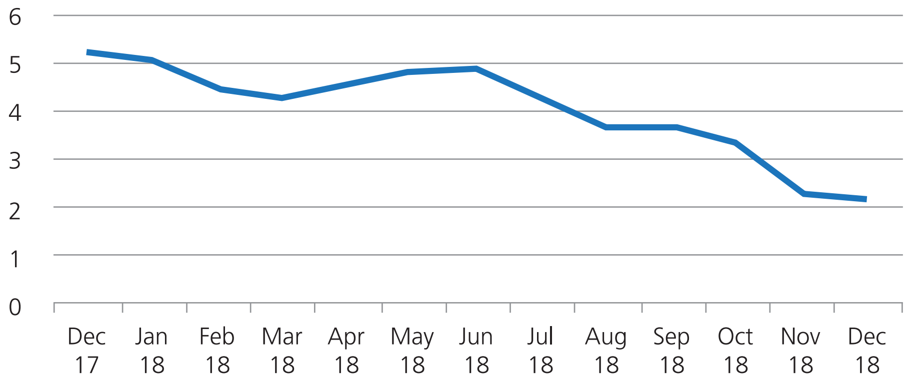
Debt Market Review

L&T Financial Services
Mutual Fund

January, 2019

Indian sovereign bond posted a rise of 12 bps to 7.49% in January 2019 vs 7.37% in December 2018. With the headline inflation edging towards the lower end of RBI's target band, it may have a leeway to soften its monetary stance on February 7, 2019 meeting. In February, the RBI also plans to buyback bonds worth Rs 375 billion, taking the FY19 haul to Rs 2.86 trillion.

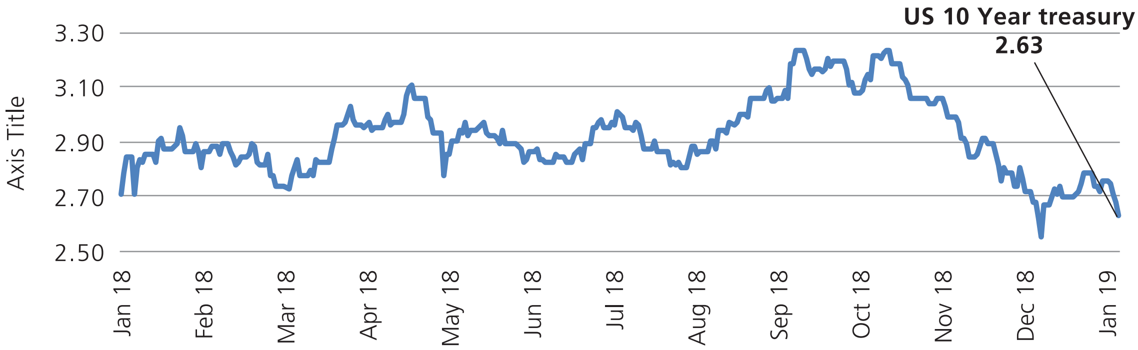
CPI Combined



Source: Bloomberg code --INFUTOTY Index

Globally, the 10-year Treasury note yield tumbled 6.3 basis points to 2.631%, its lowest since January 3, 2019 contributing to a month-long drop of 5.3 basis points. Investors took comfort in the outcome of a Federal Reserve meeting that signaled a pause in rate hikes.

US 10 Year treasury



Source: Bloomberg; Bloomberg code --USGG10YR Index

Market Performance

The 10-year benchmark G-Sec yield closed at 7.49%, up by 12 bps from its previous close of 7.37% while that on the short-term 1-year bond ended 3 bps higher at 6.97%. In the corporate bond segment, yields rose across the yield curve over the month.

The 10-year AAA bond yield ended 20 bps higher at 8.75%, while the short-term 1-year AAA bond yield ended 20 bps up at 8.30%. The spread between 1-year and 10-year AAA bond stayed flat. Within the short term segment, yield on 3-month commercial paper (CP) was up 10 bps to 7.30% while 1-year CP yield was down 20 bps at 8.70%.

House View

Yield on the 10 year G-Sec hit a low of 7.22% in December 2018 on the back of announcement of an aggressive OMO purchase plan till March 2019, coupled with a collapse in oil prices and a sharp fall in US Treasury yields. However throughout January, yields on 10 year inched up on the concerns of pan India farm loan waivers or direct benefit transfers to alleviate agriculture and rural distress. Brent crude prices also went up from the recent lows to 62$ a barrel. The announcement of new 10 year G-Sec also lead to a selloff on the old 10 year and the spread between the old and the new 10 year has been in the range of 20-25bps.

In the Interim Union Budget presented for FY 20, fiscal deficit is pegged at 3.4% of GDP, slightly higher than market expectations. Revised Fiscal deficit estimate for FY 19 estimate was also higher at 3.4% of GDP. The Gross borrowing for FY20 is pegged at 7.1 trillion higher than the market estimates. Also the current years dated market borrowing in increased by 36000 cr. This lead to a sell-off in bond yields and the 10 year yields jumped up 10 bps from 7.28% to 7.38%.

The yields on the old 10 year moved up by 13 bps from 7.48% to 7.61%. While the internals of the budget assumptions looks ambitious, markets will have to deal with political uncertainty till general elections as well as higher dated securities supply in the coming months and possibility of reduced OMO purchases by RBI as liquidity shifts towards neutral. The market will watch out for the MPC meeting in which a stance change from "calibrated tightening" to "neutral" is warranted, the MPC members might just hold on any rate changes as it would want certainty on the core inflation which has been moving significantly higher in the last 3 months.

We have trimmed down our overweight durations across funds going into the Union Budget and the way forward is unlikely to be as one-sided as over the past 3 months. Accordingly, a more nimble approach to duration management will be critical. Also, while demand supply technicals for the moment are clearly much more supportive of G-Sec versus corporate bonds, we expect this to gradually start changing as we head into next fiscal, and with ***10 year AAA corporate bond spread at over 100 bps – this makes a compelling case for investors with a longer investment horizon. The L&T Triple Ace Bond Fund is well positioned in this segment.***

While systemic liquidity has fluctuated from negative to surplus depending on how much the government has accessed the WMA account, ***short end rates of 7.8-8.3% in the 9 months - 3 year segment, continue to provide extremely good pickup over the policy repo rate. Funds such as the L&T Ultra Short Term Fund, L&T Money Market Fund and L&T Short Term Bond Fund*** are high credit quality funds positioned to benefit from this carry, while keeping interest rate risks relatively low.

Finally, while credit risk funds have witnessed turbulent times, given the IL&FS as well as NBFC / HFC scare and recently the loan against shares triggers, none of our funds have any kind of exposure to IL&FS and its SPVs and ***we have zero exposure to any kind of loan against shares NCDs.*** We believe that spreads offered by such funds are actually very attractive compared to the past. It is in times of such risk aversion, that issuers are forced to pay higher rates, which compensate adequately for their underlying credit risks.

Well managed funds, with a majority of exposures in the AA segment, offer a good risk –return tradeoff. L&T Credit Risk Fund and the ***L&T Low Duration Fund*** offer good vehicles to take advantage of the attractive credit spreads on offer.

Macroeconomic Overview

The government has revised the Gross Domestic Product growth rates by 110 basis points from 7.1% to 8.2% for 2016-17 and by 50 basis points from 6.7% to 7.2% for fiscal 2017-18. Growth of eight core sectors slowed down to 2.6% in December 2018 on account of negative growth in expansion of crude oil, refinery products and fertilisers. Industrial growth fell to a 17-month low in November as a post festival season decline in manufacturing.

Lower fuel prices further eased retail inflation in December to 2.19% from the annual rate of 2.33% in November. WPI fell to a 8-month low of 3.80% in December, 2018 vs 4.64% in November on softening prices of fuel and some food items. The Manufacturing Purchasing Managers' Index slowed down to 53.2 in December vs 54 in November. Services Purchasing Managers' Index slipped to 53.2 in December vs 53.7 in November.

This product is suitable for investors who are seeking*

L&T Ultra Short Term Fund
(An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months.)

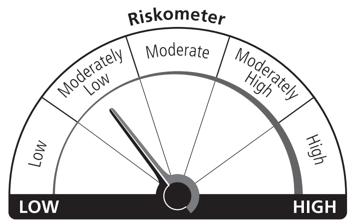
- Generation of reasonable and stable income and liquidity over short term
- Investments predominantly in highly liquid money market instruments, government securities and corporate debt

L&T Short Term Bond Fund (Formerly known as L&T Short Term Opportunities 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.)

- Generation of regular returns over short term
- Investment primarily in securities issued by Banks, Public Sector Undertakings and Public Financial Institutions in India

L&T Money Market Fund (Formerly known as L&T Floating Rate Fund)
(An open ended debt scheme investing in money market instruments.)

- Generation of regular income over short to medium term
- Investment money market instruments



Investors understand that their principal will be at moderately high risk

L&T Credit Risk Fund (Formerly known as L&T Income Opportunities Fund)
(An open ended debt scheme predominantly investing in AA and below rated corporate bonds)

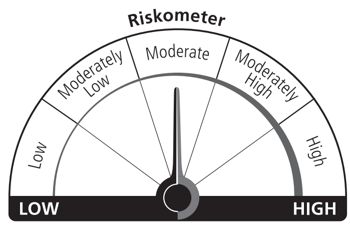
- Generation of regular returns and capital appreciation over medium to long term
- Investment in debt instruments(including securitized debt), government and money market securities

L&T Triple Ace Bond Fund
(An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)

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

L&T Low Duration Fund (Formerly known as L&T Short Term Income Fund)
(An open ended low duration debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 6 months to 12 months)

- Generation of reasonable returns over short to medium term
- Investment in fixed income securities and money market instruments



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

Source: MOSPI, Internal