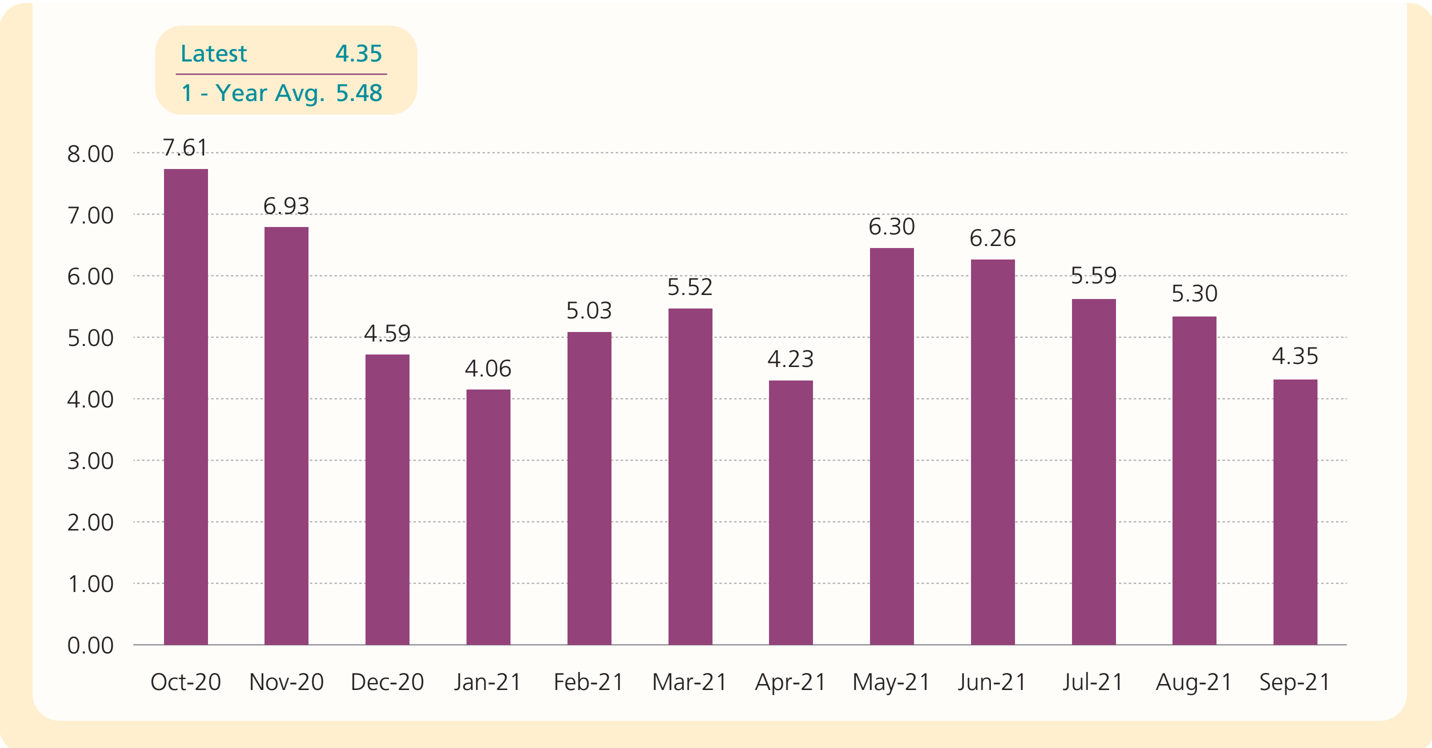
The FOMC minutes for the September policy (released in October) indicated that financial conditions in the US were broadly unchanged and remained accommodative. The spread of the Delta variant posed some risks to near term growth outlook, however the guidance on growth beyond 2021 remained constructive. The progress on vaccinations would likely reduce the effects of the public health crisis on the economy.The recent dip in payroll data was also attributed to temporary factors and is expected to recover over time.The US CPI print came in at 5.4% (fifth consecutive month of CPI print at or above 5%). The minutes acknowledged that inflation was boosted by surge in demand, accompanied with effects of supply bottlenecks. Risks to inflation remained on the upside and could eventually turn out to be more persistent than expected.

The minutes provided guidance to the markets that tapering of asset purchases were imminent and could possibly commence as early as in November and end by mid-2022. However, it was reiterated that tapering should be not considered as a signal for interest rate hikes and both events are independent. The Dot plot indicated a move up in target rates with policy normalisation expected over 2022 to 2024. Median policy rates were projected at 0.25% (from earlier 0.125%) for 2022, 1.0% (from earlier 0.625%) for 2023 and 1.75% for 2024, with long term policy rate unchanged at 2.5%. However, the timing of the commencement of rate hikes remained divergent among members. 10-year US Treasury yields have been volatile this month, trading in 1.45%-1.70% band and currently ~ 1.55%.

Energy prices continued to see a sharp move up based on increased demand. Crude has stayed above USD 80/bbl during the month and is currently trading ~ USD 85/bbl (this is the highest level seen in the last 3 years). OPEC has decided to stick to their existing plan of gradual increase of supply by 400,000 barrels per day, amid calls for further supply increases from major oil consuming nations. Natural gas prices have also seen a sharp surge with prices breaching USD 6/MMBTU this month. With the onset of winter, Natural gas prices might continue to remain under pressure. High energy prices have started fuelling into inflation with recent CPI prints in various countries seeing an uptick. Sustained period of high Energy prices would remain a key risk to global growth and inflation.

On the domestic front, CPI inflation for September 2021 came in at 4.35% (vs 5.30% in August), slightly lower than market expectations, due to lower food prices and a favourable base effect. Core CPI remained sticky at 5.80%. WPI inflation for September 2021 cooled off slightly to 10.66% due to lower food prices. However, higher fuel and manufacturing prices continued to keep WPI prints higher. This is the sixth consecutive month of WPI print above 10%. IIP for August 2021 came in at 11.9% with mining and electricity showing acceleration in growth. Trade deficit for September 2021 came in at USD 22.59 bn (vs USD 13.81 in August). Although exports continue to remain resilient, huge jump in imports pushed Trade deficit higher and might continue to widen as the economy opens up further and if surge in Crude prices continue.

CPI Combined (YoY)



The MPC in the October policy, decided unanimously to keep policy rates unchanged, however, the decision to continue with the accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remained within the target going forward was not unanimous. Professor Jayanth Varma expressed his clear dissent against staying accommodative and called for beginning of normalization of the LAF corridor. The theme of reduction in excess liquidity and raising the Reverse Repo rate is gaining ground among members. The members also acknowledged the risks to inflation due to high commodity prices and supply side bottlenecks.

As outlined by the Governor in the MPC speech, Variable Rate Reverse Repo (VRRR) auctions have been used as a tool to manage high surplus liquidity, and markets have witnessed both 14-day VRRR auctions (staggered increase in auction sizes) and shorter tenor VRRR auctions for fine tuning liquidity. The cut-offs for these auctions are now coming closer to the Repo rate, with some auctions not being able to garner the full size. This has pushed short tenor rates higher. The RBI on October 27, 2021, announced the first 28-day VRRR auction worth INR 50,000 Crs for the first time this financial year.

Money market levels during the month moved up by 20-30 bps due to higher VRRR auctions and cut-offs. G-Sec and Corporate bonds in the 2-3 year segment also moved up by 10-20 bps. G-Sec and Corporate bonds in the 5-10 year segment saw a relatively smaller move of 5-10 bps, in spite of RBI not announcing any G-SAP/OMO/OT auction since the October MPC policy.Corporate bonds in this segment have continued to see some demand from end investors. The OIS curve on the other hand, has also moved sharply during the month, with levels higher by 25-40 bps across tenors.

Moody's revised its outlook on Government of India's rating from Negative to Stable, while keeping the rating at Baa3/Stable, indicating that downside risks to Indian economy is diminishing. S&P already has Government of India's rating outlook at Stable. This along with timely progress on bond index inclusion will provide a positive sentiment in an otherwise cautious market environment.

MARKET PERFORMANCE

The 10-year benchmark G-Sec yield closed at 6.39%, up by 15 bps from its previous close of 6.24% while that on the short-term 1-year bond ended 20 bps higher at 4.15%.

In the corporate bond segment, yields rose across the yield curve over the month. The 10-year AAA bond yield ended 02 bps higher at 6.86%, while the short-term 1-year AAA bond yield ended 18 bps up at 4.40%.

The spread between 1-year and 10-year AAA bonds narrowed. Within the short-term segment, the yield on 3-month commercial paper (CP) was up 35 bps to 3.90% while 1-year CP yield was up 20 bps at 4.40%.

10-Year G-Sec

Past performance may or may not be sustained in the future.

OUTLOOK

RBI has been conducting 14 days Variable Rate Reverse Repo (VRRR) auctions, the volumes of which are being increased in a staggered manner. Additionally shorter tenor VRRRs are also being conducted as liquidity fine tuning operations. The RBI on October 27, 2021, announced the first 28-day VRRR auction worth INR 50,000 Crs for the first time this financial year.

Although the Governor has reiterated that this should not be misconstrued as reversal of accommodative stance, this can be considered as the first step towards policy normalization. The subsequent steps could be increasing the quantum of longer tenor VRRR, reduction in the LAF corridor to 25 bps, stance change to neutral followed eventually by a rate hike. Although these steps could be spread over the next 3-4 quarters, the process initiation has begun.

The shorter end of the curve (0 to 5 years) is likely to remain under some pressure, with an upward bias to yields. However, the pace of the recent upmove implies that a fair bit of the policy normalisation is being increasingly priced into these segments.

The longer end of the curve (5 year +) needs to come to terms with a halt to the GSAP programme by the RBI. However, with manageable supply and the likely inclusion of India Government bonds in global indices over the next few quarters, yields are likely to remain well supported, albeit with an upward bias. We expect the 10 year G-Sec yield to move into the 6.5-7% range over the next few quarters in line with the normalisation of policy and demand supply factors.

INVESTMENT STRATEGY & FUND RECOMMENDATIONS

The L&T Short Term Bond Fund and L&T Bankingand PSU Debt Fund are suited for investors who would want to ride this upwards rate cycle with lower volatility over the next 2-3 years with highest quality portfolios.

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 positioned for long term investments, especially versus tax free bonds but comes with lot of potential volatility through the year. The yields on this part of the curve (7 years average maturity) are the most favourable from a risk-reward perspective.

L&T Resurgent India Bond Fund is positioned with an attractive yield while still having more than 80% of the portfolio in the AAA segment. The interest rate volatility is relatively lower as the average maturity of the fund is around 3 years, making it an ideal investment opportunity for investors seeking higher returns over a plain vanilla AAA fund over a 3 year period.

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

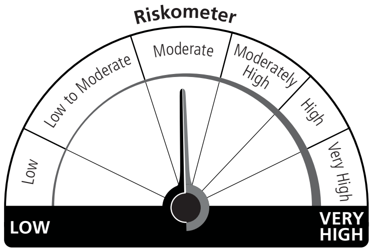
L&T Triple Ace Bond Fund
(An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)

- 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 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

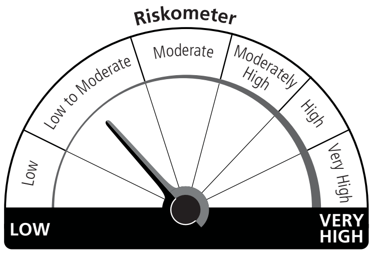
Riskometer is as of October 31, 2021



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 moderate risk

***Investors should consult their financial advisers if in doubt about whether the product is suitable for them.**

Source: MOSPI, Internal, Bloomberg