

Key Market Highlights

- In its quarterly monetary policy review, RBI hiked Repo Rate and Reverse Repo Rate by 25 bps each to 6.50% and 5.50% respectively.
- CRR was unchanged at 6.00%.
- Additional liquidity support under LAF of 1% was extended till April 8, 2011
- RBI believes that growth momentum remains stable and it has retained its projection of 8.5% growth in GDP for FY11 with an upward bias.
- RBI stated that Inflation is the dominant concern. Apart from recent spike in food articles such as vegetables and fruits, structural demand-supply mismatch and increase in prices of global commodities such as metals and oil, have added to inflationary pressure. RBI hiked its March 2011 projection of WPI inflation from 5.5% to 7.0%
- India's IIP growth dipped to a dismal 2.7% (consensus estimates was 6.6%) in November 2010 as against 11.3% for October (revised upwards from 10.8%). The manufacturing growth fell to 2.3% as against 11.9% in the previous month while consumer non-durables posted a contraction of 6% y-o-y. 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 December 2010 spiked up to 8.43% as against 7.48% for November 2010. October WPI inflation was revised upwards from 8.6% to 8.9%. The spike in December was led by primary articles rising by 16.5%, fuel index by 11.2% and manufactured products by 4.5%. Certain fruits and vegetables have shown very high inflation (of more than 20%) due to lower production caused by unseasonal rains.
- Export growth improved significantly to 36.4% for the month of December 2010 compared to 26.5% for the month of November 2010.
- Import contracted by 11% (for the first time in last 15 months) as against 11.2% growth for November 2010.
- Credit growth fell marginally to 23.58% in mid January 2011 compared to 23.71% in mid December 2010.
- Deposit growth improved to 16.44% in mid January 2011 compared to 14.71% in mid December 2010.

Source: www.rbi.org.in, Bloomberg

Market impact

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

During the month, we saw bearish movement in Government securities market. As the Open Market Operation (OMO) programme of RBI came to an end in middle of the month, bearish sentiment spread in the markets. Also, headline WPI inflation for the month of December 2010 came at 8.43%, which was much higher than 7.48% for the month of November 2010. This brought fear in the market about an aggressive rate hike by RBI to contain inflation. The market estimate was between 25 and 50 bps hike in Repo and Reverse Repo Rate in the quarterly monetary policy meeting. As a result, the yield on 10 year benchmark bond touched 8.25% during the month. However, there was buying support seen at this level and yields softened a bit. In its quarterly monetary policy, RBI hiked both the Repo Rate and the Reverse Repo Rate by only 25 bps, which brought relief to the market. Also, as the scheduled borrowing programme of the government is approaching its end, there was buying interest seen in the market and by the end of the month, the yield on 10 year bond fell to 8.14%.

The spread between the 12 year security and 10 year benchmark security contracted from 11 bps by end of the previous month to 2 bps by end of January 2011 as the fear of the 10 year benchmark security becoming illiquid returned.

While liquidity situation improved during the month due to RBI OMO and spending by government, it was still far from comfortable. As a result, the short term rates continued to harden and the 1 year bank CD rate hardened further from around 9.50% to around 9.90%. Corporate bonds in the 2-3 year maturity bucket also saw hardening from 9.05% to 9.40-50% during the month. The yield curve continues to be inverted and it is expected to remain so till the time liquidity continues to be under stress.

INR Swap curve hardened further due to rate hike by RBI and continued tightness in the liquidity. 1 year OIS hardened from 7.13% by end of December 2010 to 7.43% at the end of January 2011. 5 year swap rates closed at 7.98% as against 7.73% at the end of the previous month.

Our assessment

INR Yields were bearish during January on account of:

1. OMO by RBI coming to an end by middle of the month.
2. WPI inflation coming at 8.43%, due to higher prices of food articles. Market sentiment turned very bearish due to expectation of aggressive rate hike from RBI.
3. However, RBI hiked rates by 25 bps only, which brought relief in the market.
4. Also, as the borrowing programme of the government is approaching its end, there was buying interest seen in the market and yields marginally softened by the end of the month.

Going Forward

1. Government securities market is expected to remain volatile in the near term as elevated inflation along with increasing global commodity prices including crude oil and metals could induce bearish sentiment.
2. But on the other hand, as the scheduled borrowing programme is coming to an end, the yields could soften due to renewed buying interest in the market.
3. Also, if there is announcement of a new 10 year benchmark bond by RBI, there could be improvement in sentiment as there would be a lot of buying interest for a benchmark bond.

Our portfolio strategy

Recap – January 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 further as the sentiment was turning bearish.
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 a 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 commodity 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 governments 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 range bound 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 8.14% by end of January 2011 compared to 7.91% by end of December 2010

Credits: The yield on the 1 year CDs further hardened from to have around 9.50% in previous month to around 9.90%. During the month, the yield on a 10 yr AAA corporate bond also hardened from 8.95% by end of December 2010 to around 9.15% by end of January 2011

OIS: Swap curve hardened further due to rate hike by RBI and continued tightness in the liquidity. 1 year OIS hardened from 7.13% by end of December 2010 to 7.43% at the end of January 2011. 5 year swap rates closed at 7.98% as against 7.73% 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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