Market Wrap

L&T Financial Services
Mutual Fund

October, 2018

Equity Market Wrap

Markets witnessed selling pressure in the month of October with the BSE Sensex falling 1,785 points, or 5%, at 34,442 while the NSE Nifty lost 543 points, or 5%, to 10,387 mark.

Banking crisis brought about by the IL&FS default and the resultant liquidity crunch, rising oil prices, swelling current account deficit, a faltering rupee, global trade tension and rise in US borrowing costs added to the selling momentum in whole of October.

FII continued to be net sellers in month of October with $3.7 bn of outflows during the month which took their YTD net outflow to $5.7 bn. Domestic investors continued to be net buyers with net inflows of $3.5 bn taking their YTD tally to $15.7 bn. Mutual Fund continued to be net buyer for 27th straight month with net buying of $3 bn in October.

House View

Nifty has wiped out majority of its gains in the last two months led by escalating volatility on the back of unsupportive global and domestic events. We can expect volatility at elevated levels especially given the market concerns about a global trade war and uncertainty around oil. It looks likely that markets will continue to closely monitor election outcomes in few key states in run up to general elections. We expect the economy to recover as GST related disruption smoothens and consumption revives on back of improving farm income and implementation of pay commission.

Q2FY19 earnings season has started well and management commentary sounds promising. After the recent correction valuations are now trading closer to long term averages and provide opportunity to invest in strong and able management. The liquidity concerns have improved over past few weeks as money market rates have been coming of its recent highs. We continue to remain positive on long term India story and stay invested in companies with earnings visibility and reasonable valuations.

Debt Market Wrap

Indian sovereign bond posted their first monthly decline in three by a drop of 20 bps to 7.83% vs 8.03% in September. The 10-year G-Sec yields cooled this month as the central bank bought debt to replenish liquidity

In October, the Reserve Bank of India (RBI) announced Rs.360 billion of open market operations (OMO) to buy bonds from the secondary market. In November, it plans to buy Rs.400 billion worth of secondary market bonds.

The 10-year benchmark G-sec yield closed at 7.83%, down by 20 bps from its previous close of 8.03% while that on the short-term 1-year bond ended 15 bps lower at 7.45%.

In the corporate bond segment, yields fell across the yield curve over the month. The 10-year AAA bond yield ended 10 bps higher at 8.75%, while the short-term 1-year AAA bond yield ended 5 bps down at 8.65%.

House View

October has clearly been a tale of two extreme halves. The first half of October saw the peak of market jitters, with oil hitting a high of USD 86/barrel, INR hitting a low of 74.48/USD, 10 year government bond yield at a high of 8.16% and credit worries around solvency of NBFC/HFCs threatening to unleash a systemic panic attack. Nervousness spread to the equity markets too, with sharp falls across segments but especially in NBFCs/HFCs due to the credit issue overhang.

However, each of these parameters started turning around in the second half of October.

- Oil, after hitting a peak of USD 86/barrel, collapsed by almost USD 10 by month end. INR too reversed course with a sharp rally, driven not just by oil, but also broad EM currency strength seen across other hitherto vulnerable currencies such as BRL and TRY.
- With RBI proactively announcing its calendar of OMOs (Rs.36,000 cr for October, followed by Rs.40,000 cr for November – the demand supply situation in gilt markets has clearly turned around with hardly any net G-Sec supply for the markets to absorb. With momentum swinging around, FPI selling in bond markets abated, and traders got back into action on the long side after a protracted period of neutral to short positions.
- Finally, with various NBFCs/HFCs taking drastic measures such as loan sell down, stopping incremental disbursements, raising funds at high interest rates – gradually worries around another default in the CP market started abating, and primary fund raising deals at least in the short end (2-3 month CPs) for a few NBFCs/HFCs started getting done, thereby gradually unfreezing the markets for such borrowers.

The chart on the following page sums up our take on the markets now. While earlier all three indicators (viz. global macro, India macro and onshore credit issues) were flashing red, October has seen a significant movement towards green – thereby changing our outlook to a less pessimistic one as far as bond markets are concerned.

Global Macro

- Oil price
- Fed tightening, US Treasury yields, Dollar Strength
- Sovereign crises in any of the DM/EM countries
- Risk sentiment towards EM

India Macro

- Current account deficit trends and FPI flow trends in debt/equity
- INR trajectory and RBI intervention trends
- Liquidity drain from system for festive season and state elections
- Policy coordination (orlack of it) between RBI and GoI

Credit Issues

- CP market virtually closed for NBFC/HFC
- Entire shift from capital markets to banks in a very short timeframe
- Though probability of a credit accident is low, the -ve impact would be very large
- Asset quality issued in certain categories, as refinancing cycle stops

Initial signs of macro headwinds stabilising - all three layers gradually improving. While volatility over next few months may continue, we believe tall risks of extreme sell-off have reduced meaningfully.

Having said that, some of these factors such as oil, global risk sentiment, FX weakness could come back just as fast, and hence investors need to be vigilant about these risks. The on-going war of words between the RBI and the Government could also take an ugly turn, if not handled properly by both sides and hopefully – professionalism and a pragmatic approach towards problem solving will get the two parties back on the same path. If not, markets could see a sudden rise in volatility and risk aversion as well.

As pointed out earlier, we have moved from a cautious, short duration stance across our various funds, to a neutral (in a few funds- overweight) duration approach. Cash levels, which were running high in anticipation of further sell-off, are gradually being deployed back by us, into specific segments where we believe the sell-off provides attractive carry while still keeping risks limited.

The 2-5 year G-Sec segment appears attractive, so also does the 1-3 year AAA corporate bond segment. The L&T MF approach of keeping high quality funds such as L&T Ultra Short Term, L&T Short Term Bond Fund, L&T Banking and PSU Fund invested only in the top quality AAA papers ensures that credit risks in these funds are kept at a minimum, and we would advise investors to start looking at these segments gradually, given the attractive carry they offer.

As pointed out in our earlier outlooks as well, while we are cautious in our outlook for yields over the next 1-2 quarters, from a longer term perspective however, we believe interest rates are nearing the upper end of the range, and price in a majority of the negative factors currently at play.

From a 3-5 year perspective, we believe investors who can absorb near term volatility, could gradually allocate a portion of their long term savings (by spreading out investments over the next 2 quarters) to debt products which invest in the longer end of the AAA corporate bond curve such as the L&T Triple Ace Bond Fund. We believe such a strategy should do quite well, especially compared to investing in tax free bonds or long term FDs where current yields are quite unattractive.

Macro-Economic Highlights

The Reserve Bank of India in its fourth Monetary Policy Committee meeting of FY19 kept the repo rate unchanged at 6.50%.

The Nikkei India Manufacturing Purchasing Managers' Index rose to 52.2 in September from 51.7 in August on the back of stronger gains in new orders, output and employment.

Services sector touched 50.9 in September, down from 51.5 recorded in August as higher fuel costs and stronger US dollar made imported goods expensive.

Industrial production growth slipped to a 3-month low of 4.3% in August vs 6.6% in July mainly due to a sharp decline in the mining sector output and poor offtake of capital goods.

Retail inflation rose marginally in September to 3.77% vs 3.69% in August, nudged up by food and fuel prices. wholesale price inflation (WPI) surged to 5.13% in September from 4.53% in August.

Trade deficit narrowed to a 5-month low at $13.98 billion in September. Exports contracted 2.15% in September while imports grew 10.45% in dollar terms.

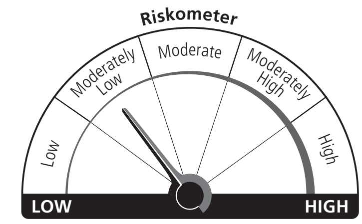
This product is suitable for investors who are seeking*

L&T Ultra Short Term Fund
(An open-ended ultra short debt scheme investing instruments such that 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 (please refer to page no.16 under the section "Asset Allocation Pattern" in the SID for details on Macaulay's Duration))

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



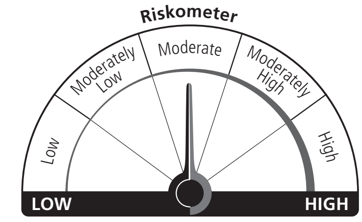
Investors understand that their principal will be at moderately low risk

L&T 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)

- 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

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
- Investments predominantly in AA+ and above rated corporate bonds and money market instruments



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.**

Source: BSE, NSE, Bloomberg