March, 2019

Debt Market Review

Indian sovereign bond posted 5 bps fall to 7.35% in the month on March from 7.40%. RBI would launch an auction to buy dollars' worth 5 billion on April 23 to infuse liquidity into the system. This is the second FX swap after the success of the first FX-Swap conducted by RBI for $5 billion in the month of March.

The government will also introduce new seven-year benchmark government security and may extend 15-19 years gilt maturity bracket to 15-24 years. For FY20, the Centre had pegged gross market borrowing at a nine-year high of Rs 7.1 lakh crore and net borrowing at Rs 4.73 lakh crore.

Market Performance

The 10-year benchmark G-Sec yield closed at 7.35%, down by 5 bps from its previous close of 7.40% while that on the short-term 1-year T-Bill ended 12 bps lower at 6.55%. In the corporate bond segment, yields fell across the yield curve over the month.

The 10-year AAA bond yield ended 35 bps lower at 8.30%, while the short-term 1-year AAA bond yield ended 50 bps down at 7.50%.

The spread between 1-year and 10-year AAA bond widened. Within the short term segment, yield on 3-month commercial paper (CP) was down 40 bps to 7.10% while 1-year CP yield was down 70 bps at 8.0%.

Macro-economic Overview

Manufacturing PMI rose to a 14-month high of 54.3 in Feb vs 53.9 in Jan. Services PMI rose to 52.5 in Feb vs 52.2 in Jan. IIP for the month of January 2019 fell to 1.7% vs 2.4% in December CPI inflation stood at 2.57% in Feb vs 1.97% in Jan 2019. WPI rose to 2.93% in Feb vs 2.76% in Jan vs 2.6% growth posted in Dec 2018.

Current account deficit widened to 2.5% of GDP in the third quarter of the current fiscal from 2.1% a year ago. Exports rose 2.44% to $26.67 billion in February from a year earlier, while imports were down 5.41% to $36.26 billion.

Outlook

The month of March saw yields on G-Sec trading in the range of 7.27% - 7.40%. While the yields on the longer end AAA corporate bonds came down significantly from 8.55% to 8.20% ahead of the policy with reduced supply expectations, the yields on the 10year Gilts remained range bound as supply concerns through the year, lower expected OMO purchases with the announcement of 2 USD-INR swaps of $5 bln each, higher crude oil prices and fiscal slippage weighed on the markets.

The MPC as widely expected reduced repo rate by 25bps from 6.25% to 6% while keeping the stance of the policy "neutral". 4 members voted in favor of a cut whereas the other 2 members voted for a status quo. The rate cut is against the backdrop that output gap remains negative and there is a need to strengthen domestic growth impulse by spurring private investment.

Post policy 10 year gilts moved up by 10 bps from 7.22% to 7.33% as the broader market went into the policy with an expectation of stance change to accommodative over and above the 25 bps cut.

Going forward we remain positive on our outlook for interest rates to move lower but the timing and the quantum remains a question mark that the MPC has now delivered back to back rate cuts. Factors that we think are favorable toward a further rate cut in this cycle are:

- US Fed moving towards an extended pause along with other Central banks
- Global interest rate backdrop being supportive
- Oil prices staying range bound
- Domestic growth slowdown with CPI inflation
- RBI Policy being more pro-growth (compared to earlier)

Investment Strategy

With the 25 bps rate cut and RBI providing sufficient liquidity through OMO purchases, FX swaps and term repos, short end rates have come down significantly in the first week of April from 7.8%-8.3% in the 1 year -3 year segment to 7%-7.50%. Still the ***1-3 year AAA corporate bond segment offers good carry over the repo rate and 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.

At the longer end of the curve, despite a positive fundamental outlook for interest rates, near term technical factors such as demand supply mismatch may keep longer end yields volatile and elevated. The corporate bond curve is very steep with the difference in yields between 10 year and 5 year paper of the same issue is at 60 bps. Hence, from a medium term perspective, we believe the longer end of the ***AAA corporate bond curve is an attractive investment opportunity***, with spreads in the 80-120 bps range versus the historical average of 50-60bps. The ***L&T Triple Ace Bond Fund is well positioned in this segment.***

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. 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 trade-off.***

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.)

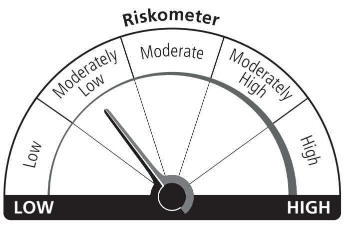
- Generation of reasonable and stable income and liquidity over short term
- Investments predominantly in highly liquid money market instruments, government securities and corporate debt

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.)

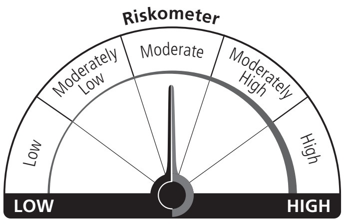
- Generation of regular income over short to medium term
- Investment money market instruments



Investors understand that their principal will be at moderately high risk

L&T 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



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

Source: Bloomberg, Internal