

## Key Market Highlights

- The growth in Index for Industrial Production (IIP) rose to 7.3% for the month of March vis-à-vis 3.6% for the month of February 2011 and significantly higher than the market consensus of 4%. The index was high largely due to high base of 15.5% in March 10. Growth for the full year (Apr-Mar FY11) was up 7.8%YoY, vs. 10.5% last year. This was led by manufacturing 8.1%, mining 5.9% and electricity 6%.
- Inflation for the month of April 2011 came at 8.66% compared to market expectation of 8.5%. Also February WPI inflation was revised upwards from 8.3% to 9.5%. The increase in inflation during April was led by Fuel Index by 13.3% and Primary articles by 12%. However, manufactured non-food products index posted moderation to 6.3% from 7.3% for the last month. This was due to higher manufactured food products to 5.7% from 2.4%. Going forward, price hikes in domestic fuel prices will exert upward pressure on yields.
- Export growth reduced to 34.4% for April 2011 compared to 43.5% for March 2011.
- Import growth also reduced to 14.1% for April 2011 as against 17.3% for March 2011
- Credit growth rose to 22.50% in early May 2011 as against 21.97% in early April 2011.
- Deposit growth was flat at 17.05% in mid May 2011 as against 17.93% in mid April 2011.

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

## Market impact

Government securities market was bearish during the month of May 2011

Market sentiment was bearish at the beginning of the month as there was announcement of 50 bps rate hike due to high inflation. The 10 yr bond fell almost 15-20 bps in 2 days following the announcement. It stabilized before the inflation and IIP data, however, it fell another 10-15 bps after the data announcements.

IIP growth for March came at 7.3%, which was negative for the markets, WPI inflation came at 8.66% as against market expectation of 8.5%. 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 8.41%.

Liquidity situation tightened as excess liquidity was absorbed in T Bill auctions and cash management bills. Cash Management Bills (CMB) auctions along with weekly government securities auction drained liquidity from the system and the system again become negative to the extent of INR 50-55k cr as reflected in the Liquidity Adjustment Facility (LAF) window.

Due to tight liquidity situation, CD rates hardened significantly throughout the month. In early May, 3 month CD rates touched 9.15-20% (from 8.40% in April) while one year CD rates moved to around 9.80-90% (from 9.50% in April). However, towards the end of the month, as liquidity worsened, 3 month rates moved up to around 9.70-75% and one year CD rates moved up to 10-10.10%.

INR Swap curve hardened due to high inflation and aggressive rate action by RBI. 1 year OIS hardened from 7.87% at the end of April 2011 to 8.20% by end of May 2011. However, the 5 year swap rates closed at 8.12% as against 8.28% at the end of the previous month.

## Our assessment

INR Yields were bearish during May on account of:

1. IIP reading for March 2011 came at 7.3%, which was much higher than expectations and than the previous month, WPI for April 2011 came at 8.66% which was also much higher than market expectation and as a result, yields hardened.
2. The sentiment turned very negative due to aggressive rate hike by RBI due to high inflation and expectation of pass through of increase in international crude prices in domestic markets.
3. Crude oil remained in the range of \$98-102 per barrel, aggravating concerns on inflation.

## 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 – May 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. We kept duration low due to expectation of aggressive rate hikes by the RBI and also due to high WPI inflation and high IIP data.
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
<b>Short Term</b>	➤ Negative	<ul style="list-style-type: none"> <li>➤ High supply during first half of FY12 i.e. 60% of the total borrowing programme is scheduled in first half of FY12</li> <li>➤ Expectation of further rate hikes by RBI to fight inflation</li> <li>➤ 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</li> </ul>	<ul style="list-style-type: none"> <li>➤ Crude oil prices fall sharply due to resolution of geo-political events</li> <li>➤ Food inflation falls more than expected</li> </ul>
<b>Long Term</b>	➤ Neutral	<ul style="list-style-type: none"> <li>➤ Lesser supply of G sec in FY12 compared to last year could keep yields supported</li> <li>➤ Fears of inflation giving negative surprise due to higher food and commodity prices could cause yields to harden</li> </ul>	<ul style="list-style-type: none"> <li>➤ Inflation falls more than expected</li> <li>➤ Weaker global / domestic growth numbers</li> <li>➤ Crude oil prices fall sharply due to resolution of geo-political events</li> </ul>

## Corporate bond outlook matrix

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

## Month end levels

**Sovereign:** The 10 year benchmark bond i.e 7.80% Govt bond maturing in 2021 closed at 8.41% by end of May 2011

**Credits:** 1 year CDs were at 10-10.10% by end of May 2011 as against 9.70-75% by end of April 2011. During the month, the yield on a 10 yr AAA corporate bond hardened to 9.50% by end of May 2011 as against 9.21% by end of April 2011

**OIS:** INR Swap curve hardened due to expectation of aggressive rate hike to anchor inflationary expectations. 1 year OIS hardened from 7.87% at the end of April 2011 to 8.20% by end of May 2011. 5 year swap rates closed at 8.12% as against 8.28% at the end of the previous month.



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INVESTMENT MANAGEMENT



[www.ingim.co.in](http://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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