Debt Market Review

L&T Financial Services
Mutual Fund

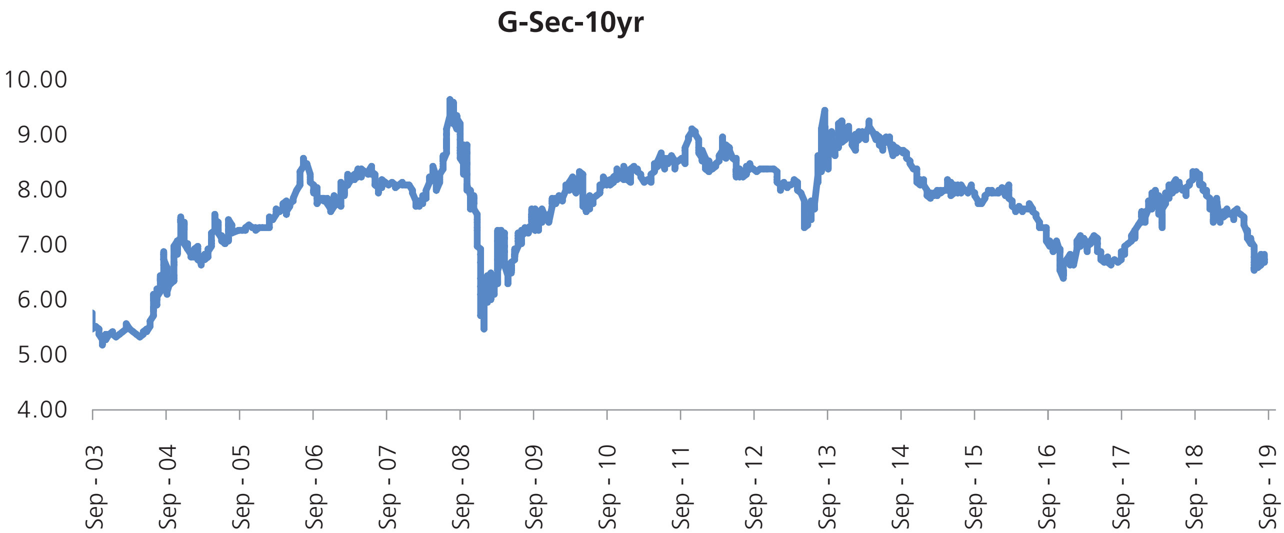
August, 2019

Indian sovereign bond ended 19 bps higher to 6.56% in August vs 6.37% in July. The Reserve Bank of India said it will transfer Rs 1.76 lakh crore surplus to the government this fiscal, easing worries over the Centre's fiscal deficit target for this financial year. Meanwhile, the rupee depreciated by 3.65% against the dollar during the month, its steepest monthly decline in six years.

Market Performance

The 10-year benchmark G-Sec yield closed at 6.56%, up by 19 bps from its previous close of 6.37% while that on the short-term 1-year bond ended 20 bps lower at 5.74%. In the corporate bond segment, yields fell across the yield curve over the month. The 10-year AAA bond yield ended flat at 7.45%, while the short-term 1-year AAA bond yield ended 35 bps down at 6.70%.

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 30 bps to 5.8% while 1-year CP yield was down 20 bps at 6.80%.



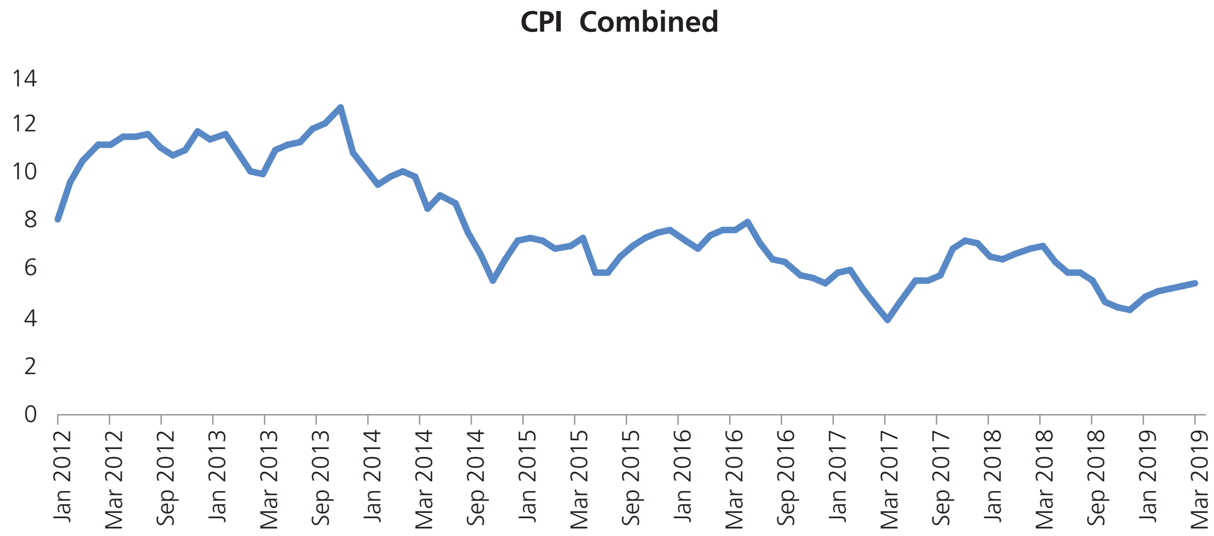
Macro-economic Overview

India's GDP expanded at lower-than-expected 5% year on year in the April-June quarter, the slowest in over six years, driven by weak investment growth and sluggish demand.

Factory output growth slipped to 4-month low of 2% in June, lower than the 7% growth recorded in June 2018.

Retail inflation rate in July grew 3.15%. Wholesale inflation hit a 25-month low in July, highlighting weak demand in the economy and triggering calls for further rate cuts by the Reserve Bank of India.

Growth in eight core sectors of India slipped to 2.1% during July vs 7.3% in June. Exports growth turned positive in July, spurting 2.25%, while trade deficit narrowed to a 4-month low of $13.43 billion.



Market Impact and Outlook

The 10-year benchmark G-Sec has traded in the range of 6.30%-6.65% in the month of August. The MPC reduced the repo rate by 35 bps from 5.75% to 5.40% in August MPC meeting keeping the stance of the policy "accommodative". Since then yields on the 10-year G-Sec have moved higher. Higher than expected core CPI, probable issuance of new 10-year benchmark, Indian rupee depreciation vs USD and fiscal slippage due to lower tax collections and stimulus have put upward pressure on yields.

However, GDP print for the first quarter came in at 5%, 70 bps to 1% lower than market expectations and has opened up the space for rate cuts in upcoming October policy itself. High frequency growth indicators for the 2nd quarter have also been on the weaker side and RBI will have to revise the full year GDP forecast for FY20 significantly downwards from the current forecast of 6.9%.

We expect atleast another 40 bps of rate cuts in this cycle as MPC will focus to address slowing growth by reducing rates. Real rates are still very high at 250 bps and downside risks to growth as pointed out by MPC are clearly materializing.

The ***broad trading range for the current 10-year G-Sec will be in the range of 6.25% - 6.65%*** and the new 10-year will likely trade in between 6% to 6.40% when it is issued. The G-Sec curve is quite steep and > 14-year G-Secs are trading in the range of 6.80% to 7%. The yield curve has steepened in the last 1 month with spreads between 10-year and 5-year has widened from 10 bps to 37 bps.

While we are tactically bullish on rates, risks to the trade are: any kind of fiscal stimulus and extra borrowings through market, absence of OMO purchase in the near future due to higher than expected dividend transfer by RBI to Govt and any spurt in CPI.

Investment Strategy & Fund Recommendations

We remain positive on AAA corporate bond curve and spread over G-Sec. With liquidity likely to remain positive over the coming year atleast, and bank deposit rates likely to move sharply lower, we ***expect the short to medium part of the curve to move lower significantly from current levels.***

Accordingly, we would continue to encourage investors to look at products such as the ***L&T Banking & PSU Fund (a passive 3.5 year roll down strategy)*** and the ***L&T Short Term Bond Fund which invests predominantly in the 2-5 year part of the AAA corporate bond curve.*** These funds have a yield pickup over G-Sec of upwards of 100-120 bps, which we believe can fall towards the 50-60 bps range or potentially even lower, given the chase for the limited supply of high quality AAA assets in this space.

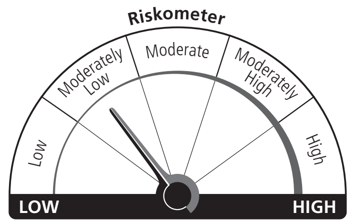
The ***L&T Triple Ace Bond Fund, which invests in the 2028-29 maturity segment, with investments in the highest credit quality AAA corporate bonds is also a good carry product, especially versus tax free bonds.*** While the underlying government bond yields are somewhat lower than the longer term fair value, we are still positive in our outlook for the spread of AAA corporate bonds over G-Sec, which currently continues to trade in range of ~85-100 bps, versus the long term average of 50-55 bps. We expect that this spread will compress over the coming quarters, thereby, allowing corporate bonds to outperform underlying G-Secs.

For ***investors looking at products which benefit from some of the credit risk aversion*** prevalent currently and the attractive spreads available on the less liquid bonds, the ***L&T Resurgent India Bond Fund is ideally positioned with attractive yield and spread pick-up*** while still having more than 70% of the assets in the AAA segment.

This product is suitable for investors who are seeking*

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 in fixed income securities of shorter term maturity.



Investors understand that their principal will be at moderately low risk

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

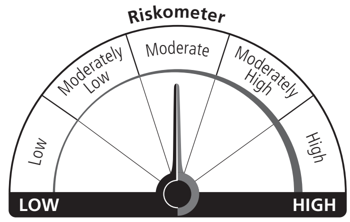
- Generation of regular and stable income over medium to long term
- Investment predominantly in AA+ and above rated corporate bonds and money market instruments

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 Resurgent India Bond Fund (Formerly known as L&T Resurgent India Corporate Bond 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)

- Generation of income over medium term
- Investment primarily in debt and money market securities



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: MOSPI, Internal, Bloomberg

Disclaimer: The article (including market views expressed herein) is for general information only and does not have regard to specific investment objectives, financial situation and the particular needs of any specific person who may receive this information. The data/information used/disclosed in the article is only for information purposes and not guaranteeing / indicating any returns. The article provides general information and comparisons made (if any) are only for illustration purposes. Investments in mutual funds and secondary markets inherently involve risks and recipient should consult their legal, tax and financial advisors before investing. Recipient of this document should understand that statements made herein regarding future prospects may not be realized. Recipient should also understand that any reference to the indices/ sectors/ securities/ schemes etc. in the article is only for illustration purpose and are NOT stock recommendation(s) from the author or L&T Investment Management Limited, the asset management company of L&T Mutual Fund ("the Fund") or any of its associates. Any performance information shown refers to the past and should not be seen as an indication of future returns. The value of investments and any income from them can go down as well as up. Neither this article nor the units of the Fund have been registered in any jurisdiction except India. The distribution of the article in certain jurisdictions may be restricted or totally prohibited and accordingly, persons who come into possession of the article are required to inform themselves about, and to observe, any such restrictions.

For distributor's circulation only.

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