

Fixed Income Markets:

Current Environment and Outlook

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Macro Economic Events - Domestic

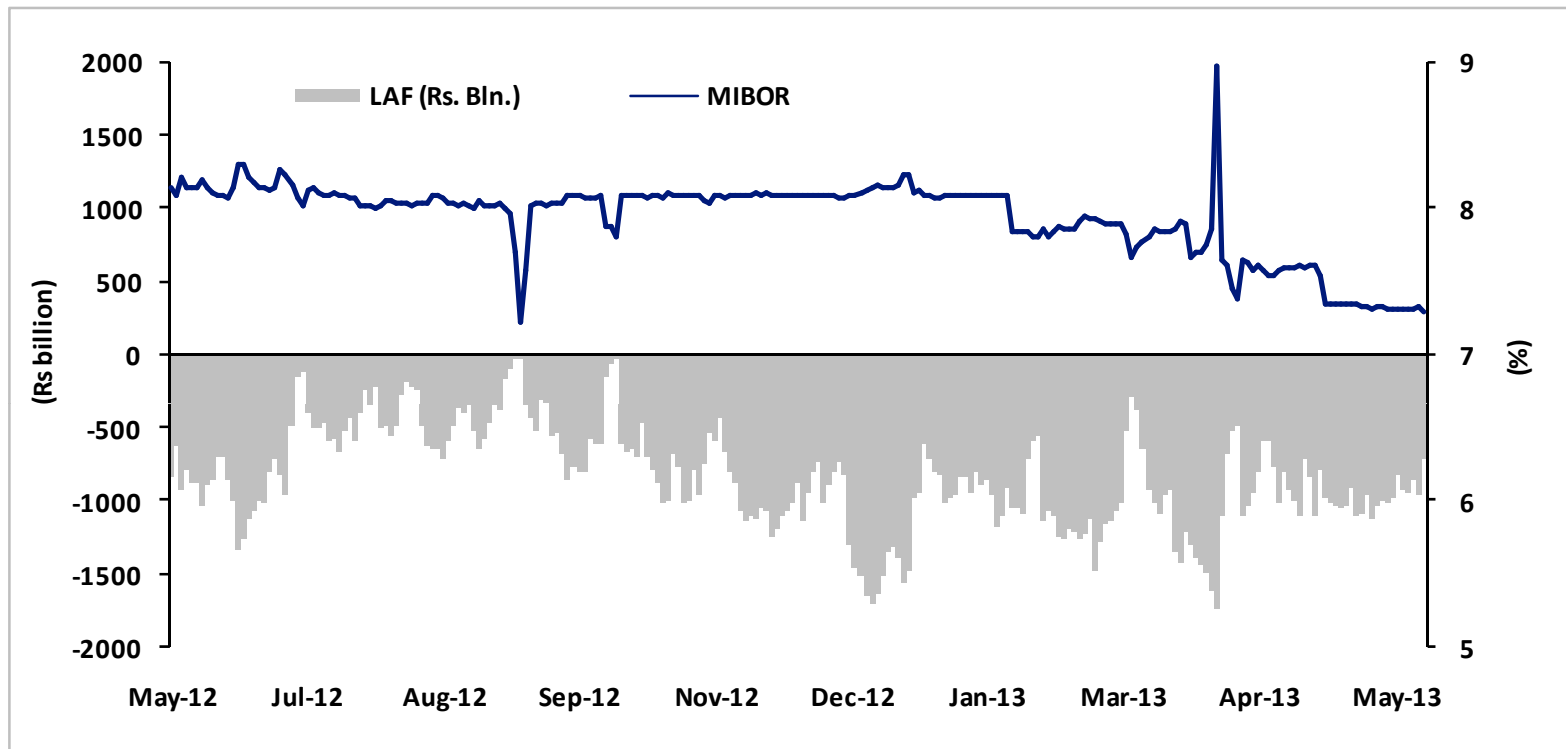
- The economic data is pointing at mixed results
- While there has been a sharp drop in WPI, the CPI decline is muted
- The IIP and exports growth points at a sluggish domestic production and external demand

	May 13	Apr 13
CPI	9.31%	9.39%

	Apr 13	Mar 13
Imports	10.96%	-2.87%
Exports	1.68%	6.97%
WPI	4.89%	5.96%
IIP	2.00%	3.40%

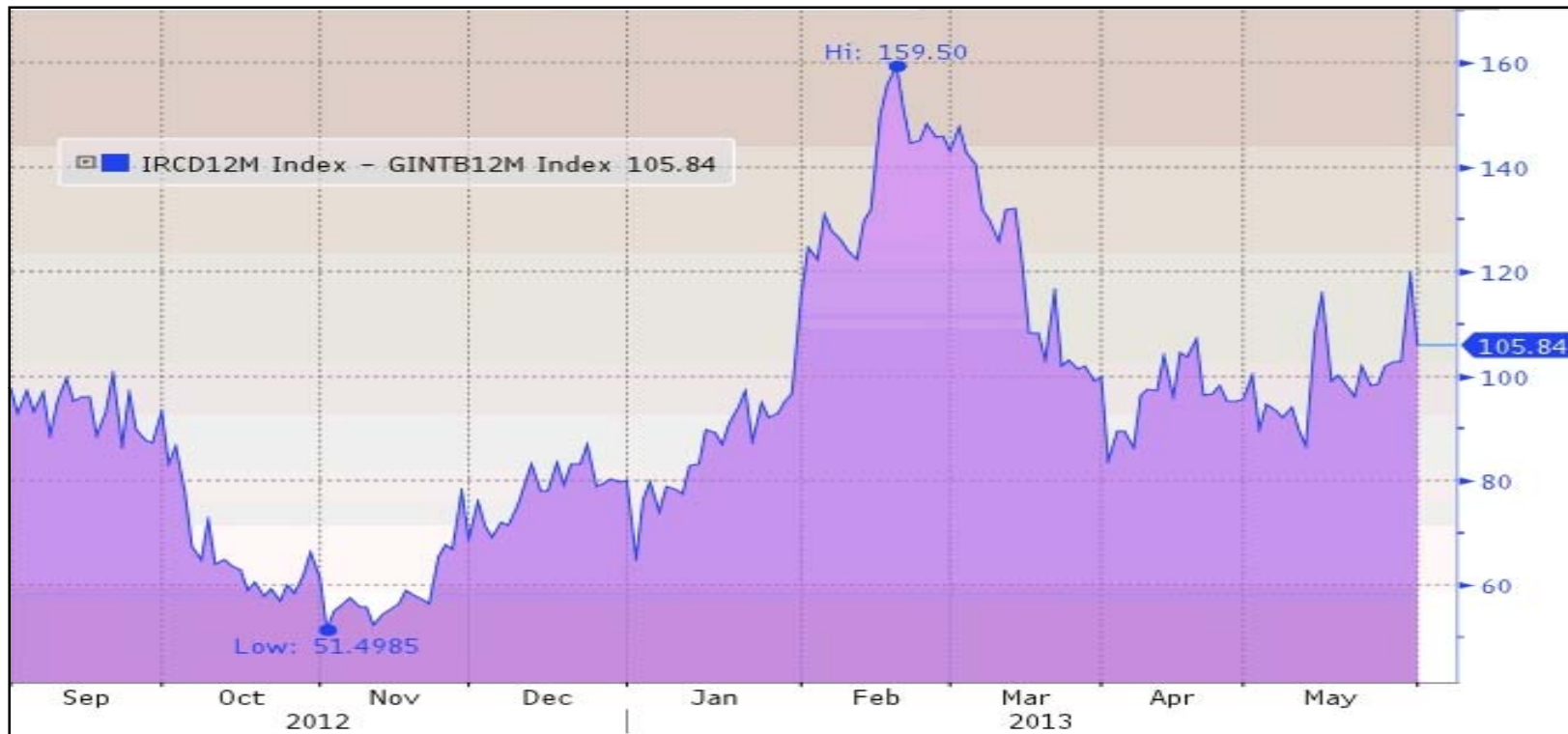
	Mar 13	Dec 12
GDP	4.80%	4.70%

	Dec 12	Sep 12
CAD	-32.55 USD Bn	-22.63 USD Bn



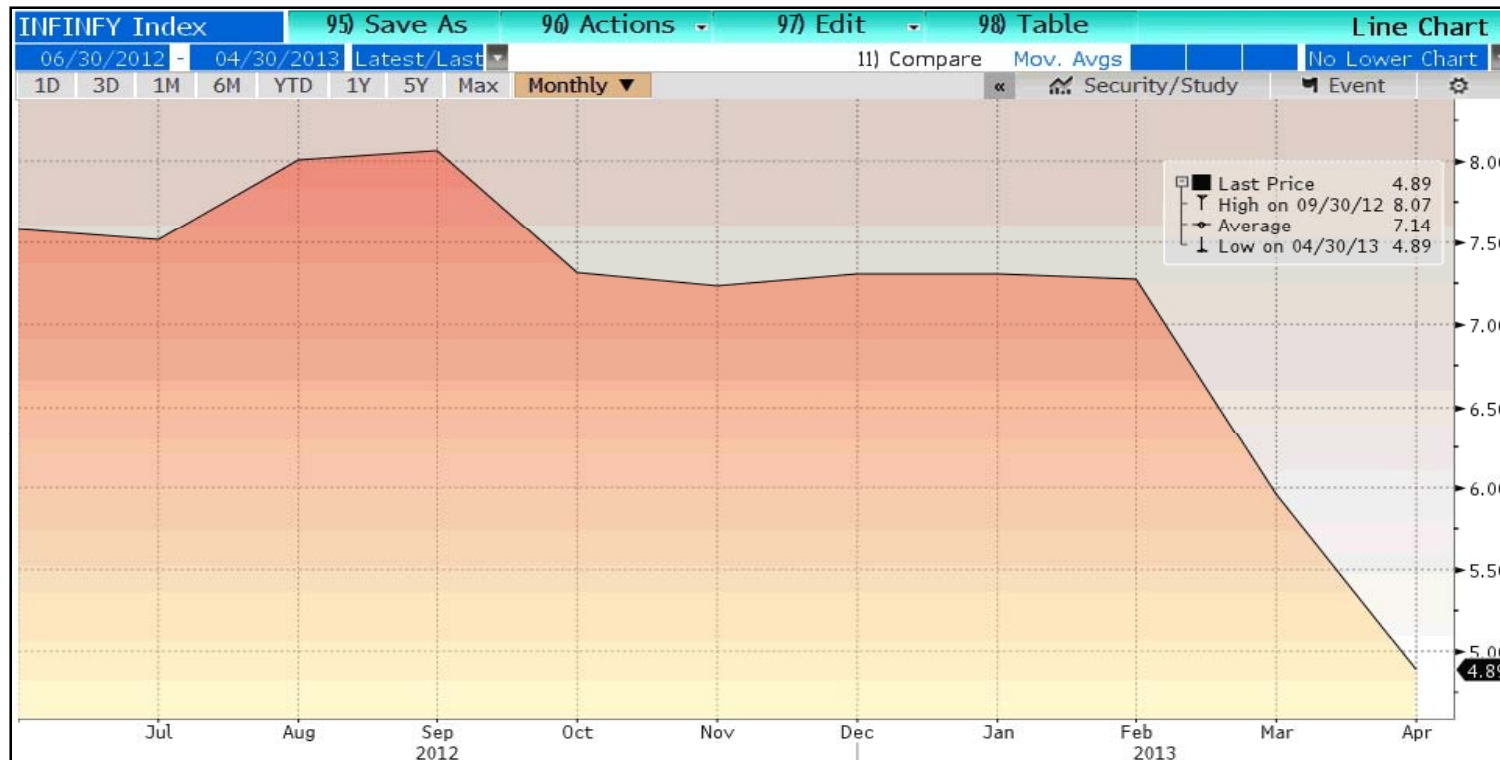
- Despite RBI reducing the CRR by 200bps from Jan'12, the liquidity position within the banking system is negative. The liquidity on an average for the month has remained negative by Rs. 973 billion
- The negative position within the banking system is continuing for over **3 years**

Money Market (spread between 12M T bill & CD)



- There was a marginal decline in the yields of money market securities
- The decline in the yields of T-bills was higher compared to the bank CD
- T-bills outperformed bank CDs

Inflation Dynamics



- The drop in the WPI inflation has been sharp and opens up opportunities for rate reductions from RBI¹

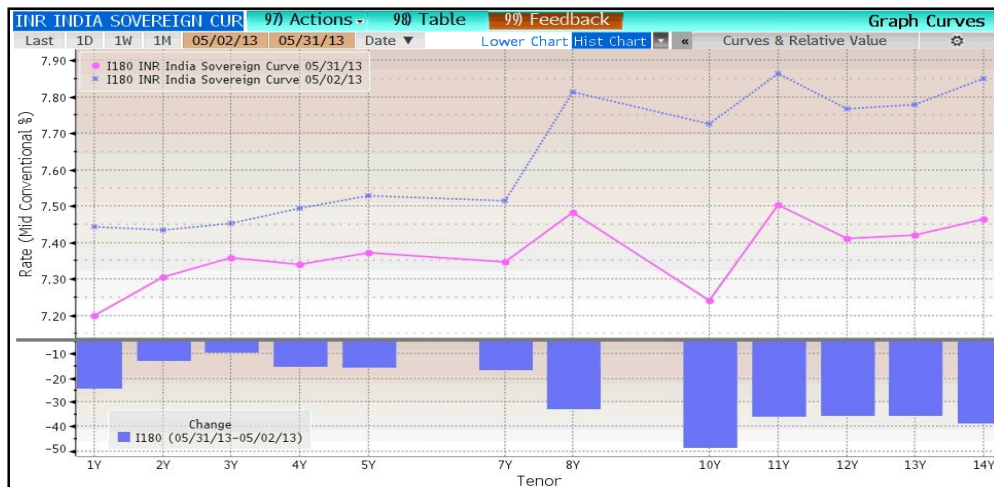
G-Sec Yield Curve

10 Year G – Sec Yield Curve



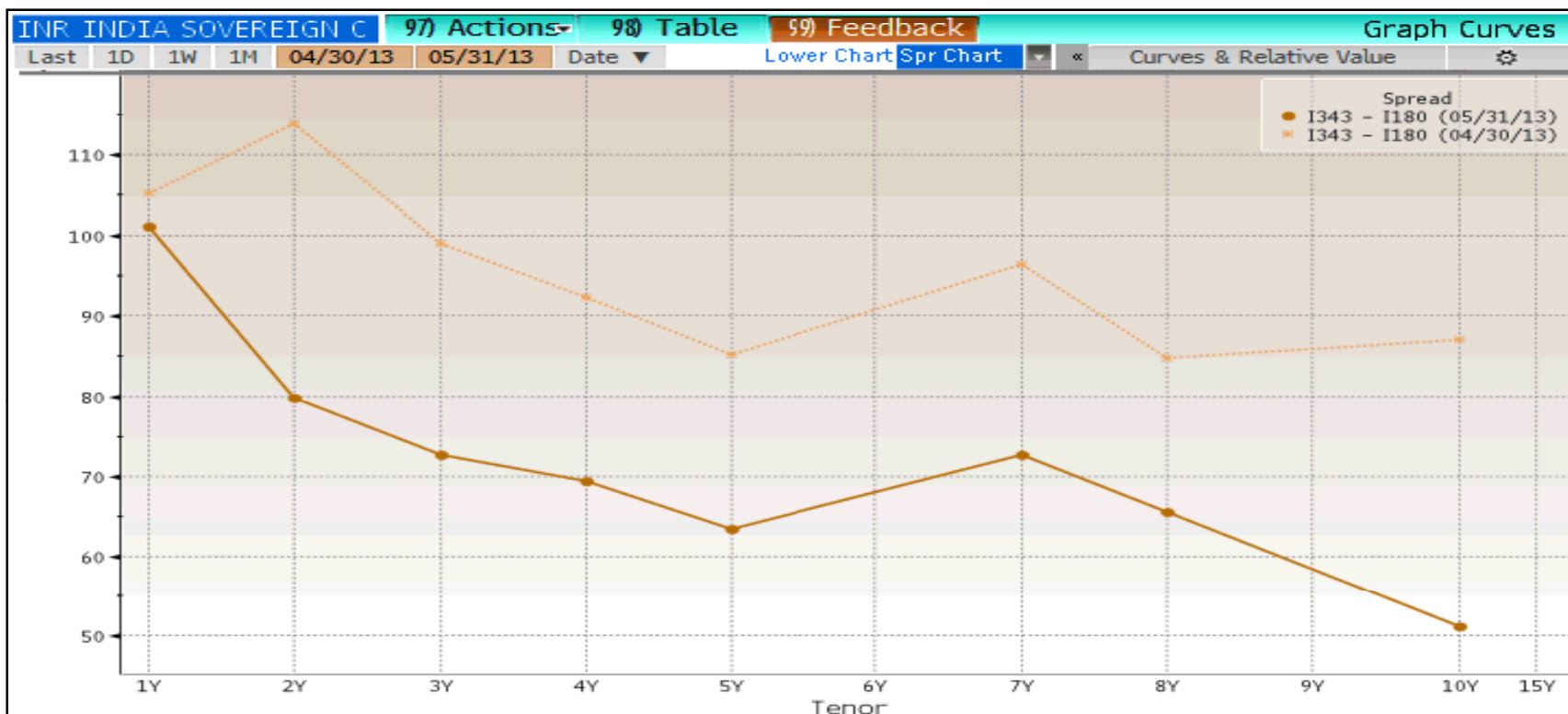
- The gilts segment witnessed a strong rally
- After a swift decline in yields over the month of April which was largely led by the domestic players, the month of May saw a huge demand from the foreign investors despite a steady drop in the value of INR
- The demand for gilts was strong till about the first 3 weeks of the month. Thereafter cautionary comments from RBI governor and the currency decline led to sell off in the market space

G – Sec Yield Curve Change



- During the month, there was the introduction of the new 10 year benchmark paper at 7.16% about 30bps lower than the previously quoted 10 year benchmark
- While the expectation of further rate reduction continues due to WPI dropping to 4.89%, the behavior of the currency brought in some nervousness amongst market participants

Corporate Bond spreads compressed



- The credit spreads compressed on back of the rally in the bonds space
- There was widespread participation from both foreign & domestic investors, and led to a decline in the spreads

Fixed Income Outlook and Opportunities

Fixed Income Market Outlook

Negatives

- While there has been some respite in the international commodity prices, the decline in the value of INR might push up the import costs, reverse the present decline in WPI and defer further rate reduction
- While it appears, there is a bigger room for rate reduction given the drop in the WPI inflation, the current account deficit issues and the fiscal deficit will continue to play an important role in the policy actions

Positives

- The recent government actions in terms of improving the accessibility of Indian debt and gilts for foreign investors is expected to increase the demand for Indian papers, subject to currency risk. The demand for Indian assets is expected to increase over time and be higher than the supply of assets
- The demand for assets from domestic participants also continues to be strong and is expected to soften the yields of bonds over the quarters

Outlook

- The market yields are expected to be guided by the behavior of the currency and RBI policy action
- Notwithstanding, the recent volatile market conditions, we expect the yields to be lower due to improving inflation over the remainder of the year and will also be determined by the progression of the monsoon and the ensuing food prices
- Whilst the fiscal, current account deficit and currency risks continue to remain, RBI actions over the quarters are expected to remain benign in a phase of contained inflation risk
- The risk-reward matrix is in favor of staying invested in the bond market, and investors are encouraged to select funds with duration longer than their investment horizon in an environment of declining interest rates

Portfolio Actions during the month



- **Religare Invesco Liquid Fund:** The fund has started increasing the non-bank exposure. The rate decline has improved the financing conditions amongst select credits
- **Religare Invesco Ultra Short Term Fund:** The fund is maintaining a marginal exposure to MTM assets and moderating the exposure actively
- **Religare Invesco Short Term Fund:** The fund has maintained duration between 18-24 months, mostly through corporate bonds
- **Religare Invesco Credit Opportunities Fund:** The fund has been successfully investing in mis-priced credits with low interest rate risk
- **Religare Invesco Active Income Fund:** The fund has been actively trading in the liquid PFI credit segment apart from the 10 year plus gilt segment. We actively managed the portfolio duration between 4-6 years. The exposure to gilts has been pared down to slightly conservative 5-10 year segment given the market volatility
- **Religare Invesco Gilt Fund – Long Duration Plan:** The fund has been actively trading in the liquid 10 year plus gilts. Its investing upto 30 years gilts. Currently maintaining a portfolio modified duration between 5-8 years
- **Religare Invesco Gilt Fund – Short Duration Plan:** The fund has been actively trading in the liquid segment of the gilts market. The average maturity has been mostly within 2 years
- **Religare Invesco Bank Debt Fund:** The fund is largely invested in the Bank CD and Bank Bonds segment. Its maintaining a portfolio modified duration between 3.5 - 4 years
- **Religare Invesco Medium Term Bond Fund:** The fund has maintained a duration around 3 years through a combination of debt, gilts and money market securities of up to 5 years residual maturity

Ideas for investors

- The market opens up several opportunities for investors in an environment of a moderating GDP growth, moderating inflation and lower core inflation while keeping an eye on volatile currency and widening current account deficit. Investors are encouraged to select funds, which are maintaining a longer duration than their individual investment horizon. Moreover, investors are encouraged to rebalance over next 6-9 months
- The *Religare Invesco Credit Opportunities Fund* offers an opportunity for investors with short investment horizons of 1-3 months and moderate level of credit risk appetite. The fund is ideally positioned to capture mis-priced risk in an environment of deficit liquidity and superior credit spreads of short maturity papers
- The *Religare Invesco Short Term Fund* offers accrual along with a contained interest rate risk. Ideal for investors with 3-6 months investment horizon
- The *Religare Invesco Medium Term Bond Fund* offers higher current yield and moderate interest rate risk. The present duration of around 36 months opens up opportunities of capital appreciation over a 3-9 month investment horizon for investors with moderate risk appetite
- The *Religare Invesco Active Income Fund* – It opens up opportunities of capital appreciation in an environment of the yield curve steepening through active duration management within 3-6 years. It is intended for investors with varied investment horizon (at least 3 months) with moderate to high risk appetite
- The *Religare Invesco Bank Debt Fund* – a thematic high credit quality portfolio comprising of bank CD and bank bonds, along with a small allocation to gilts/PFI. It's a superior investment allocation for credit risk averse long term investors, looking for stable returns, along with some capital appreciation from a well regulated industry over a 1 year investment horizon
- The *Religare Invesco Gilt Fund – Long Duration Plan* – It opens up opportunities of capital appreciation in an environment of credit risk aversion and hence higher demand for gilts. An actively managed gilt portfolio during phases of credit risk aversion is intended for investors with varied investment horizon (at least 3 months) with moderate to high interest risk appetite

Disclaimer

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Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

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