBI officials and finance ministry officials made hawkish statements about the persistently high food price inflation, which added to the negative sentiment.

At the same time the outstanding stock of the current 10 year benchmark bond breached the INR 50,000 crs mark, which gave rise to expectations that this bond will soon become illiquid and go out of circulation. As a result, the selling pressure mounted and by the end of the month, this bond touched 8.18%. However, this fear was assuaged by the RBI officials to some extent with their statements that there was no new 10 year bond expected for some more time, which brought back some buying interest in this bond and the 10 year benchmark bond closed at 8.13% by the end of the month.

The spread between the 12 year security and 10 year benchmark security reduced from 14 bps at the beginning of the month to negative 5 bps by end of the month as market participants exited the 10 year security and entered into the more liquid 12 year security.

During the month, we saw liquidity scenario becoming very strained due to public offering of Coal India Ltd, of around INR 15,500 crs, which was the largest public offering in Indian stock markets.

This was very well received by the markets and it was oversubscribed to the extent of more than 15 times. As a result pressure on liquidity mounted and the yields on the shorter corporate securities rose sharply during the month with 1 year CD rate spiking up from around 8.05% to around 8.40%. Similarly corporate bond yields in 2-3 year bonds segment spiked up from around 8.00% to around 8.40% during the month.

INR Swap curve continued to harden, with the shorter end hardening more than the longer end, due to further tightness in the liquidity because of the Coal India IPO outflows. 1 year OIS hardened further during the month from 6.48% at the end of September to 6.72% by end of October 2010. 5 year swap rates closed at 7.19% as against 7.01% at the end of the previous month.

Our assessment

INR Yields hardened during October on account of:

1. Continuous supply of government securities by way of weekly auction pushed yields up throughout the month.
2. Inflation coming at 8.62%, which was higher than expectation and revision to July inflation from 9.8% to 10.3% added to negative sentiment.
3. Also, the outstanding of the current 10 year benchmark paper breached INR 50,000 crs. which brought fears of illiquidity in this security, which added to the selling pressure.

Going Forward

1. Government securities market is expected to remain volatile in the near term as inflation could surprise on the negative side, while industrial production could continue to slow.
2. We expect that RBI could hike policy rates by another 25-50 bps during the second half of FY10-11 if inflation continues to be in double digits or high single digits. This could push yields to higher level.
3. However, if inflation data falls more than expected, we could see the yields softening.
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 – October 2010

1. In the ING Income Fund and ING Gilt Fund Provident Fund Dynamic Plan, we had moderate duration at the beginning of the month. We added duration during the month as the yields hardened after inflation data. We continue to hold high duration in these funds as we expect that rates could soften in the near to medium term as inflation is expected to moderate in coming months.
2. In the 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 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. If the yields soften significantly, we would reduce duration, and if rates move up, we would increase 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 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 by RBI could push yields higher ➤ Weaker domestic growth or fear of weaker growth in developed economies may induce softening bias 	<ul style="list-style-type: none"> ➤ Inflation continues to be high single digit to double digit for a long period of time ➤ 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 ➤ Possibility 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 ➤ 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 ➤ Tight liquidity situation could keep interest low in corporate papers 	<ul style="list-style-type: none"> ➤ Inflation continues to be high single digit to double digit for a long period of time ➤ Stronger than expected global / domestic growth numbers
Long Term	➤ Positive	<ul style="list-style-type: none"> ➤ Expectation of positive bias in the base G-sec Curve ➤ Moderation in inflation due to higher base effect and a good monsoon ➤ Possibility of faltering growth in developed economies 	<ul style="list-style-type: none"> ➤ Stronger than expected global / domestic growth numbers ➤ 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 8.13% by end of October 2010 as against 7.85% at the end of September 2010

Credits: The yield on the 1 year CDs hardened from around 8.05% in previous month to around 8.40%. During the month, the yield on a 10 yr AAA corporate bond also hardened from 8.67% at the end of September 2010 to around 8.79% by end of October 2010

OIS: The 5 year swap rates closed at 7.19% as against 7.01% a month ago. The 1 year OIS rate also increased from 6.48% at the end of previous month to 6.72% at the end of October 2010.



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INVESTMENT MANAGEMENT



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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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