

May, 2019

Indian sovereign bond ended 38 bps lower to 7.03% in May as decline in oil prices and expectations of a rate cut softened yields on government bonds. The yield has fallen the most since November 2016 helped by foreign inflows after Narendra Modi's election win.

The central bank's plan to infuse up to Rs 15,000 crore of liquidity into the system on June 13 through open market operations helped lift bond prices, driving yields lower.

US government debt yields slid to new multi-month lows after President Donald Trump's new tariff threats on all Mexican imports took investors by surprise and aggravated an already-stressed US trade outlook. The US 10-year Treasury yield hit a 20-month low at 2.17%, while the 2-year treasury yields fell to their lowest since February 2018 at 2.007%.

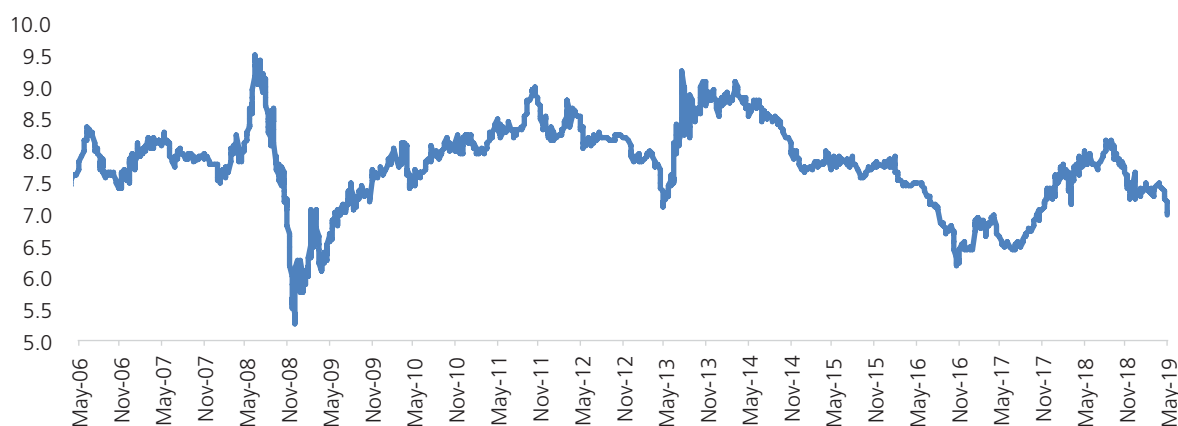
## Market Performance

The 10-year benchmark G-Sec yield closed at 7.03%, down by 38 bps from its previous close of 7.41% while that on the short-term 1-year bond ended 30 bps lower at 6.30%.

In the corporate bond segment, yields fell across the yield curve over the month. The 10-year AAA bond yield ended 40 bps lower at 8.00%, while the short-term 1-year AAA bond yield ended 70 bps down at 7.30%.

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 100 bps to 6.70% while 1-year CP yield was down 90 bps at 7.60%.

**G-Sec-10yr**



## Macro-economic Overview

India's economic growth fell to 5.8% in the January-March period of 2018-19, the lowest in 20 quarters, due to a sharp slowdown in investment and manufacturing growth as well as a contraction in agricultural production. This pulled down the GDP expansion to 6.8% in FY19.

Nikkei India Services Purchasing Managers' Index (PMI) dropped to 51 in April from 52 in March. The Nikkei India Manufacturing PMI declined to 51.7 vs 52.7 in March.

Retail inflation touched a six-month high in April to 2.92% vs 2.86% in March on high food prices. WPI-based inflation was pegged at 3.07% in April vs 3.18% in March on cheaper fuel and manufactured items.

Growth of eight core sectors slowed to 2.6% in April. Exports stood at \$26.07 billion in April, managing an overall positive growth rate due to high realisations from petroleum receipts. Import growth reached a five-month high, registering 4.4% growth.



CPI Combined



## Market Impact & Outlook post RBI Policy

Pre policy, the 10-year benchmark was trading at around 7.00% with most market participants expecting a 25bps rate cut. However, the market was divided on the stance change; in fact the majority of the market was expecting a 'neutral' stance. So the 25 bps rate cut along with an accommodative stance came as a positive surprise. Further, that the decision was a unanimous 6-0 vote also triggered rally in the bond markets with 10 gilts trading around 6.90%. 5 year gilts also traded better from 6.85% to 6.75%. Yields on corporate bonds in the 5 year and 10 year were also lower by 5-10 bps.

***With an accommodative stance, there can either be a rate cut or a status quo in the next policy. With this rate cut of 25 bps, the MPC since December 2018 has cut repo rate by 75 bps from 6.50% to 5.75% and changed the stance from 'calibrated tightening' to 'neutral' to 'accommodative'. We think that the next policy will be guided by more clarity on inflation trajectory especially with the factors like food prices movements, June and July rainfall across the country, crude price movement, some certainty on trade issues between US and China and core inflation prints. The RBI would focus on transmission or the cumulative 75 bps rate cuts and also debate on the space where the MPC has to lower rates in order to maintain 4% headline CPI. 5.75% on the repo rate is the lowest repo rate since the formation of the MPC.***

## Investment Strategy

The 1-3 year AAA corporate bond curve (PSU) ahead of the policy has already priced in a 25 bps rate cut and had rallied to 7%-7.30%. With repo rate at 5.75%, the ***1-3 year AAA corporate bond segment still offers good carry over the repo rate*** and funds such as ***the L&T Ultra Short Term 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 issuer 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 over G-Secs in the 80-120 bps range versus the historical average of 50-60 bps. The L&T Triple Ace Bond Fund is well positioned in this segment.***



**This product is suitable for investors who are seeking\***

**L&T Ultra Short Term Fund**

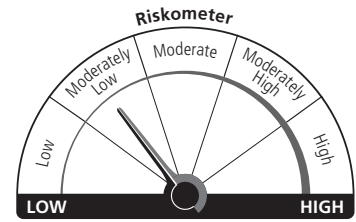
(An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months.)

- 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

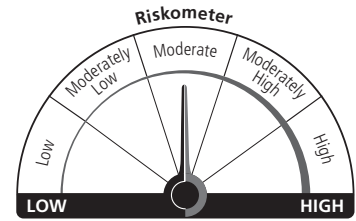


Investors understand that their principal will be at moderately low risk

**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



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:** Bloomberg, Internal

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