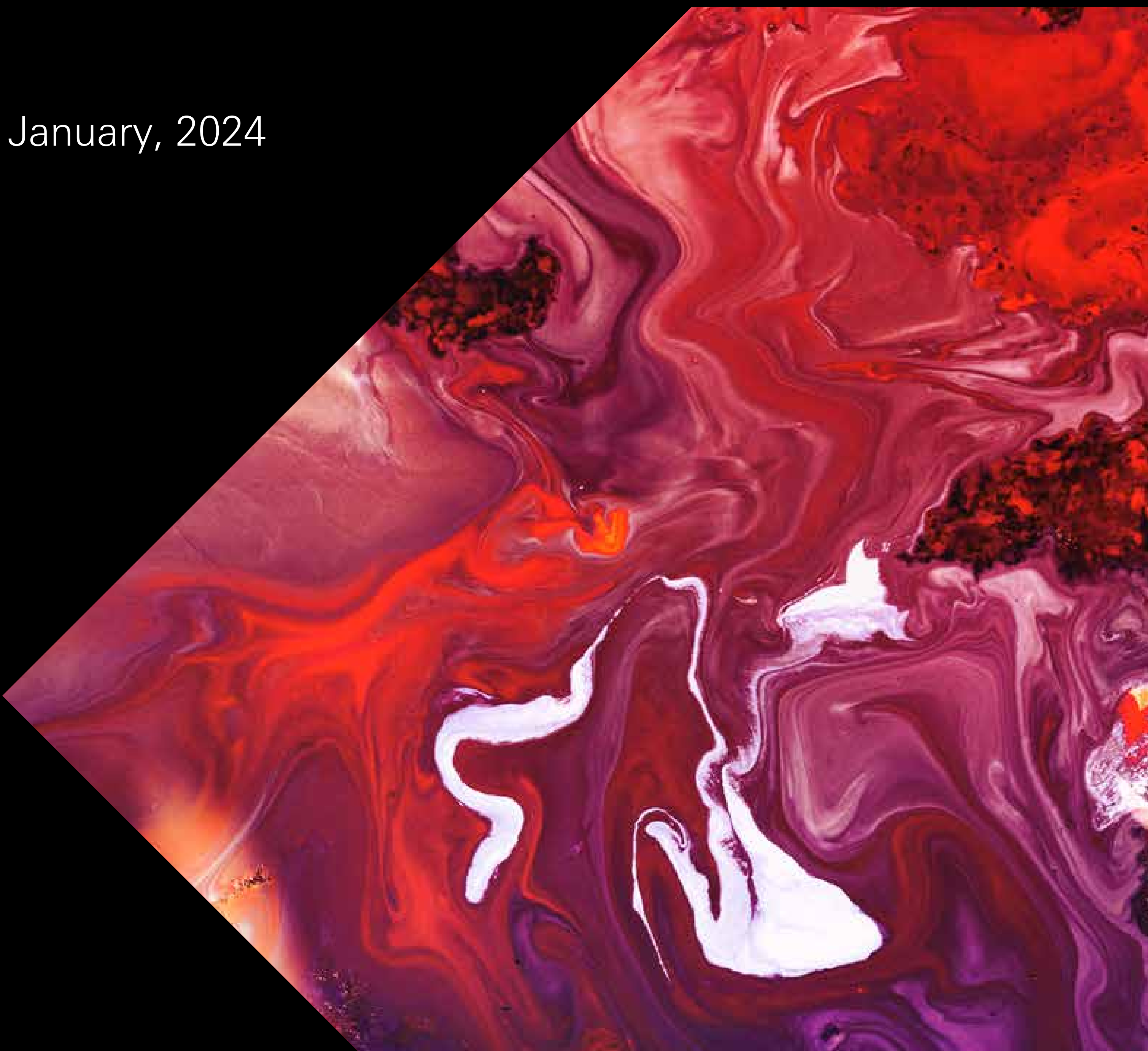
HSBC Mutual Fund

Debt Market Review

January, 2024

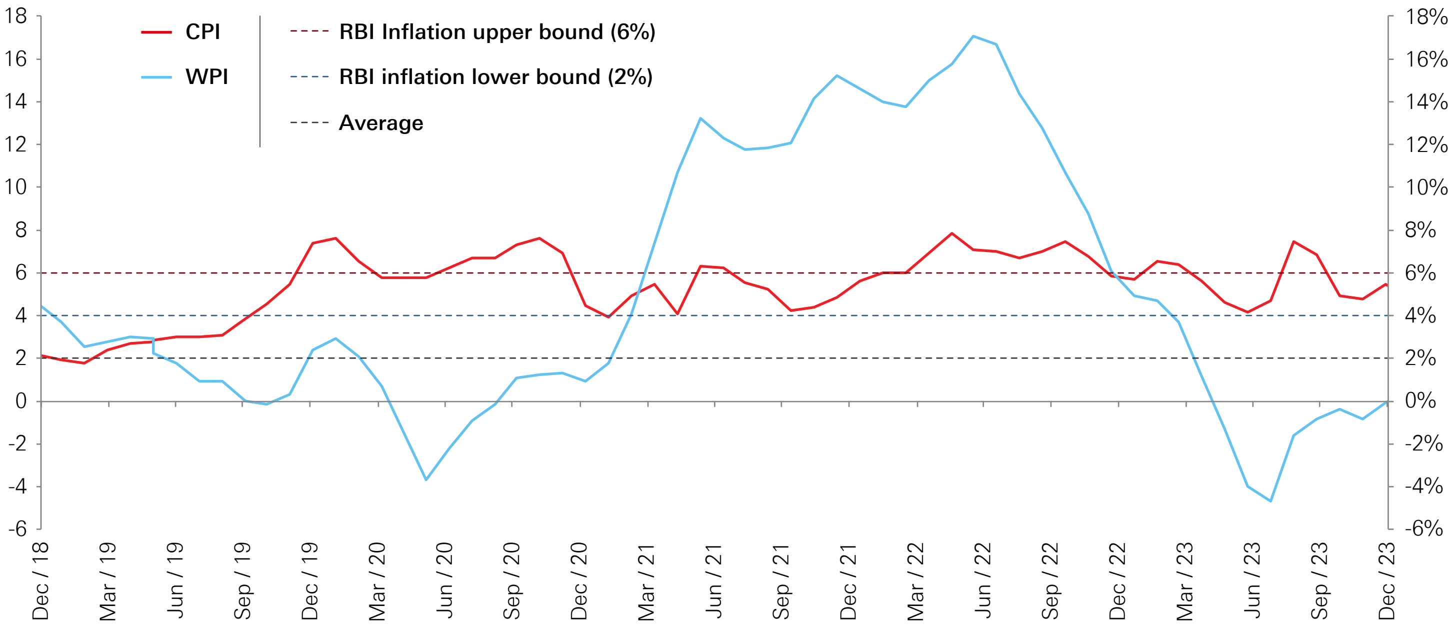


The Federal Open Market Committee (FOMC) maintained status quo on rates in its January policy meeting while removing "additional policy firming" from the statement, hinting that policy rates have peaked. However, they ruled out any easing in March (which markets have been pricing). The Fed Chair indicated that the Central Bank would want to see further progress on inflation and labour market rebalancing before they started easing rates. Among other major economies, the European Central Bank (ECB) and Bank of England (BoE) also left policy rates unchanged, acknowledging that inflation has eased further but remaining data dependent before commencing policy easing. Recent CPI inflation prints in the US, Eurozone and UK came in at 3.4%, 2.8% and 4.0%, respectively. 10-year US Treasury yields traded in the 3.85%-4.20% band during the month, closing at 3.91% (similar to December end) in January 2024. The 10-year vs 2-year spread remained inverted at 30 bps. Crude prices remained range bound during the month, with Brent trading in the USD 75/bbl – USD 83/bbl band.

Domestic Macro-economic Developments

- CPI inflation for December 2023 came in lower than market expectations at 5.69% led by softening in vegetable inflation. Core inflation remained benign, printing at below 4%. Average CPI inflation for Q3 FY2024 stands at 5.4% (20 bps below RBI expectations).

Inflation target and trend



Source: CRISIL, MOSPI, RBI, Data as on 31 January 2024, **Past Performance may or may not be sustained in future.**
Investors should not consider the same as investment advice.

- Trade deficit for December 2023 narrowed to USD 19.8 bn led by lower oil imports and is now at USD 188 bn for YTD FY2024.
- IIP for November 2023 came in sharply lower at 2.4%, partly due to unfavourable base effect. For YTD FY2024, IIP growth stands at 6.4%. GST collections for the month continued to remain robust at INR 1.72 trillion (y-o-y growth of 10.4%).
- Liquidity remained in deficit through the month (despite G-Sec maturity) partly due to increase in currency in circulation. RBI continued to provide short term liquidity through Variable Rate Repo (VRR) auctions. FX reserves were reported at USD 616.7 bn as of January 26, 2024.
- FPI investments in Indian Government Bonds (IGBs) for the month stood at ~ USD 2.4 bn, taking the total investments since the J.P. Morgan index inclusion announcement to ~ USD 6.8 billion.

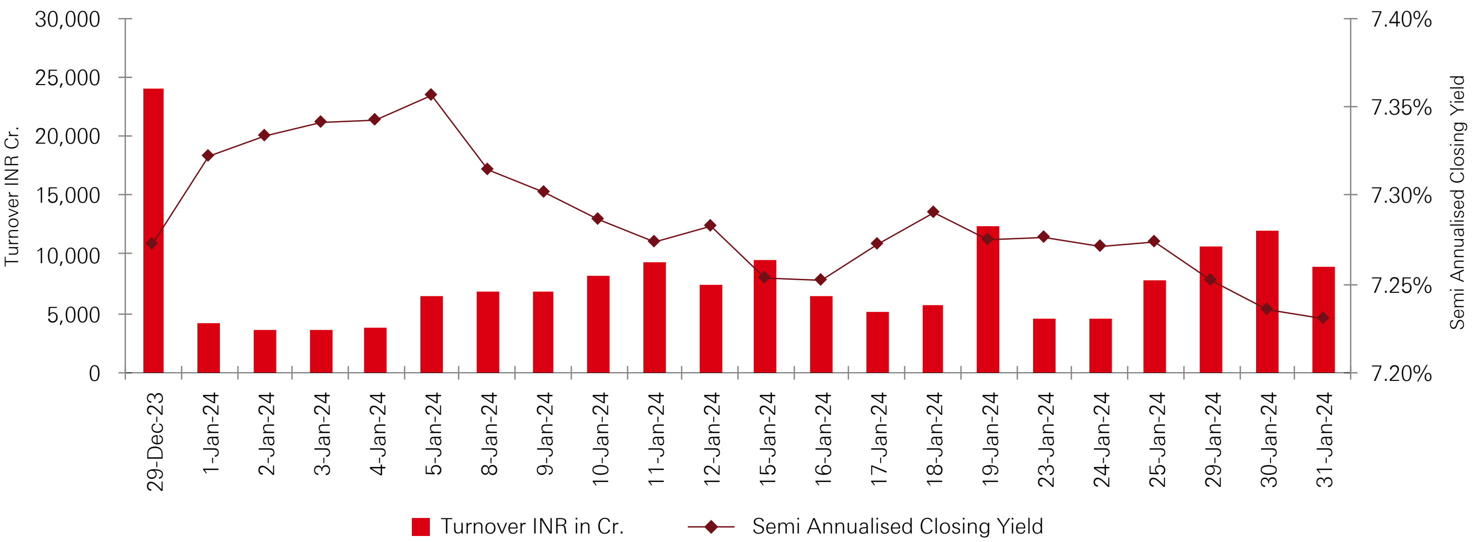
Interim Budget 2024

The Finance Minister announced the Interim Budget on February 01, 2024. Despite markets expecting some populist measures, the Government continued its focus on fiscal consolidation without compromising on growth. The Fiscal Deficit for FY2024 has been revised to 5.8%, against a Budget Estimate of 5.9%, while the Fiscal Deficit for FY2025 is projected at 5.1% (lower than market expectations of ~ 5.3%). This puts the Government in a good position to achieve the 4.5% target by FY2026. Gross market borrowing for FY2025 was announced at INR 14.1 trillion, with Net market borrowing at INR 11.8 trillion (including utilisation from GST compensation fund).

Market Movements

G-Sec in the 5-10 year segment inched lower by 4-5 bps during the month driven by continued buying from FPIs. The longer end of the curve saw good appetite from end investors and traders, pushing yields lower by 6 bps in the 14-year security and by 14 bps in the 30-year security during the month. On the other hand, the money market segment moved sharply higher during the month due to tight liquidity and supply pressures. Post the Budget announcement, markets rallied further on account of lower gross borrowing and fiscal prudence demonstrated by the Government. Yields of G-Sec in the up to 5-year segment fell by 3-5 bps, while in the 10-30 year segment moved lower by 7-10 bps.

Movement of 10-Year Gilt Benchmark



Source: CRISIL Fixed Income database. Data as on 31 January 2024, **Past Performance may or may not be sustained in future.** Investors should not consider the same as investment advice.

Outlook

Post the FOMC meeting, Fed fund futures are now pricing in 5-6 rate cuts over the next one year (against 6-7 rate cuts prior to the FOMC). While the volatility in global bond yields may continue and market expectations of the timing and quantum of rate cuts may keep shifting, 2024 is likely to witness an easing cycle across most developed and emerging economies.

Indian bond markets have so far been less volatile relative to global bond markets. While we do expect an easing cycle in India as well, the rate cutting cycle will probably be a shallow one. Given that growth is holding up much better and with the Government's continued focus on capital spending, the need for RBI to support the economy through any dramatic monetary easing measures

Outlook (contd.)

is much less. Prior to the first rate cut, however, RBI is likely to gradually shift the liquidity deficit into a surplus, consistent with an easing cycle. Hence, despite a potential rate cut of only 50 bps, the overnight rates are likely to move down by 75-100 bps on account of the reversal of liquidity conditions, and overnight rates flipping from the top to the bottom of the rate corridor. Additionally, lower gross borrowing announced in the Budget as well as FPI buying on the back of index inclusion as well as strategic allocations will keep demand for IGBs buoyant.

Hence, we believe there is a favourable case to add duration to investor portfolios with a 1.5-2 year investment horizon.

We believe the below mentioned strategies make investment sense:

- With AAA PSU corporate bond yields in the 7.70%-7.85% band, investors can look at bond funds in the 2-5 year maturity segment. **HSBC Corporate Bond Fund** and **HSBC Banking and PSU Debt Fund** are positioned in these segments
- With markets now expecting multiple rate cuts in the US as well as in India through 2024 and 2025, investors may consider allocation to longer duration products such as **HSBC Dynamic Bond Fund** and **HSBC Gilt Fund** to take advantage of such market movements
- And for the next level of alpha seeking investors, adding an element of measured credit risk to these strategies (through products such as **HSBC Medium Duration Fund**), can become a favorable proposition

Scheme name	Potential Risk Class
HSBC Corporate Bond Fund HSBC Banking and PSU Debt Fund HSBC Dynamic Bond Fund HSBC Gilt Fund	see table below

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		

Scheme name	Potential Risk Class
HSBC Medium Duration Fund	see table below

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	

HSBC Mutual Fund

Product Labels

Scheme name and Type of scheme | ***Riskometer of the Scheme**

This product is suitable for investors who are seeking#

HSBC Banking and PSU Debt Fund (Banking and PSU Debt Fund) **-** An open ended debt scheme predominantly 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.

(Benchmark: Nifty Banking & PSU Debt Index)

HSBC Dynamic Bond Fund (Dynamic Bond Fund) **-** An open ended dynamic debt scheme investing across duration. Please refer to the SID for explanation on Macaulay duration. Relatively high interest rate risk and relatively low credit risk.

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

(Benchmark: NIFTY Composite Debt Index A-III)

HSBC Gilt Fund (Medium to Long Duration 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.

(Benchmark: Nifty All Duration G-Sec Index)

HSBC Medium Duration Fund (Medium Duration 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 Page no. 9 of the SID for explanation on Macaulay duration. A relatively high interest rate risk and moderate credit risk.

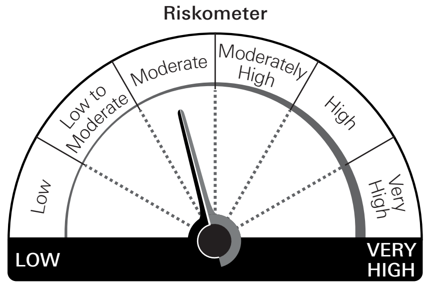
- Generation of income over medium term
- Investment primarily in debt and money market securities.

(Benchmark: NIFTY Medium Duration Debt Index Fund B-III)

HSBC Corporate Bond Fund (Corporate Bond Fund) **-** An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds. A relatively high interest rate risk and relatively low credit risk.

- Generation of regular and stable income over medium to long term
- Investment predominantly in AA+ and above rated corporate bonds and money market instruments.

(Benchmark: Nifty Corporate Bond Index)



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.**

Please refer notice cum addendum available on website of HSBC Mutual Fund for updates on riskometer/product labeling of the scheme. Riskometer is as on 31 January 2024.

Source: Bloomberg & HSBC MF estimates as on Jan 2024 end or as latest available

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Mutual Fund investments are subject to market risks, read all scheme related documents carefully. CL1122