Market Wrap

L&T Financial Services
Mutual Fund

August, 2018

Equity Market Wrap

Indian stock market extended gains in the month of August led by decent earning season and positive flows from the FIIs and DIIs. The S&P BSE Sensex and the broader Nifty50 index surged around 3%. However, broader markets outperformed the benchmark indices with BSE Midcap and Smallcap indices rising between 4-5.5%.

On the global front, markets were cautious on the back of escalating trade war worries. Dow Jones was the top performer with 2% gains followed by Nikkei, Hang Seng, Euro Stoxx and FTSE, falling between 2-4%.

On the sectoral front, Healthcare was the top performer with over 12% gains followed by Metal, Power, Information Technology, Consumer Staples and Capital Goods, all rising between 4-9%.

FII turned net buyers August with $101 million of inflows during the month. Mutual Fund continued to be a net buyer for 25th straight month with net buying of $546 million while Insurance companies continued to remain sellers with outflow of $143 million during the month.

House View

While markets are touching new highs, valuations are above long term averages. The performance of Indian benchmark indices over last 12 months is supported by handful of stocks. We see increased volatility and macro risks from potential escalation in US-China trade issues, possible sanctions on Iran leading to sharp decline in Iran oil exports and higher crude oil prices and possible EM contagion given Turkey's fragile macroeconomic situation and weak macroeconomic positions of several EMs.

India's delicate macroeconomic position will be hurt by higher oil prices given oil's large influence over current account deficit, bond yields and inflation. Earnings growth has started to show signs of recovery since Q1FY19. We expect consumption recovery to be strong, led by rural consumption on back of MSP hikes and implementation of pay commission. Benefits of GST are also expected to be visible over next few months. Currency depreciation makes export theme attractive.

Strong domestic flow from mutual fund industry has been a support to markets and any potential slowdown could be near term headwind for the market. Earnings revival will be vital as valuations are above long term averages. We are positive on long term India story and continue to invest with strong and able management with earnings visibility.

Debt Market Wrap

Indian sovereign bonds rose in August by 18 bps to 7.95% from 7.77% despite rupee hitting multiple new lows in the past two weeks. A rout in emerging-market currencies, elevated oil prices and fears of fiscal slippage before a general election next year have combined to make the rupee Asia's worst performer in 2018.

The 10-year benchmark G-Sec yield closed at 7.95%, up by 18 bps from its previous close of 7.77% while that on the short-term 1-year bond ended 30 bps higher at 7.15%. In the corporate bond segment, yields rose across the yield curve over the month.

The 10-year AAA bond yield ended 09 bps higher at 8.62%, while the short-term 1-year AAA bond yield ended 20 bps up at 8.15%. The spread between 1-year and 10-year AAA bond widened. Within the short term segment, yield on 3-month Commercial Paper (CP) was up 25 bps to 7.75% while 1-year CP yield was up 60 bps at 8.60%.

House View

After trending slightly lower in July, Government bond yields resumed their uptrend. While the RBI MPC and the minutes of the meeting were broadly in line with expectations, the sell-off through the month was mainly driven by the sharp weakness in rupee and higher oil prices.

Brent prices pushed back to its highs at $78 per barrel, and that combined with a weaker rupee has meant sharp increase in onshore prices of various fuels. While CPI data for July was lower than market expectations - printing at 4.17% versus market expectation of ~4.5%, the July trade deficit data was however, more worrying coming in at almost $18bn vs $15-16bn expected by the market. Hence, a combination of weak EM environment with Turkey, Argentina bearing the brunt of significant losses in their currencies, and weak domestic Current account deficit trends for us here - have implied that the INR too has weakened sharply, to be among the worst performing currencies in Asia at 10% weakness YTD.

While markets have priced in another rate hike before year end, and inflation trends so far are within expected ranges (especially with food inflation continuing to be very well behaved) - the markets are worried about the sharp weakening trajectory of the rupee, and importantly how the RBI is likely to tackle this issue. While there are suggestions by certain sections of the market around issuance of a large NRI deposit / bond raising similar to 2013 to shore up confidence vis-à-vis the rupee, so far there is no such indication from the authorities.

In the absence of such strong measures, we are likely to remain vulnerable to global sentiment and behavior of other EM currencies, and the INR with its relatively large CAD, basic balance and dependence on portfolio flows - is likely to experience further weakness. With 10 year gsec yields close to breaching 8%, we could see further upside in yields with new cycle highs getting created. We continue to remain cautious in our outlook for yields over the next two quarters, and advice investors to keep duration risks low.

Liquidity deficit has been in the Rs 0 to 30,000 cr range, with currency in circulation having stabilized in this quarter. Shorter end yields have been stable to slightly lower, thereby benefiting funds such as L&T Ultrashort and L&T Money Market Fund, invested in the 3-6 month maturity range.

With MCLRs gradually rising, spreads for non AAA issuers are becoming more lucrative, thereby aiding accrual oriented funds such as the L&T Low Duration Fund and the L&T Credit Risk Fund, should prove to be attractive from a 1 to 3 year investment horizon.

As pointed out earlier, 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.

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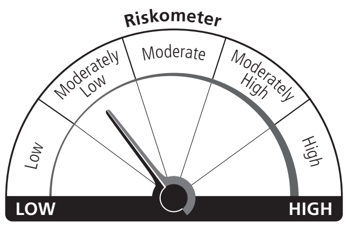
This product is suitable for investors who are seeking*

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 Money Market Fund
(An open-ended debt scheme investing in money market instruments)
- Generation of regular income over short to medium term
- Investment money market instruments

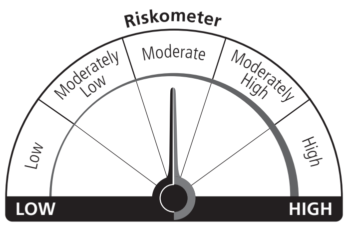


Investors understand that their principal will be at moderately low risk

L&T Low Duration 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 xed income securities and money market instruments

L&T Credit Risk 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
- Investments 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.**

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

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