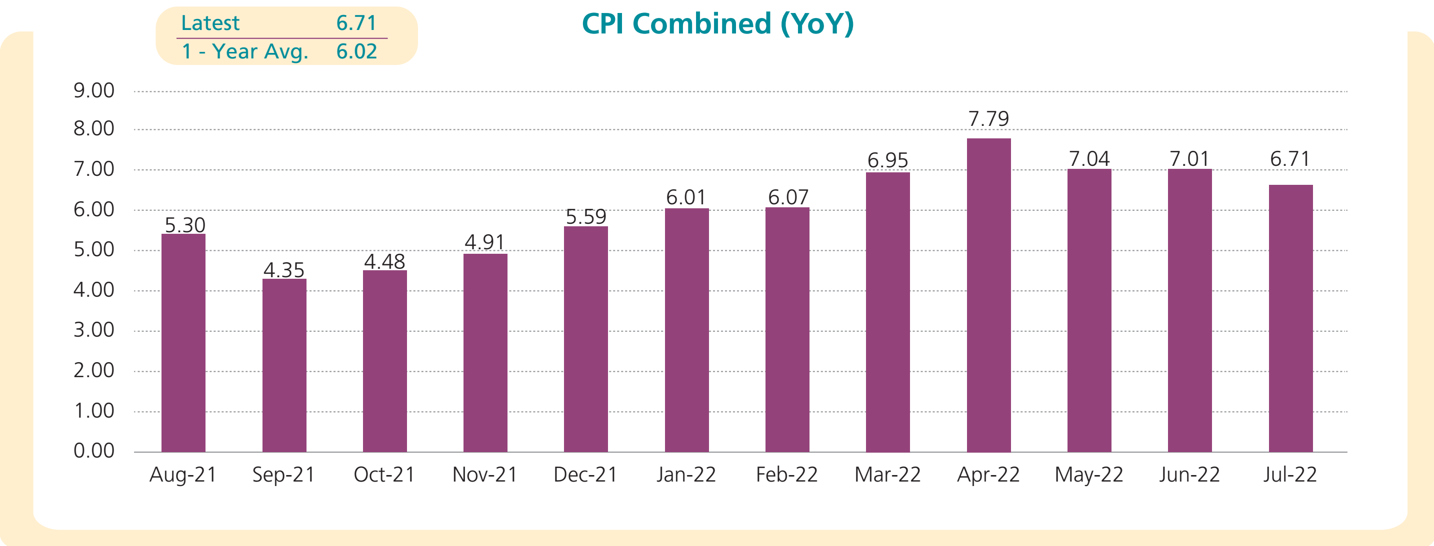
Debt Market Review

The Federal Open Market Committee (FOMC) minutes published in August 2022 reiterated that inflation remained a key concern and continued tightening was required to curb price pressures. Members believed that moving to a restrictive policy was required to meet the Committee's dual mandate of employment and price stability. The minuteacknowledged that aggressive policy tightening would result in an economic slowdown, future rate actions would remain data dependent and a slower pace of rate hikes would be warranted as the impact of frontloading would be assessed on the economy. In his speech at the Jackson Hole symposium, the Fed Chair remained hawkish and reiterated the Fed's commitment to anchor inflation even at the expense of growth. Other major economies are also grappling with higher inflation and aggressive tightening would remain a common theme. US CPI inflation for July 2022 fell marginally to 8.5% (from 9.1% in June 2022), while CPI inflation in UK moved to double digits. US Treasury yields remained volatile throughout the month, with 10-year US Treasury moving from 2.55%-2.60% to 3.20% during the month. The yield curve continues to remain inverted with 2-yr vs 10-yr currently at 15-20 bps. Crude prices during the month traded in the range of USD 90/bbl to USD 105/bbl.

MACROECONOMIC DEVELOPMENTS

On the domestic front, CPI inflation eased to 6.71% in July 2022 (from 7.01% in June) due to a dip in vegetable inflation. Core CPI also fell marginally to 5.8%. WPI inflation also eased from 15.18% in June 2022 to 13.93% in July. The impact of softening commodity prices should reflect in WPI readings in the upcoming months and eventually feed into CPI prints. IIP data for June 2022 came in at 12.3% due to pick up in capital goods and consumer durables. PMI numbers are encouraging and GST revenues remain buoyant with August collections at INR 1.44 Lakh Crs. Credit off-take remains upbeat with non-food Bank credit growing at 15.1% in July 2022. However, GDP numbers for Q1 FY2023 came in lower than estimates, with GDP growth at 13.5% and GVA at 12.7%. Trade deficit widened further in July 2022 to USD 30/bbl. With economic slowdown witnessed in other economies, exports have slowed down.



Although USD continues to strengthen against other currencies, Rupee remains one of the better performing currencies among EMs. The large surplus that RBI built over time has helped the Central Bank to contain volatility and absorb shocks. Outflows by FPIs from equity markets, along with widening trade deficit have resulted in a sharp fall in FX reserves by USD 70-75 bn since Sep 2021. However, structurally, India, with its strong macro-economic fundamentals, remains one of the more promising destinations for global investors. RBI has shown a commitment to keep volatility low and will continue to tread along that path keeping the impact of outflows to a minimum. The recent news on JP Morgan consulting investors on adding India to their Bond Index has given hope to markets which were grappling with supply demand mismatch. Given that markets are expecting inflows of around USD 30 bn over the next 1-2 years if IGBs get added to the global index, timely inclusion remains a key monitorable.

MARKET PERFORMANCE

On a month-on-month basis (as on Aug 31, 2022) With CD issuances having picked up substantially, 3-month and 1-year CD rates moved up by 15-20 bps. G-Sec continued to witness spread compression with the 10-year G-Sec moving lower by around 15 bps during the month while the 2-3 year point moved up by 3-5 bps. With the lack of corporate bond supply in the longer end along with end investor demand for such papers, 5-10 year corporate bonds rallied by 10-20 bps during the month. On the other hand, OIS levels moved up by 10-15 bps during the month.

OUTLOOK

10-year G-Sec yields have seen a sharp move down from the highs of 7.60% based on softening of Crude prices, global recessionary narrative picking up and discussions around possible inclusion of IGBs in the global bond index. However, the MPC seems focused on bringing back inflation to the mandated 4% and we will continue to see further hikes. While expectations of terminal rates of around 6.5% have tempered down, we believe terminal repo rate will likely be in the range of 6.00%-6.25% and 10-year G-Sec yields might push back again to the 7.40%-7.50% band. A sooner than expected confirmation of inclusion of IGBs in the Bond Index and/or easing of inflation remain risks to this G-Sec view.

10-Year G-Sec

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

While in the near term, our markets are likely to take cues from US treasury yield movements and oil prices, we do believe certain segments of our market, such as the 3-4 year part of the yield curve, have priced in risks adequately and offer relatively good value. **L&T Banking and PSU Debt Fund is predominantly positioned in this segment. The extra carry offered by the longer end of G-Sec curve (5 year + segment) is quite unattractive. Hence, while tactical allocations to that segment may make sense from time to time, we remain underweight the longer end till better value emerges.**

Markets are now a lot more volatile, with frequent sharp moves in both directions. While this on the one hand warrants caution, on the other, this also means more opportunities for dynamically managed funds (both from duration and credit perspective) to be able to tactically, as well as strategically deliver alpha. Hence, **for investors desiring alpha through duration calls, funds like the L&T Flexi Bond Fund, L&T Gilt Fund are attractive opportunities to be considered.**

Additionally, given that credit spreads have narrowed, funds which have higher allocation to G-Sec with the ability to switch to corporate bonds once spreads widen, provide another avenue. L&T Short Term Bond Fund and L&T Resurgent India Bond Fund are positioned to take advantage of such asset allocation strategies, along with active duration calls.

L&T Financial Services
Mutual Fund

L&T Gilt Fund | L&T Flexi Bond Fund | L&T Banking and PSU Debt Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	A-III		

L&T Resurgent India Bond Fund

Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

L&T Short Term Bond Fund

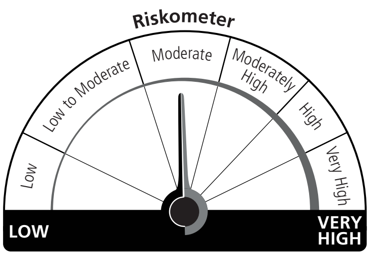
Potential Risk Class			
Credit Risk → / Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)		B-II	
Relatively High (Class III)			

This product is suitable for investors who are seeking*

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 (please refer to page no. 18 under the section "Asset Allocation Pattern" in the SID for details on Macaulay's Duration)#. A relatively high interest rate risk and moderate credit risk)
- Generation of income over medium term
- Investment primarily in debt and money market securities

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.) A relatively high interest rate risk and relatively low credit risk:
- 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

Riskometer is as of August 31, 2022

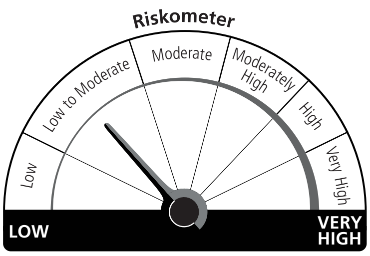


Investors understand that their principal will be at moderate risk

L&T Flexi Bond Fund
(An open-ended dynamic debt scheme investing across duration. A relatively high interest rate risk and relatively low credit risk)
- Generation of reasonable returns over medium to long term
- Investment in fixed income securities

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.) A moderate interest rate risk and moderate credit risk:
- Generation of regular returns over short term
- Investment in fixed income securities of shorter term maturity.

L&T Gilt Fund
(An open-ended debt scheme investing in government securities across maturity. A relatively high interest rate risk and relatively low credit risk)
- Generation of returns over medium to long term
- Investment in Government 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

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