



Indian sovereign bond closed at 5.84% vs 5.88% from its previous close. The Reserve Bank of India decided to keep the benchmark repo rate unchanged at 4%, and reverse repo rate at 3.35%.

Brent oil price gained 4.7% in July to end the month at US\$42.8/bbl while the Indian Rupee appreciated by 0.9% and ended month at 74.82/\$ in July.

Global yields have eased meaningfully as central banks globally have cut policy rates aggressively and have announced large QE programs, to counter the negative impact on global growth from the COVID-19 outbreak. US 10Y yields are at 0.53% (-149 bps over the last 1 year).

## MARKET PERFORMANCE

The 10-year benchmark G-Sec yield closed at 5.84%, down by 04 bps from its previous close of 5.88% while that on the short-term 1-year bond ended 07 bps higher at 3.47%.

In the corporate bond segment, yields fell across the yield curve over the month.

The 10-year AAA bond yield ended 15 bps lower at 6.45 %, while the short-term 1-year AAA bond yield ended 05 bps down at 4.05%. The spread between 1-year and 10-year AAA bond narrowed.

Within the short term segment, yield on 3-month commercial paper (CP) was flat at 3.50% while 1-year CP yield was down 05 bps at 4.05%.

10-Year G-Sec





## MACRO-ECONOMIC DEVELOPMENTS

**Inflation & IIP:** Retail inflation grew 6.09% in the month of June while the WPI inflation contracted by 1.8% vs -3.2% (MoM). IIP numbers for May, which fell (-34.7%) on a (YoY) basis, vs (-55.5%) contracted in the month of April.

**PMI & Trade Deficit:** June Composite PMI for India improved from 14.8 in May to 37.8 in June. Services PMI improved to 33.7 in June (vs 12.6 in May). Similarly, the Manufacturing PMI printed at 47.2 in June vs 30.8 in May. India's monthly merchandise trade balance printed a surplus of US\$790mn in June, first surplus in 18 years.

CPI Combined (YoY)



## KEY TAKEAWAYS OF RBI POLICY

- While the status quo on rates wasn't a surprise, the tone of the MPC document was slightly more hawkish than expected, flagging upside risks to inflation (albeit supply side driven factors) and the need to see CPI move decisively lower (durable reduction) within the inflation targeting band, before the MPC thinks about using any additional space for further rate cuts. ***This effectively implies that markets may need to wait till the December policy for any potential rate cut, which also would be dependent on the CPI trajectory over the coming months***
- The other important point to note is that despite the unprecedented growth impact on account of the pandemic, ***the MPC recognizes its primary mandate is to achieve medium term target for CPI*** of 4% within a band of +/-2% and not diluting or rationalizing non-achievement of this target
- Lastly, there was no mention about future course of action with regard to the huge supply of Government bonds, either through OMOs or via monetization of deficit, which effectively means that ***the market would need to continue digesting the upcoming supply***, while the uncertainty about the scale and timing of RBI's OMO strategy continues to be an overhang.



## MARKET REACTION

Markets were slightly disappointed by the RBI's focus on inflation control, despite the collapse in growth. However, continuation of the accommodative stance, adequate liquidity surplus in the system and expectation that RBI will not allow a significant sell-off in bond markets, meant that the negative reaction was quite muted and yields were up by only about 3-5bps across the medium to longer end of the curve. [READ MORE](#)

## OUTLOOK, INVESTMENT STRATEGY & FUND RECOMMENDATIONS

Flush liquidity in the system, good demand for bonds by banks in absence of meaningful credit growth and healthy flow trends in mutual funds are all likely to remain positive drivers, ensuring that yields remain low, especially with the RBI backstop at play.

Thus, *on a risk-adjusted basis, the yield curve continues to remain steep, with carry likely to remain attractive* as we move longer on the yield curve. Accordingly, in our view, *the AAA curve remains attractive both on the 3-year space (where our L&T Short Term Bond and L&T Banking & PSU Debt Fund are invested), and also at the longer end (where L&T Triple Ace Bond Fund is positioned).*

*For investors looking to make additional alpha, a good alternative is to play duration actively.* The current bond market environment is a tricky one, where rates are likely to stay low or rally over the coming year, with potential for normalization (upward movement) of rates in late 2021/2022 as and when the economic situation in the post COVID era improves. Active management of duration, to capture the ongoing rally, while limiting losses in later years through well timed duration reduction – may offer an optimal strategy. We believe, *L&T Flexi Bond Fund and L&T Gilt Fund, both have a demonstrated track record of active duration management in past such cycles, and are well suited in the current market conditions.*

*The other alternative for alpha generation that is slowly catching investor attention is good quality, but less liquid securities in the AAA/AA+/AA rating buckets.* While the credit environment surely remains extremely challenging and warrants abundant caution, we do believe that funds which can offer access to good quality issuers in these higher rating buckets could be considered by investors willing to move up a notch in the risk-reward chain. We believe that *L&T Resurgent India Bond Fund is well positioned in this space, with a pickup of around 300 bps over 3-year AAA PSU yields.*



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

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

**L&T Flexi Bond Fund**

(An open ended dynamic debt scheme investing across duration)

- Generation of reasonable returns over medium to long term
- Investment in fixed income securities

**L&T Gilt Fund**

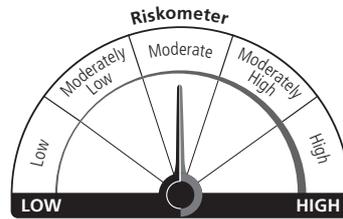
(An open ended debt scheme investing in government securities across maturity)

- Generation of returns over medium to long term
- Investment in Government Securities

**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

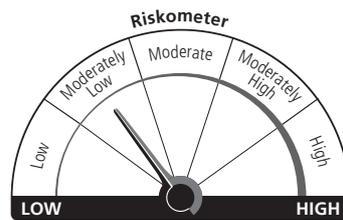


Investors understand that their principal will be at moderate risk

**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

**\*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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