Key Market Highlights

- S&P cut the long-term U.S. credit rating by one notch to AA+ on concerns about the government's budget deficit and rising debt burden. Downgrade of U.S. sovereign rating & debt concerns in Europe have heightened risk perception and uncertainties in a global economy where the downside risks were already material.
- Q1FY12 GDP growth came at 7.7%, which was in line with market expectations. Services grew by 10%, while manufacturing by 5.1%. Due to monetary policy tightening and weaker global prospects, the full year GDP growth may be lower than 8%
- The Index of Industrial Production (IIP) grew by 8.8% during June 2011 as against expectation of 5.8%. This was led by growth in Manufacturing sector which rose by 10% due to electrical machinery which was up 89%. Mining grew at a lacklustre 0.6% while Electricity remained buoyant at 7.9%. 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.
- WPI Inflation for the month of July 2011 came at 9.22% in line with market expectations but lower than the last month's level of 9.4%. Also May WPI inflation was revised upwards by 50 bps to 9.56%. Food inflation moderated to 7.97% from 8.42% in June while fuel inflation at 12.04% captured the full direct impact of the hike in administered fuel prices announced in the last week of June. Core inflation rose to 7.53% in July from 7.31% in June. Additionally, the upward revision in electricity prices and the higher MSPs in 2011 is expected to provide upward pressure to overall inflation.
- Export growth increased to 81.8% for the month July 2011 compared to 46.5% for June 2011.
- Import growth also increased to 51.5% for July 2011 compared with 42.5% for June 2011.
- Credit growth rose from 19.33% in mid July to 20.22% in mid August 2011.
- Deposit growth reduced from 19.24% in mid July 2011 to 18.37% in mid August 2011.

Source: www.rbi.org.in, Bloomberg

Market impact

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

Market sentiment was bearish at the beginning of the month. With IIP number coming higher than expected, the expectation was that RBI may continue its rate hiking cycle and may hike the policy rates by another 25-50 basis points. Also the inflation number came at 9.22% which although was marginally lower than last month's level of 9.4%, it still was much higher than RBI's comfort level. This further built expectation of a hawkish stance by RBI to tame inflation. As a result the yield on 10 year G sec touched a high of 8.45% in the first half of the month.

However global geopolitical events, fear of sovereign debt problem worsening in Europe and downgrade of US debt led to the expectation of a dovish policy stance by the RBI and eased pressure across the yield curve. As a result, yield on the 10 yr benchmark bond softened to 8.22% during the month. However, due to supply pressure from weekly auctions, its yield hardened to 8.32% by the end of the month.

Liquidity in the system continued to tighten for most of the month due to Treasury bill and Gsec auctions. The average net absorption by RBI under the LAF window for the month of August stood at INR 405.21 bn.

Due to tight liquidity situation, CD rates continued to remain high during the month. At the beginning of the month, 3 month CD rates were at 9.10-15% while one year CD rates were at around 9.75-80% level. However, toward the middle of the month the CD curve softened especially in the 6 months to 1 year segment. By the end of the month 1 year rates were at around 9.60% levels.

INR Swap curve softened around the middle of the month due to global events and expectation of a dovish policy stance going forward. 1 year OIS softened from 8.31% by end of July 2011 to 7.71% by mid of August 2011 and closed at 7.84% by the end of the month. The 5 year OIS rate also fell sharply from 7.52% at the end of the previous month to 6.86% by the mid of August 2011 but rose again to 7.02% towards the end of the month.

Our assessment

INR Yields hardened during the beginning of the month, however they softened towards the end of the month on account of:

1. IIP reading for June 2011 came at 8.8% which was higher than expectation of 5.8%. This raised concerns about RBI continuing with its rate hiking cycle.

2. Inflation for the month of July 2011 came at 9.22% which although lower than the previous month reading of 9.4%, was still higher than RBI comfort level.

3. However, during the month global growth prospects worsened with weakness in US and Europe zone.

4. Crude oil prices also softened due to possibility of weakness in global markets and concerns on growth in the developed economies.

Going Forward

1. Government securities market is expected to remain range bound due to possibility of weaker growth going forward globally as well as domestically, which would be positive for the bond markets as RBI may have to follow a more accommodative monetary policy stance.

2. On the other hand, inflation is expected to remain at higher levels for the next few months, which could push yields higher.

3. There is weekly supply of INR 11,000-12,000 till the end of first half of FY12. Also, the borrowing in the second half of the financial year could be higher than budgeted number due to possibility of higher food and oil subsidy, which seem to be insufficiently provided for in the budget.

Our portfolio strategy

Recap –August 2011

1. In the ING Income Fund and ING Gilt Fund – Provident Fund Dynamic Plan, we had low duration at the beginning of the month. However, we increased duration moderately in the second half of the month with emerging concerns on global growth.
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 and the yields soften substantially, we would 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 50-60% exposure to accrual assets, which are being traded at higher rates due to tight liquidity situation.
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	➢ Opposing forces of weaker growth and higher inflation would keep market range bound ➢ However, higher inflation could keep monetary policy stance towards fighting inflation	➢ Rebound in global or domestic growth ➢ Inflation continue to be at higher levels ➢ RBI may keep its stance hawkish to fight inflation and to anchor inflationary expectations
Long Term	➢ Neutral	➢ 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 moderation in the RBI monetary policy stance to support growth	➢ 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 in second half of FY12 due to under-provisioning of fuel and food subsidy

Corporate bond outlook matrix

	Outlook	Key Drivers	Key Risks
Short Term	➢ Neutral	➢ Expectation of liquidity remaining in strained ➢ Outflows in the month of September due to advance tax outflows may exert pressure on yields.	➢ Significant improvement in liquidity ➢ Contraction in spreads due to lower than expected supply of corporate bonds in the market
Long Term	➢ Neutral	➢ Expectation of stability in the base G-sec Curve ➢ Improvement in liquidity expected over longer horizon due to government expenditure.	➢ 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 10 year benchmark bond i.e 7.80% Govt bond maturing in 2021 closed at 8.32% by end of August 2011 compared to 8.45% by end of the previous month.

Credits: 1 year CDs were at 9.55-60% by end of August 2011 as against 9.75-80% by end of July 2011. During the month, the yield on a 10 yr AAA corporate bond softened to 9.38% compared with 9.46% at the end of the previous month.

OIS: INR Swap curve softened due global sovereign concerns with 1 year OIS softening from 8.31% by end of July 2011 to 7.84% by end of August 2011. Also, the 5 year swap softened from 7.52% at the end of the previous month to 7.02% by the end of August 2011.

Mr. Ramanathan K
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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 a 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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