

September, 2019

Indian sovereign bond ended 14 bps higher to 6.70% in September. The Reserve Bank of India has cut its benchmark repo rate by 25 basis points to 5.15%, in the fifth straight interest rate cut. In this year, the central bank has cut rates four times by 110 basis points.

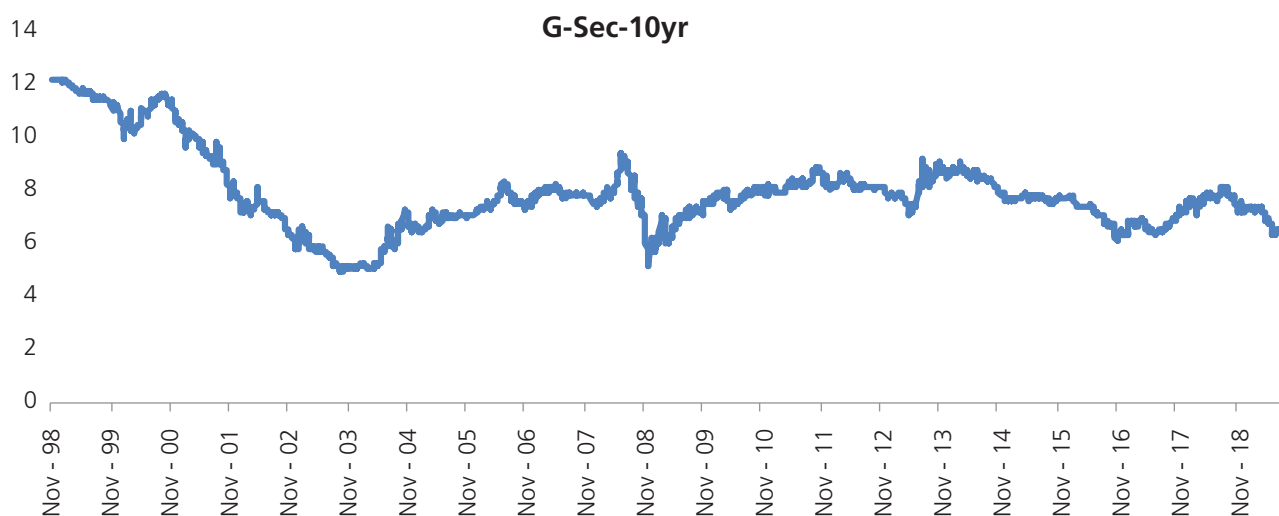
In September, the rupee appreciated after Finance Minister Nirmala Sitharaman announced corporate tax cut. The government announced it would borrow ₹2.68 trillion from the bond market in the second half, in line with expectations.

## Market Performance

The 10-year benchmark G-Sec yield closed at 6.70%, up by 14 bps from its previous close of 6.56% while that on the short-term 1-year bond ended 13 bps lower at 5.61%.

In the corporate bond segment, yields rose across the yield curve over the month. The 10-year AAA bond yield ended 15 bps higher at 7.60%, while the short-term 1-year AAA bond yield ended flat at 6.70%.

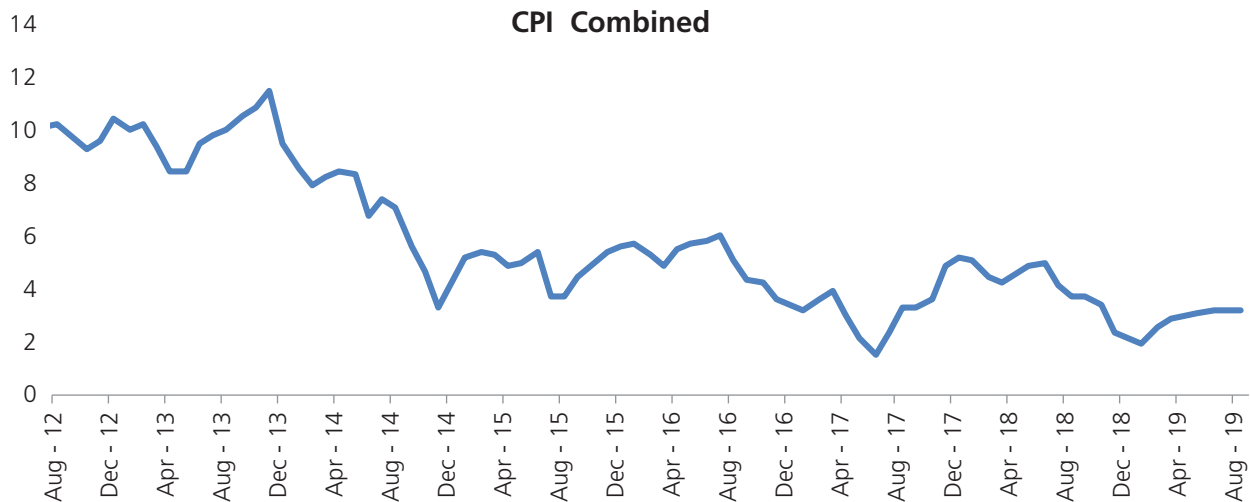
The spread between 1-year and 10-year AAA bond widened. Within the short term segment, yield on 3-month commercial paper (CP) was down 30 bps to 5.50% while 1-year CP yield was down 10 bps to 6.40%.



## Macro-economic Overview

The Nikkei Manufacturing Purchasing Managers' Index declined to 51.4 in August from July's 52.5 while services index came down to 52.4 in August from 53.8 in July. Industrial activity rebounded in July to 4.3% on a broad-based recovery across sectors such as mining, manufacturing and construction. The eight core industries' output contracted 0.5 per cent in August.

Retail inflation rate increased to a 10-month high in August. Annual retail inflation in August was 3.21% vs 3.15 in July. WPI inflation dips to 1.08% in July with sharp fall in fuel, power prices. Fiscal deficit stood at Rs 5.54 lakh crore at the end of August while the exports in August have dropped by 6.05% to \$26.13 billion.



## Key highlights of RBI policy

The Monetary Policy Committee (MPC) today reduced repo rate by 25 bps from 5.40% to 5.15%. The stance of the policy remained unchanged at “accommodative”. Five member of the MPC voted to cut rates by 25 bps whereas one member (Dr. Ravindra H. Dholakia) voted for a 40 bps rate cut.

- The path of CPI inflation remains broadly unchanged from that given in the August policy. CPI is projected slightly upwards at 3.4% for Q2 2019-2020 whereas projections are retained at 3.5-3.7% for H2 2019-2020 and 3.6% for Q1 2020-2021 with risks evenly balanced.
- GDP growth for 2019-20 has been revised downwards from 6.9% in the August policy to 6.1% –5.3% for Q2 2019-20 and in the range of 6.6-7.2% for H2 – with risks evenly balanced. GDP growth for Q1 2020-2021 has also been revised downwards to 7.2% from 7.4%
- The MPC noted that the negative output gap has widened further since the last policy and the continuing slowdown warrants focus to revive growth. The MPC noted that there is policy space to address these growth concerns given that inflation for the next year will be broadly in the 4+/- 2%.
- The MPC has decided to continue with an accommodative stance “as long as it is necessary to revive growth” ensuring that inflation remains within the target, thereby, giving a clearer forward guidance for its policy trajectory.

## Market impact and outlook post RBI MPC

While the MPC delivered a 25 bps cut as broadly expected by the market, with a dovish bias in its post –policy commentary, the government security market did not react too positively. While the rate cut with accommodative stance, and a positive liquidity backdrop will continue to be a positive driver for the short to medium part of the yield curve, the longer end of the G-Sec market is really grappling with the issue of fiscal deficit and worries about extra borrowings in Q4.

Also, the MPC did not give any indication of its likely OMO strategy in H2, leaving the markets to continue worrying about potential demand supply mismatch.

The 10-year benchmark which was trading pre-policy at around 6.58-6.61%, sold off sharply to end the day 9 bps higher at 6.69%. The new 10-year benchmark was auctioned at a yield of 6.45%, but failed to enthrone the G-Sec market.



**Post the rate cut, the G-Sec yield curve steepened with the 5-year up 3 bps at 6.27%, the 10-year up by 9 bps at 6.69% and the 14-year up by 11 bps at 6.96%.**

The spread between the new 10-year and 14-year Gilt is at 40 bps and spread between the old and the new 10-year is at 20 bps. **We believe that a lot of the supply concerns are already priced in and, if yields back up to the 6.75-7% range (for old 10-year), it offers a good risk vs reward opportunity.**

The short to medium part of the corporate bond curve, however, continued to perform well post policy. 6 month to 1-year CDs traded lower by 10 bps while 2-3 year AAA corporate bonds yields also moved lower.

With liquidity likely to remain in surplus over the next few quarters and space for another 15-40 bps of

## Investment strategy & fund recommendations

With repo rate at 5.15%, surplus liquidity conditions and a relatively steep yield curve at the shorter end, the carry remains very attractive for investors in 6-12 month products such as **L&T Ultra Short Term Fund** and **L&T Money Market Fund**.

The 2-4 year AAA corporate bond curve is trading in the range of 6.80% to 7.20% at a spread of 60-100 bps over corresponding G-Secs and despite the rally over past few months – continues to offer very good carry in our view. **L&T Short Term Bond Fund** and **L&T Banking PSU Debt Fund** are both high credit quality funds positioned to benefit from this carry.

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 attractively positioned for long term investments, especially versus tax free bonds.

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 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 Money Market Fund**

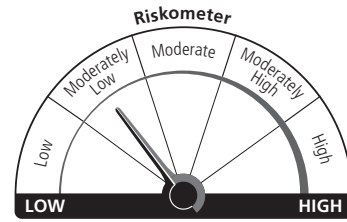
(An open ended debt scheme investing in money market instruments)

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

**L&T Short Term Bond 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 Banking PSU Debt Fund**

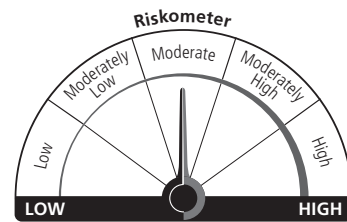
(An open ended debt scheme primarily investing in debt instruments of banks, public sector undertakings, public financial institutions and municipal bonds)

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



Investors understand that their principal will be at moderate risk

**L&T Resurgent India 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 should consult their financial advisers if in doubt about whether the product is suitable for them.**

**Source:** MOSPI, Internal, Bloomberg

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