HSBC Mutual Fund

Debt Market Review

December, 2022

The recent inflation prints in the US, UK and Eurozone read as 7.7%, 11.1% and 10.0%, respectively. Although US CPI came slightly lower than expectations, inflation prints in the UK and Eurozone continue to remain high. The Federal Open Market Committee (FOMC) minutes published, indicated mixed signals from Fed officials, with a majority of officials supporting slowing down the pace of interest rate hikes soon while some other hinting that monetary policy might need to be tightened more than anticipated next year. The European Central Bank (ECB) minutes also indicated that inflation might be getting entrenched, supporting the case for the 75 bps hike undertaken in the previous policy.

US Treasury yields inched sharply lower towards the latter half of the month with the 10-year UST moving to 3.60% at the end of November v/s 4.05% at the end of October and inched further lower to ~3.50% levels as on date. The UST yield curve remains inverted with 2-year v/s 10-year spread currently at 80-85 bps. Crude prices, while volatile, also inched lower to USD 85/bbl at the end of November v/s USD 95/bbl at the end of October and is currently trading marginally below USD 80/bbl.

Macro-Economic Developments

- On the domestic front, CPI inflation has remained above the MPC's targeted band throughout the financial year. The MPC had to write to the Government explaining the reasons for inflation remaining above the mandated band for three consecutive quarters. CPI inflation for Oct 2022 came in slightly lower than expectations at 6.77% (vs 7.41% in Sep). Core CPI however remained broadly unchanged at 6.0%. WPI has seen a correction recently and has now fallen to single digits after a period of 18 months, with the October print at 8.39% (vs 10.70% in September).
- IIP data continues to remain weak with the September 2022 print at 3.1% (vs a contraction of 0.7% in August). Consumer durables and consumer non-durables continue to remain in contraction.
- Although, exports had picked up earlier, the recent trend shows exports falling and Trade Deficit widening. Trade Deficit for October 2022 stands at USD 26.91 bn, taking the cumulative Trade deficit for FY2023 (YTD) to USD 148.46 bn.
- PMI numbers continue to remain in expansion, GST revenues remain buoyant and credit off-take upbeat.
- India's Fiscal Deficit up to Oct 2022 now stands at INR 7.6 Lakh Crs (45.6% of BE). GDP growth for Q2 FY2023 came in at 6.3%, in line with RBI expectations while GVA growth was lower at 5.6%.

Market Performance

- Short term rates eased slightly given improved liquidity conditions, with yields lower by 5-10 bps.
- The G-Sec curve inched lower by 15-25 bps across various points of the curve with the shorter end of the curve up to 5 years outperforming.
- The corporate bond curve inched lower by 5-15 bps across the curve.
- The OIS curve also moved sharply lower, with 1 yr OIS lower by ~30 bps and 5 yr OIS lower by 57 bps.
- The rupee rallied in line with the move in dollar index, moving from 82.80 levels to 81.40 levels during the month.

On a month-on-month basis (as on Nov 30, 2022)

Outlook

The hike of 35 bps was largely a unanimous expectation of the market in the immediate run up to the policy and the RBI delivered the same. The dissent by some of the MPC members on the rate hike and policy stance, were also in line with the views expected by those members during the previous MPC's minutes.

However, it was the tone and messaging during the Governor's statement and the ensuing press conference which did the job of signaling to the market that the RBI's battle against inflation was not done just yet. Deputy Governor Dr. Patra's press conference comment that the RBI was still some distance away from neutral rates and the focus on breaking core inflation persistence - suggest that the MPC does not want the markets to assume that the guard can be let down.

We view the current policy as mildly hawkish versus market expectations. With the stance being maintained as "withdrawal of accommodation", markets would need to factor in at least one more rate hike as a high probability, although dependent on incoming data between now and February.

Another important point in our view, was the repeated emphasis on the need to move to the 4% CPI target, and not just the upper bound of 6%. This seems to have been a deliberate attempt by the RBI to dispel the market's notion that headline CPI below 6% was good enough for the MPC to relax on the inflation front.

Overall – the policy has put a temporary brake on the bond market rally, which was driven by expectations of a possible MPC pause in February. While a lot of factors viz. oil prices, US inflation trends and the Fed's rate actions, domestic inflation trends in headline, food, services and core inflation – all will have a bearing on the next rate action by the MPC – for now we believe that markets need to price in a 25 bps hike in February. With a possible 6.5% Repo Rate, G-Sec yields are likely to consolidate around the 7.25-7.50% levels, thereby not leaving much room for a significant rally from current levels.

Fund strategy

We continue to believe that at levels close to 7.25-7.50%, the 1-3 year part of the yield curve offers good carry and relative value vis-à-vis other points on the curve, for investors who are looking at a medium-term investment horizon. Also, compared to the longer end of the curve, corporate bond spreads in this segment have become more attractive. Accordingly, **HSBC Banking and PSU Debt Fund** and the **HSBC Short Duration Fund** which are both predominantly positioned in this segment, are attractive investment opportunities in this space.

At the longer end, AAA corporate bond spreads remain unattractive, and we expect them to widen over the coming few months based on the strong banking system credit growth. Also with banks needing to raise more resources to fund credit growth, pressure on FD and CD rates to continue to trend higher is likely to persist. We believe this is likely to provide a good tactical opportunity over the coming months for investors to enter into products in the 6 months to 1-year space.

Finally, with rate hikes nearing the peak, there are likely to be more opportunities for dynamically managed funds to be able to tactically, as well as strategically deliver alpha. For investors desiring alpha through duration calls, funds like the **HSBC Dynamic Bond Fund, HSBC Gilt Fund** and **HSBC Medium Duration Fund** are all attractive opportunities to be considered by medium to long term investors.

HSBC Mutual Fund

Product Labels

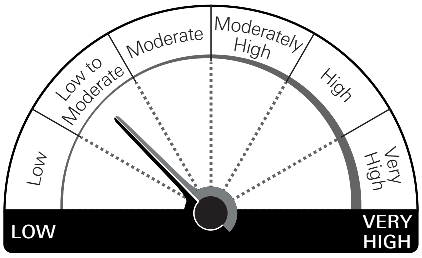
Scheme name and Type of scheme	*Riskometer of the Scheme	Riskometer of the benchmark

This product is suitable for investors who are seeking#

HSBC Short Duration Fund (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 the SID for explanation on Macaulay duration. Moderate interest rate risk and moderate credit risk.
• Generation of regular returns over short term
• Investment in fixed income securities of shorter term maturity. (Benchmark: NIFTY Low Duration Debt Index B-II)

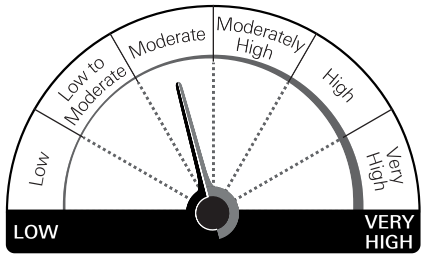
HSBC Banking and PSU Debt Fund (Banking and PSU Debt Fund) - An open ended debt scheme predominantly investing in debt instruments of banks, public sector undertakings, public financial institutions and municipal bonds. A relatively high interest rate risk and relatively low credit risk.
• Generation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

Riskometer



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

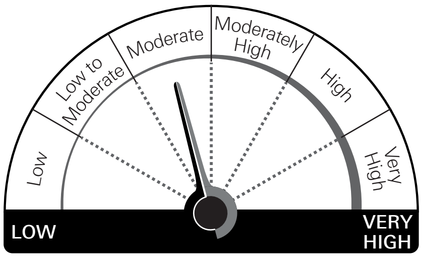
Riskometer



HSBC Dynamic Bond Fund (Dynamic Bond Fund) - An open ended dynamic debt scheme investing across duration. Please refer to the SID for explanation on Macaulay duration. 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)

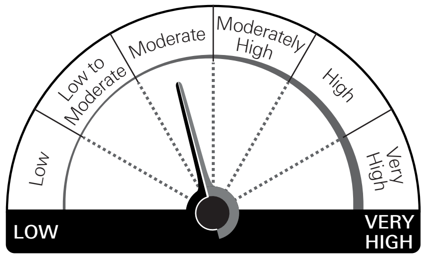
HSBC Gilt Fund (Medium to Long Duration Fund) - An open ended debt scheme investing in government securities across maturity.
A relatively high interest rate risk and relatively low credit risk.
• Generation of returns over medium to long term • Investment in Government Securities. (Benchmark: Nifty All Duration G-Sec Index)

Riskometer



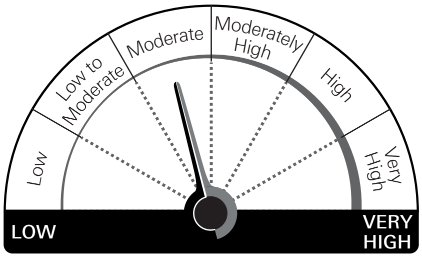
Investors understand that their principal will be at Moderate risk

Riskometer



HSBC Medium Duration Fund (Medium Duration Fund) - An open ended medium term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 years to 4 years. Please refer Page no. 9 of the SID for explanation on Macaulay duration. A relatively high interest rate risk and moderate credit risk. • Generation of income over medium term • Investment primarily in debt and money market securities. (Benchmark: NIFTY Medium Duration Debt Index Fund B-III)

Riskometer



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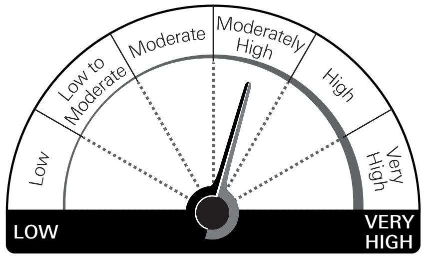
Riskometer



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

Scheme name	Potential Risk Class
HSBC Short Duration Fund	see table below

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)		B-II	
Relatively High (Class III)			

Scheme name	Potential Risk Class
HSBC Banking and PSU Debt Fund HSBC Dynamic Bond Fund HSBC Gilt Fund	see table below

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		

Scheme name	Potential Risk Class
HSBC Medium Duration Fund	see table below

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)		B-III	

Past performance is not an indicator of future returns. Source: Bloomberg & HSBC M. Data as on November 30, 2022, unless otherwise mentioned.

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