

Key Market Highlights

- The growth in Index for Industrial Production (IIP) reduced marginally to 3.6% for the month of February vis-à-vis 3.9% for the month of January 2011 (revised upwards from previously announced growth of 3.7%). Mining grew by 0.6%, manufacturing by 3.5% and electricity by 6.7%. 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 March 2011 came much higher at 8.98% compared to market expectation of 8.36% and almost one percentage point higher than RBI projection of 8.00%. Also January WPI inflation was revised upwards from 8.23% to 9.35%. The increase in inflation during March was led by Fuel Index by 12.92%, Primary articles by 12.96%. However, the worrying trend of higher non-food manufactured goods inflation (which is considered as 'core inflation') continued with 7.08% for March 2011 as against 6.10% for the previous month. This is an indication that inflation is increasingly becoming demand led inflation.
- Export growth reduced to 43.5% for March 2011 compared to 49.7% for February 2011.
- Import growth also reduced to 17.2% for March 2011 as against 21.2% for February 2011.
- Credit growth reduced further to 21.9% in mid April as against 23.2% in mid March 2011.
- Deposit growth improved to 17.2% in mid April as against 16.6% in mid March 2011.

Source: www.rbi.org.in, Bloomberg

Market impact

Government securities market was bearish during the month of April 2011.

Market sentiment was marginally positive at the beginning of the month as there was announcement of a new 10 year benchmark bond and there was expectation that there would be a lot of demand for this bond. The bond was very aggressively bid by the market participants and it came at a coupon of 7.80% due to very high investor interest. However, with no further positive triggers and expectations of high inflation numbers, the market showed signs of weakness and the yields moved higher.

While IIP growth for February came at 3.6%, which was positive for the markets, WPI inflation came very high at 8.98% as against market expectation of 8.36%. This was also much higher than the RBI projections of 8.00% (original projection for March 2011 was much lower at 5.50% a few months back). This along with higher international crude oil prices, which are expected to be reflected in domestic fuel prices in a short time brought back fears of very aggressive rate hike by RBI and the yields started moving up very sharply. Yield on the new 10 year G sec bond continued to rise and by the end of the month it rose to 8.13%.

Liquidity situation improved dramatically as government spent its surplus balance very aggressively. The system liquidity was positive for a brief period of 8-10 days. However, RBI drained this liquidity with Cash Management Bills to the extent of around INR 26,000 crs. This along with weekly auction drained liquidity from the system and the system again became negative to the extent of INR 20-30k cr as reflected in the Liquidity Adjustment Facility (LAF) window.

Due to improved liquidity situation, CD rates softened significantly in the first half of the month. 3 month CD rates touched 8.40-50% (from 10.20% in March) while one year CD rates moved to around 9.40-50% (from 9.50-60% in March). However, as liquidity worsened, 3 month rates moved up to around 8.85-90% and one year CD rates moved up to 9.70-75% by month end.

INR Swap curve hardened due to high inflation and expectation of aggressive rate action by RBI. 1 year OIS hardened from 7.41% at the end of March 2011 to 7.87% by end of April 2011. 5 year swap rates closed at 8.28% as against 7.71% at the end of the previous month.

Our assessment

INR Yields were bearish during April on account of:

1. Initially, market sentiment was marginally positive due to announcement of a new 10 year benchmark bond, which brought back investor interest in the market.
2. However, while IIP reading for February 2011 came at 3.6%, which was lower than previous month, WPI for March 2011 came higher much than market expectation and also higher than RBI projection and as a result, yields hardened.
3. The sentiment turned very negative due to expectation of aggressive rate hike by RBI due to high inflation and expectation of pass through of increase in international crude prices in domestic markets.

Going Forward

1. Government securities market is expected to remain bearish due to supply pressure of weekly supply of INR 11,000-12,000 crs.
2. Also, inflation could rise from the current levels due to imminent hike in domestic fuel prices along with demand side pressures being persistently felt in the economy.
3. With RBI expected to hike rates further to combat inflation and anchor inflationary expectations, the yields could move higher over medium term.

Our portfolio strategy

Recap – April 2011

1. In the ING Income Fund and ING Gilt Fund Provident Fund Dynamic Plan, we had moderate duration at the beginning of the month. However, we reduced duration significantly as the WPI inflation was worse than expected.
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 may add duration with a view to reducing it when yields fall.
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. We would also continue to have exposure to 1 year CDs as they are at attractive levels.
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	➤ Negative	<ul style="list-style-type: none"> ➤ High supply during first half of FY12 i.e. 60% of the total borrowing programme is scheduled in first half of FY12. ➤ Expectation of further rate hikes by RBI to fight inflation. ➤ Geopolitical events could push crude oil prices high, which is negative for inflation as well as fiscal deficit as oil subsidy seems to be under provided for in the Budget. 	<ul style="list-style-type: none"> ➤ Crude oil prices fall sharply due to resolution of geopolitical events. ➤ Food inflation falls more than expected.
Long Term	➤ Neutral	<ul style="list-style-type: none"> ➤ Lesser supply of G sec in FY12 compared to last year could keep yields supported. ➤ Fears of inflation giving negative surprise due to higher food and commodity prices could cause yields to harden 	<ul style="list-style-type: none"> ➤ Inflation falls more than expected. ➤ Weaker global / domestic growth numbers. ➤ Crude oil prices fall sharply due to resolution of geopolitical events.

Corporate bond outlook matrix

	Outlook	Key Drivers	Key Risks
Short Term	➤ Negative	<ul style="list-style-type: none"> ➤ Expectation of yields heading higher in the base G-sec Curve. ➤ Due to higher supply of G sec in first half of FY12, there could crowd out effect for corporate bonds. 	<ul style="list-style-type: none"> ➤ Inflation falls more than expected. ➤ Significant improvement in liquidity due to higher spending by government.
Long Term	➤ Neutral	<ul style="list-style-type: none"> ➤ Expectation of stability in the base G-sec Curve ➤ Improvement in liquidity expected over longer horizon due to government expenditure. 	<ul style="list-style-type: none"> ➤ Inflation falls more than expected ➤ Weaker global / domestic growth numbers.

Month end levels

Sovereign: The 10 year benchmark bond i.e 7.80% Govt bond maturing in 2021 closed at 8.13% by end of April 2011.

Credits: 1 year CDs were at 9.70-75% by end of April 2011 as against 9.50-60% by end of March 2011. During the month, the yield on a 10 yr AAA corporate bond hardened to 9.21% by end of April 2011 as against 9.15% by end of March 2011.

OIS: INR Swap curve hardened due to expectation of aggressive rate hike to anchor inflationary expectations. 1 year OIS hardened from 7.41% at the end of March 2011 to 7.87% by end of April 2011. 5 year swap rates closed at 8.28% as against 7.71% 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.

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