

## Key Market Highlights

- India's IIP growth continued its strong performance with 11.7% for November 2009 v/s 10.3% in October 2009
- Export growth reduced from 18.2% in November 2009 to 9.3% in December 2009. However, it was still in positive territory after 13 consecutive months of negative growth prior to November 2009
- Import growth further improved and was at 27.2% for December 2009 as against -2.6% for November 2009.
- Inflation came at 7.31% for December 2009, higher than 4.78% for November 2009, which was led by primary articles 14.9% (food price inflation was high at 19.2%)
- Credit growth improved to 13.88% in mid January 2010 as against 10.5% in mid December
- Deposit growth dropped to 16.85% in mid January 2010 v/s. 18.33% in mid December 2009
- M3 growth was flattish at 16.5% at the end of January 2010 as against 17.2% at the end of December 2009

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

## RBI Quarterly Monetary Policy

- RBI hiked Cash Reserve Ratio (CRR) by 75 bps from 5.00% to 5.75% (higher than market expectation of 25-50 bps hike). This is expected to drain around Rs 36,000 crs of liquidity from the system.
- RBI kept Reverse Repo Rate unchanged at 3.25% and Repo Rate unchanged at 4.75%.
- RBI kept Bank Rate unchanged at 6.00%. Statutory Liquidity Ratio (SLR) was also kept unchanged at 25%.
- RBI increased its growth target i.e. GDP growth estimate to 7.5% (increased from 6.0%) for full year FY10.
- Inflation projection was also revised upwards from 6.5% to 8.5% at the end of March 2010.
- Credit growth target was revised downwards from 18.0% to 16.0% for FY10.
- RBI acknowledged that while inflation (especially the food price inflation) was largely supply side phenomenon, there was evidence that this was spilling over to a more general inflation due to inflationary expectation. It was to counter this, it decided to increase CRR by 75 bps.
- RBI also indicated that an exit from accommodative monetary policy should coincide with fiscal consolidation from the government. If fiscal deficit continues to remain at elevated level, the resultant high borrowing would be very difficult to manage as the liquidity in the system in the next fiscal is expected to be far lesser than FY10. Also, higher government borrowing could have the effect of crowding out of private credit as credit growth picks up during FY11.
- RBI admitted that high inflation coupled with high borrowing for FY11 could put upward pressure on interest rates.

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

## Market impact

- Government securities market was volatile during January 2010. The sentiment in markets turned bearish with strong performance of Industrial production numbers, which were better than expected at 11.7% growth for November 2009. The yield on 10 year benchmark bond saw a high of 7.70% during the month, when monthly inflation came at a high of 7.31%. However, the yields were supported at this level as the borrowing programme of the government was coming to an end. At the same time, the market expectation regarding the quarterly monetary policy meeting at the end of the month was getting built that there would be no interest rate hike (Reverse Repo Rate or Repo Rate), and that there would be only hike in Cash Reserve Ratio (CRR) to the extent of 25-50 bps. There were also unconfirmed statements from officials of RBI stating the same. Hence, the yields softened and the yield on 10 year benchmark bond saw a low of 7.55% just before the RBI policy meeting.
- RBI, in its policy, did not raise interest rates as expected. However, it raised CRR by 75 bps, which was more than market expectation. RBI increased its growth target i.e. GDP growth estimate from 6.0% to 7.5% for FY10 and also revised its inflation projection upwards from 6.5% to 8.5% for March 2010. RBI also acknowledged that while inflation (especially the food price inflation) was driven by supply side factors, there was evidence that this was spilling over to a more general inflation due to inflationary expectation. These hawkish statements impacted the rates and the yield on the 10 year bond hardened to 7.59% by the end of the month. Going forward the market would take cues from annual budget for FY2010-11 slated to be announced by end of February 2010.
- Yield on 6.35% 2020 maturity G-sec bond, which is the new 10 year benchmark security remained flattish from 7.59% at the end of December 2009 to 7.58% at the end of January 2010. Yield on 5 yr benchmark security softened from 7.25% at the end of December 2009 to 7.15% by the end of January 2010.
- Corporate bond yields also were flattish across the curve. Yields on 3 year corporate bonds remained around 7.55-65%, whereas yield on 5 yr bonds was around 8.30-35% and yield on 10 yr corporate bond was in the range of 8.65-70% during the month.
- INR Swap curve also range bound with 5 year swap rates at around 6.90-95% and 2 year OIS rate was around 5.67-77% during the month

*[Source: Bloomberg](#)*

## Our assessment

INR Yields were bearish during January on account of:

1. Robust Industrial production at 11.7% and a higher inflation at 7.31%, pushed up the yield of 10 year benchmark to a high of 7.70%. Expectation of a fast recovery and inflation kept the yields up for most of the month.
2. However, towards the end of the month, the market factored in a CRR hike and no rate hike which softened the 10 yr yield to 7.55%.
3. In the policy statement, RBI hiked its GDP estimate to 7.5% from the existing 6% and also revised its inflation projection upwards from 6.5% to 8.5% for March 2010. CRR hike of 75 bps which was more than the market expectation of 50 bps led to upward movement in yields.

## Going Forward

- 1 Markets are expected to remain bearish in the near term as RBI has indicated that inflation, which is due to supply side constraints, may become a more general inflation if inflationary expectations are not tackled.
- 2 With Union Budget for FY11 slated to be announced in end of February, there are expectations that the fiscal deficit would continue to be high and the resultant high borrowing would cause the interest rates to move upwards.
- 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 - January 2010

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 accrual assets to around 50% of the fund and we also increased our exposure to 2.5 year bonds to around 30-35% of the fund, as the spread of around 40 bps between 2 and 2.5 year bonds was attractive and higher carry on these bonds would more than offset any increase in rates of 2 year bonds if these bonds are held from 6 months or so.
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 over reacts and yields are at a very attractive level, we would look to increase duration.
2. In the Short Term fund we would continue to have a mix of around 40-50% exposure to accrual assets for steady income and 30-35% exposure to 2.5% corporate bonds which give higher carry and possibility of upside due to good roll down effect.
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

## Gilt Outlook Matrix

	Outlook	Key Drivers	Key Risks
<b>Short Term</b>	<ul style="list-style-type: none"> <li>Negative</li> </ul>	<ul style="list-style-type: none"> <li>Expectation of high fiscal deficit for FY11 which would be announced in Annual Budget</li> <li>Liquidity tightening measures taken by RBI(increase in CRR by 75 bps) and expectation of further hikes</li> <li>Concerns on high inflation</li> </ul>	<ul style="list-style-type: none"> <li>Lower than expected net borrowing figures released in budget</li> <li>Lower than expected inflation number</li> </ul>
<b>Long Term</b>	<ul style="list-style-type: none"> <li>Negative</li> </ul>	<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> <li>Lower than expected net borrowing figures released in budget</li> </ul>

## Corporate Bond Outlook Matrix

	Outlook	Key Drivers	Key Risks
<b>Short Term</b>	<ul style="list-style-type: none"> <li>Negative</li> </ul>	<ul style="list-style-type: none"> <li>Bearishness in the underlying G-sec base curve as there are concerns on inflation and borrowing numbers</li> <li>Liquidity tightening measures being undertaken by the RBI</li> </ul>	<ul style="list-style-type: none"> <li>Less than expected borrowing amount</li> <li>Stability in inflation numbers</li> </ul>
<b>Long Term</b>	<ul style="list-style-type: none"> <li>Negative</li> </ul>	<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 closed at 7.58%, 1 bp lower than the previous month closing level of 7.59%

**Credits:** The yield on the 1 year CDs increased from 5.60% in previous month to around 6.00%. During this month, the yield on a 10 yr AAA corporate bond hardened from 8.65% at the end of December 2009 to 8.69% at the end of January 2010.

**OIS:** 2 year rate softened marginally from 5.77% at the end of December 2009 to 5.68 at the end of January 2010.



**Ramanathan K**

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

## INVESTMENT MANAGEMENT



[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.

**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.