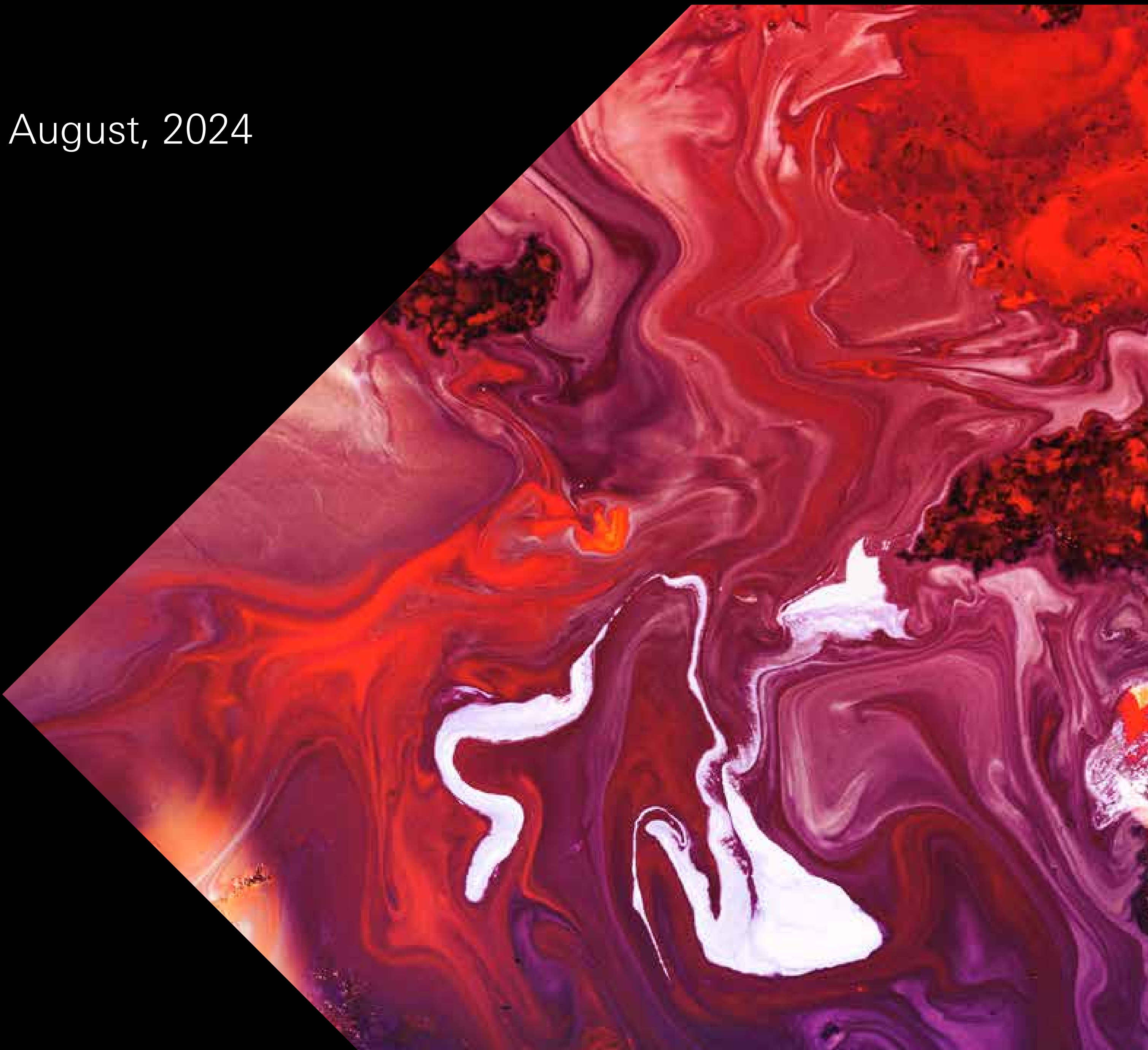
HSBC Mutual Fund

Debt Market Review

August, 2024



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Stage set for a rate easing cycle in the US

The FOMC minutes corroborated a September rate cut in the US. Some of the FOMC members even deliberated policy easing in the July policy as well. In the backdrop of inflation risks receding along with a deterioration in labour market conditions, the minutes indicated that focus had shifted from inflation to labour market to avoid any slowdown due to further weakening in employment data. The Fed Chair in his speech at the Jackson Hole Symposium reiterated that inflation is aligning with their long-term target, while any further softening in employment data may remain a key monitorable.

10-year US Treasury yields saw a sharp fall to 3.79% post the payrolls data, but moved higher during the month, closing at 3.90% due to relatively strong growth data. Markets are now pricing in around 100 bps of rate cuts in 2024 (with possibility of 50 bps of easing in September policy) and another 125 bps of rate cuts in 2025. Recent CPI prints in the US, UK and Eurozone came in at 2.9%, 2.2% and 2.2%, respectively, along with the US PCE print at 2.5%. Crude prices remained benign, trading in the USD 75-82/bbl band during the month.

Macroeconomic Data (Domestic)

- CPI inflation for July printed at almost a 5-year low of 3.54% due to favourable base effect. Core CPI moved slightly higher to 3.4% predominantly due to telecom tariff hikes.
- Trade Deficit widened in July to USD 23.5 bn due to higher imports. However, CAD is expected to remain below 1% for FY2025.
- GDP growth for Q1 FY2025 came in at 6.7% (lower than RBI estimates of 7.1%), primarily due to muted Government spending during the election period.
- GVA growth for Q1 FY2025 came in higher than the previous quarter at 6.8%, led by services sector. GDP deflator is now at 3%, with Nominal GDP growth in Q1 at 9.7%.
- IIP fell to a 7-month low of 4.2%, primary due to fall in growth in the manufacturing sector. GST collections continue to remain strong at INR 1.75 trn.
- FPIs continued to pour money into IGBs, with the cumulative purchase since the JP Morgan index announcement at close to USD 16 bn.
- RBI has been conducting OMO sales in the secondary market, with almost INR 170 bn worth of G-Sec sold by the RBI over the last few weeks. While these weekly small OMO sell trades by RBI are getting absorbed by the market, any announcement pertaining to an OMO sales calendar will remain a key monitorable.

Positive Liquidity

Liquidity continued to be positive for the month of August. Accelerated spending by the Government remained the primary reason for easing in liquidity. The net durable liquidity was unchanged around INR 4.2 trn. RBI continued its build-up of FX reserves (USD 682 bn, as of August 23, 2024) which gave a boost to liquidity while markets continued to see FPI inflows. We believe Government spending may continue, however the scheduled tax payments during the month (advance tax as well as indirect taxes in the form of excise and GST) are expected to drain out the liquidity towards the mid-month. This is expected to reverse post the month end GOI spending.

Market Movement

During the month, T-Bill rates fell by around 5-10 bps, while CD levels hardened by around 5 bps. OIS levels moved sharply lower by 14-18 bps and G-Sec yields were lower by 6-8 bps across the curve. Short end corporate bonds remained flat while the 5-10 year segment moved lower by 3-5 bps.

Market Outlook

We continue to have a positive outlook on interest rates, based on various favorable factors:

Impact on Bond Market

Banking trends - Credit Deposit ratio	Fiscal Policy	Global Interest Rate Environment
	CPI Inflation Trends	Global Bond Index Inclusion
	Monetary Policy	Current Account Deficit & Balance of Payments
	Systemic Liquidity	G-Sec Demand Supply (+LCR changes)
		Real Rates

- Global markets turning positive, with various Central Banks commencing easing of policy rates
- Focus of Fed shifting from inflation to softening of labour market data, resulting in pricing of rate cuts from September 2024
- Reduced Fiscal Deficit number of 4.9%, which looks imminently achievable
- Strong index related inflows by FPIs
- Relatively low volatility of India's bond and currency markets versus other asset classes and peers
- Favorable G-Sec supply demand dynamics
- Possible incremental G-Sec purchase by Banks to increase HQLA assets
- Benign core inflation along with expectations of a better than normal monsoon resulting in undershooting of RBI's inflation estimates
- Soft signals by Government and RBI on liquidity

In Conclusion

While Government bond yields have rallied by about 25 bps over past few months, we believe there is space for yields to move still lower and resultantly, we maintain our positive outlook on interest rates and a long duration bias across our portfolios. While our base case remains for the RBI to cut rates by 50 bps between December 2024 and March 2025, we are mindful that the recent signals on US labour markets need to be monitored closely. With the risk of a slowdown having escalated, if such a scenario does indeed materialize, the RBI is unlikely to remain immune from US Fed actions and could potentially look at more significant easing of 75-100 bps.

Positioning and Fund Proposition

Taking this into an overall context of recent events and developments, we believe the below four ongoing factors over the next 12 months are expected to be supportive of the respective segments:

Factors impacting the market	Maturity segments likely to benefit
Expected improvement in liquidity over the next 6-12 months	Upto 3 years
Implementation of revised draft LCR norms	3-7 year segment
FPI inflows following the index inclusions	7-14 years
Expected rate cuts by the RBI	Across the segments

Impact of the factors on HSBC fixed income funds

Fund	Breakup of portfolio holdings (maturity wise)	Expected favorable impact of factors on various funds			
		Liquidity Improvement	LCR norms	Index flows	RBI rate cuts
HSBC Banking and PSU Debt Fund	100%	✓			✓
HSBC Short Duration Fund	40% 60%	✓	✓		✓
HSBC Corporate Bond Fund	10% 90%		✓		✓
HSBC Dynamic Bond Fund	10% 40% 50%		✓	✓	✓
HSBC Gilt Fund	10% 25% 65%		✓	✓	✓

Source: Indicative maturity breakup based on portfolios dated August 31, 2024

Maturity Buckets for the breakup in table above:

	<3 yr
	3-7 yr
	7-10 yr
	10+ yr

As highlighted above, our different high-quality funds are positioned across various maturity buckets, and the favorable impact of the four factors may benefit these segments. Investors can look at the specific fund category as per their investment horizon and risk appetite.

Present Fund Positioning

- **HSBC Banking and PSU Debt Fund** is predominantly invested in assets maturing in the 1.5-2 year segment. With liquidity easing through this quarter and expectations of rate cuts getting priced in over the next few months, the fund may benefit from market expectations of softening in short end yields along with compression in spreads of Corporate bonds.
- **HSBC Short Duration Fund** and **HSBC Corporate Bond Fund** may be considered for investment with a medium-term horizon and slightly higher appetite for interest rate risk. These funds are primarily invested in the 2-6 year part of the curve. Liquidity easing and pricing of rate cuts along with implementation of revised LCR norms could result in (a) softening of yields in this segment, (b)

steepening of the yield curve and (c) compression in spreads of Corporate bonds. Both these funds are appropriately positioned to benefit from these developments.

- **HSBC Dynamic Bond Fund** and **HSBC Gilt Fund** are primarily invested in the 7-10 years and 10+ years part of the curve, while also having some allocation to the shorter maturity to opportunistically benefit from favorable moves in those segments. The duration of the funds is actively managed. With index inflows continuing in IGBs in an environment where demand supply dynamics is favorable and rate cut expectations get built in over the next few months, these funds may provide an opportunity to generate alpha for investors looking to play the duration theme.

Abbreviations:

IGB: Indian Government Bond
FOMC: Federal Open Market Committee
G-Sec: Government Securities
OIS: Overnight Index Swaps
CPI: Consumer Price Index
PCE: Personal Consumption Expenditures
HQLA: High Quality Liquid Assets
FPI: Foreign Portfolio Investment
OMO: Open Market Operations

Scheme name

HSBC Dynamic Bond Fund

HSBC Corporate Bond Fund

HSBC Gilt Fund

HSBC Banking & PSU Debt Fund

Potential Risk Class

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	A-III		

A relatively high interest rate risk and relatively low credit risk.

Scheme name

HSBC Short Duration Fund

Potential Risk Class

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)	A-II		
Relatively High (Class III)			

A Moderate interest rate risk and Relatively Low Credit Risk

HSBC Mutual Fund

Product Labels

Scheme name and Type of scheme | ***Riskometer of the Scheme**

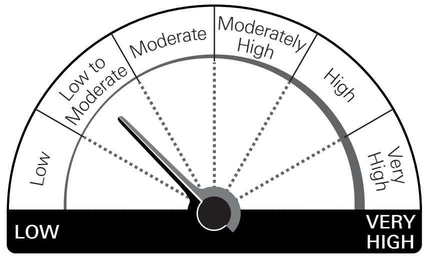
This product is suitable for investors who are seeking#

HSBC Banking and PSU Debt Fund (An open ended debt scheme primarily investing in debt instruments of banks, public sector undertakings, public financial institutions and municipal bonds. A relatively high interest rate risk and relatively low credit risk.)

- Generation of reasonable returns and liquidity over short term
- Investment predominantly in securities issued by Banks, Public Sector Undertakings and Public Financial Institutions and municipal corporations in India

(Benchmark: NIFTY Banking & PSU Debt Index A- II)

Riskometer



Investors understand that their principal will be at Low to Moderate risk

HSBC Dynamic Bond Fund (An open ended dynamic debt scheme investing across duration. A relatively high interest rate risk and relatively low credit risk.)

- Generation of reasonable returns over medium to long term
- Investment in Fixed Income Securities

(Benchmark: NIFTY Composite Debt Index A-III)

HSBC Short Duration Fund (An open ended short term debt scheme investing in instruments such that the Macaulay Duration of the portfolio is between 1 year to 3 years (please refer to page no.16 of SID for details on Macaulay's Duration). A Moderate interest rate risk and Relatively Low credit risk.)

- Generation of regular returns over short term
- Investment in fixed income securities of shorter-term maturity.

(Benchmark: NIFTY Short Duration Debt Index A-II)

HSBC Corporate Bond Fund (An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds. A relatively high interest rate risk and relatively low credit risk)

- Generation of regular and stable income over medium to long term
- Investment predominantly in AA+ and above rated corporate bonds and money market instruments

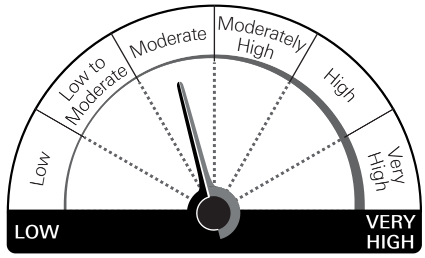
(Benchmark: NIFTY Corporate Bond Index A-II)

HSBC Gilt Fund (An open ended debt scheme investing in government securities across maturity. A relatively high interest rate risk and relatively low credit risk.)

- Generation of returns over medium to long term
- Investment in Government Securities

(Benchmark: NIFTY All Duration G-Sec Index)

Riskometer



Investors understand that their principal will be at Moderate risk

***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**

Please refer notice cum addendum available on website of HSBC Mutual Fund for updates on riskometer/product labeling of the scheme. Riskometer is as on 31 August 2024.

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial advisor for any investment decisions.

Source: Bloomberg & HSBC MF Research estimates as on August 31, 2024 or as latest available

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Mutual Fund investments are subject to market risks, read all scheme related documents carefully. CL1859