

Key Market Highlights

- GDP growth for Q2FY12 (July-Sep 2011) came at 6.9% (in line with market expectations) compared to 7.7% growth seen in Q1FY12. The fall in GDP growth was due to poor performance of manufacturing sector, which grew by 3.2% compared to 7.1% in Q1FY12. Agricultural growth was also weaker at 3.2% compared to 5.4% in the previous quarter. However, service sector growth continued to be strong with growth of 9.3% compared to 9.6% for Q1FY12.
- The Index of Industrial Production (IIP) continued to fall and printed a very low growth number of 1.9% for September 2011 (market expectation was 3.5%) compared to 3.6% during August 2011 (revised downwards from 4.1%). During September, there was contraction in mining of -5.6% and Manufacturing sector growth slowed down to 2.1%, while Electricity continued to remain strong at 9%. Due to moderation in growth and tight monetary policy, the growth in IIP is expected to remain in mid to high single digit numbers for the next few months.
- Inflation as measured by Wholesale Price Index (WPI) for the month of October 2011 came at 9.73% which was in line with consensus expectation at 9.70% and was at similar levels to previous month's reading of 9.72%. Food inflation rose to 11.1% compared to 9.2% in the previous month while fuel inflation increased to 14.8% compared to 14.1% in the previous month. Non-food manufactured products inflation, which measures demand pressures in the economy was at 7.6% for October as compared to 7.5% in September. With high base effect coming from December, inflation is expected to moderate to around 7-7.5% by March 2012.
- Export growth dropped sharply from 36.4% for September 2011 to 10.8% for October 2011
- Import growth increased marginally from 17.2% for September 2011 to 21.7% for October 2011
- Credit growth fell further from 19.45% in early October 2011 to 18.41% for early November 2011
- Deposit growth increased marginally to 16.59% in early November 2011 compared to 15.32% in early October 2011

Source: www.rbi.org.in, Bloomberg

Market impact

Government securities market was positive during the month of November 2011.

Market sentiment was bearish at the beginning of the month as there was continuous weekly supply of INR 13,000-15,000 crs due to higher than expected borrowing for second half of FY12. With this weekly supply, yields rose initially and the yield on the new 10 year benchmark bond, which was auctioned in the first week of the November at yield of 8.79%, touched 9% by middle of the month.

IIP growth for September came at a very low number of 1.9%, due to which yields stabilized somewhat. Also, inflation for the month of October 2011 came at 9.73% which was as per market expectation. RBI officials commented that the inflation number was as per their projected trajectory and that their guidance for a pause in rate hike for the next mid-quarter policy continues. This also helped in stabilizing the market sentiment and supported the yields.

During the month, liquidity in the system worsened significantly. RBI's average daily net lending to the system under Liquidity Adjustment Facility (LAF) window was to the extent of INR 92,000 crs, which was much higher than its comfort level of + / - 1% of Net Demand and Time Liabilities. This gave rise to expectation that RBI may have to conduct Open Market Operations (OMO) to infuse liquidity in the markets. As a result, there was significant buying interest seen in the markets and yields softened. As per expectation, RBI announced OMO in the second half of the month and with expectation of further OMOs there was sustained buying and by the end of the month, yield on the 10 year benchmark bond dropped to 8.74%.

Due to very tight liquidity situation, CD rates rose during the month. While CD issuances have reduced due to lower credit offtake, the 3 month CD rates increased from around 9.25-35% to around 9.40-50% level and 1 year CD rates also increased from around 9.55-65% to around 9.65-70% level during the month.

INR Swap curve also softened during the month due to RBI infusing liquidity in the system through OMOs. 1 year Overnight Indexed Swap (OIS) softened from 8.25% by end of previous month to 8.04% by the end of November 2011. The 5 year OIS rate also softened from 7.50% at the end of the previous month to 7.29% by the end of November 2011.

Our assessment

INR Yields were positive during the month on account of:

1. Sentiment was negative at the beginning of the month due to continued weekly supply of INR 13,000-15,000 crs and yields continued to rise. The yield on the new 10 year benchmark bond touched 9% in the first half of the month.
2. However, with IIP number for September coming very low at 1.9% and inflation posting 9.73%, which was as per expectation, yields stabilized.
3. Due to excess deficit in liquidity, RBI announced OMOs in the second half of the month. Due to this significant buying was seen in the market and the yield on the 10 year benchmark bond fell from 9% to 8.74%

Going Forward

1. Government securities market is expected to remain positive due to the expectation that RBI OMOs would absorb the excess supply, which is the biggest concern of the market.
2. As per RBI guidance, there is low probability of a rate hike in next mid-quarter review. This can further improve the sentiment in the market.
3. The global weakness may continue or there could be shocks coming from the Euro zone due to sovereign debt problem. This could cause the yields to remain low.
4. However, on the other hand, if there is large quantum of additional borrowing due to slippage in the fiscal deficit, yields could move up sharply.

Our portfolio strategy

Recap – November 2011

1. In the ING Income Fund and ING Gilt Fund – Provident Fund Dynamic Plan, we had moderate to high duration at the beginning of the month. However, we increased duration in the middle of the month as there was expectation of RBI conducting OMOs to infuse liquidity in the system.
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. We would continue to have high duration as the sentiment is positive due to continuing RBI OMOs. However, if rates fall excessively, we may reduce duration
2. In the ING Short Term Income Fund we would continue have around 25-30% exposure to 1-2 year papers as there is good carry in these assets. We would continue to have exposure to accrual assets, which are being traded at high rates. However, we would also look to increase duration opportunistically.
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	➤ Positive	<ul style="list-style-type: none"> ➤ Continuing OMOs being conducted by RBI to infuse liquidity in the system which helps in absorbing the excess supply. ➤ The global weakness may continue or there could be shocks coming from the Euro zone related to sovereign debt problem. 	<ul style="list-style-type: none"> ➤ Further supply coming to market due to high slippage in fiscal deficit. ➤ Inflation continue to be at higher levels ➤ Successful and meaningful resolution of the Euro zone sovereign debt crisis could bring back risk appetite in the markets and yields could move higher
Long Term	➤ Positive	<ul style="list-style-type: none"> ➤ Slow down in the developed economies as well as the domestic economy ➤ Moderation in inflation due to lower commodity prices and higher base effect coming into play ➤ Expectation of RBI cutting rates in the longer horizon to support slowdown in growth of the economy 	<ul style="list-style-type: none"> ➤ Inflation continues to remain at elevated levels ➤ Stronger than expected rebound in global or domestic growth ➤ Crude oil or commodity prices increase due to supply problems or stonger demand ➤ Higher than expected borrowing due to fiscal slippages and /or disinvestment target not being met

Corporate bond outlook matrix

	Outlook	Key Drivers	Key Risks
Short Term	➤ Positive	<ul style="list-style-type: none"> ➤ Expectation of positive movement in the base G sec curve ➤ Improvement in liquidity due to RBI OMOs 	<ul style="list-style-type: none"> ➤ Any significant issue pertaining to credit quality of issuers
Long Term	➤ Positive	<ul style="list-style-type: none"> ➤ Expectation of positive movement in the base G-sec Curve ➤ Improvement in liquidity expected over longer horizon due to government expenditure. 	<ul style="list-style-type: none"> ➤ Inflation continues to remain high ➤ Stronger than expected global / domestic growth numbers ➤ Higher supply of G sec could lead to crowding out effect for corporate bonds

Month end levels

Sovereign: The new 10 year benchmark bond i.e. 8.79% Govt bond maturing in 2021 closed at 8.74% by end of November 2011 compared 8.88%, which was the closing level of the previous 10 year bond i.e. 7.80% bond maturing in 2021, by end of October 2011

Credits: 1 year CD rates hardened due to tighter liquidity conditions from around 9.55-65% by end of October 2011 to around 9.65-70% by end of the November 2011. During the month, the yield on a 10 yr AAA corporate bond also fell from 9.75% by end of October 2011 to 9.70 % at the end of November 2011

OIS: INR Swap curve also softened during the month due to RBI infusing liquidity in the system through OMOs. 1 year OIS softened from 8.25% by end of previous month to 8.04% by the end of November 2011. The 5 year OIS rate also softened from 7.50% at the end of the previous month to 7.29% by the end of November 2011.

Source for all data in this document is www.rbi.org.in and/or Bloomberg.



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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 scheme which seeks to provide reasonable returns while providing a high level of liquidity and low risk by investing primarily in money market securities. The aim is to optimize returns while providing liquidity. **Statutory Details: Sponsor:** ING Group, through its wholly owned subsidiary, Nationale Nederlanden Interfinance B.V., **Trustee:** Board of Trustees of ING Mutual Fund, **Investment Manager:** ING Investment Management (India) Private Limited.

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