

Key Market Highlights

- In its mid-quarter credit policy review, RBI kept Repo Rate and Reverse Repo Rate unchanged at 6.25% and 5.25% respectively.
- CRR was unchanged at 6.00%.
- SLR was cut by 1% from 25% to 24% effective December 18, 2010.
- Additional liquidity support under LAF reduced from 2% to 1% for period from December 18, 2010 to January 28, 2011.
- RBI announced Open Market Operations (OMO) for purchase of Government Securities of an aggregate amount of INR 48,000 crs in the next one month.
- RBI believes that domestic growth momentum remains strong as witnessed in IIP growth and other indicators. RBI has retained its projection of 8.5% growth in GDP for FY11.
- RBI stated that liquidity has been excessively strained due to above trend currency expansion and deposit growth not keeping up with pace of credit pickup. The current liquidity deficit is above RBI's comfort level. Hence, it would take measures to reduce the deficit to bring it down to its comfort level. However, it should not be construed as change in monetary policy stance as inflation continues to remain a major concern.
- India's IIP growth rebounded sharply to 10.8% for October 2010 (market expectation of 5.5%) from 4.4% for the month of September. The manufacturing growth was up 11.3% as against 4.5% for September and capital goods was up sharply from -4.2% for September to 22.0% in October. 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 November 2010 fell to 7.48% (market expectation at 7.5%) as against 8.58% for October 2010. This was led by primary articles 13.0%, fuel index 10.3% and manufactured products by 4.6%.
- Export growth improved to 26.5% for the month of November 2010 from 21.3% for October 2010.
- Import growth increased to 11.2% for November 2010 as against 6.8% for October 2010.
- Credit growth further improved to 23.71% in early mid December compared to 22.70% in mid November 2010.
- Deposit growth further fell to 14.71% in mid December from 15.78% in mid November 2010.

Source: www.rbi.org.in, Bloomberg

Market impact

Government Securities market was positive during the month of December 2010.

During the month, we saw range bound movement in G sec market. At the beginning of the month the sentiment was negative as there was weekly supply of Government bonds by way of auction, which weighed heavy on the market sentiment. Also, liquidity continued to worsen with the quarterly advance tax outflows further putting stress on an already strained liquidity situation. The number for overnight borrowings by banks from RBI through the Repo window touched a new all time high of INR 170,000 crs during the month on December 22, 2010. Due to this, the yields continued to be at elevated level. However, RBI in its mid quarter policy, kept the Repo and the Reverse Repo Rates unchanged at 6.25% and 5.25% respectively. At the same time, to reduce stress on liquidity, RBI announced buyback of INR 48,000 crs over a span of four weeks. This along with partial postponement of auction, brought back buying interest in the market and yields softened significantly. The yield on the 10 year benchmark bond closed at 7.91% after touching a high of 8.21% earlier during the month.

The spread between the 12 year security and 10 year benchmark security widened from 1 bp at the end of the previous month to 11 bps by end of December 2010 as there was expectation that the RBI would buy back the 10 year security but not the 12 year security.

With the liquidity situation worsening during the month, the short term rates continued to harden and the 1 year bank CDs spiked up further from around 8.95% to around 9.50%. Corporate bonds in the 2-3 year maturity bucket also saw hardening from 8.60% to around 9.05% during the month. Currently the yield curve is inverted in the corporate bond segment with one year rate being higher than 2 to 3 year rates. This situation is expected to persist till the time liquidity continues to be under severe stress.

INR Swap curve continued to harden due to further tightness in the liquidity. 1 year OIS hardened from 6.80% by end of November 2010 to 7.13% at the end of December 2010. 5 year swap rates closed at 7.73% as against 7.31% at the end of the previous month.

Our assessment

INR Yields were positive during December on account of:

1. RBI in its mid quarter credit policy review kept the Repo Rate and Reverse Repo Rate unchanged.
2. Also, to reduce stress on liquidity, RBI announced OMO buyback of Government Securities of INR 48,000 crs over a period of four weeks, which brought back buying interest in the markets and as a result, the rates softened.

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 growth could slow down from here.
2. We expect that RBI may hike rates in the next policy meeting on January 25, 2011 as there is upside risk to inflation with food prices as well as crude prices firming up.
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 the sentiment as there would be a lot of buying interest for a benchmark bond.

Our portfolio strategy

Recap – December 2010

1. In the ING Income Fund and ING Gilt Fund Provident Fund Dynamic Plan, we had high duration at the beginning of the month. As yields softened after the announcement of the buyback from RBI, we reduced duration.
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 harden significantly, we would add duration, and if rates soften after that, we would reduce duration.

2. In the ING Short Term Income Fund we would continue to 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 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 Asset Liability Management (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 could push yields higher ➤ Reducing supply may bring back buying interest in markets ➤ Weaker domestic growth or fear of weaker growth in developed economies may induce softening bias 	<ul style="list-style-type: none"> ➤ Inflation falls more than expected ➤ Any additional supply of G sec due to failure to meet disinvestment target by government
Long Term	➤ Neutral	<ul style="list-style-type: none"> ➤ Fears of inflation giving negative surprise due to higher food and oil prices could cause yields to harden ➤ Possibility of a new 10 year benchmark bond being issued by RBI, which could bring buying interest in the markets and yields could soften 	<ul style="list-style-type: none"> ➤ Inflation falls more than expected ➤ Weaker global / domestic growth numbers ➤ Better fiscal management by the government

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 falls more than expected ➤ Any additional supply of G sec due to government's failure to meet disinvestment target could cause the base G sec curve to harden.
Long Term	➤ Neutral	<ul style="list-style-type: none"> ➤ Expectation of volatile movement in the base G-sec Curve ➤ Fears of inflation giving negative surprise due to higher food and oil prices could cause yields to harden 	<ul style="list-style-type: none"> ➤ Inflation falls more than expected ➤ Weaker global / domestic growth numbers ➤ Better fiscal management by the government

Month end levels

Sovereign: The 10 year benchmark bond i.e 7.80% Govt bond maturing in 2020 closed at 7.91% by end of December 2010 as against 8.07% by end of November 2010

Credits: The yield on the 1 year CDs further hardened from around 8.95% in previous month to around 9.50% by end of December 2010. During the month, the yield on a 10 yr AAA corporate bond also hardened from 8.83% to around 8.95%.

OIS: INR Swap curve continued to harden due to further tightness in the liquidity. 1 year OIS hardened from 6.80% by end of November 2010 to 7.13% at the end of December 2010. 5 year swap rates closed at 7.73% as against 7.31% at the end of the previous month.



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INVESTMENT MANAGEMENT



www.ingim.co.in

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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