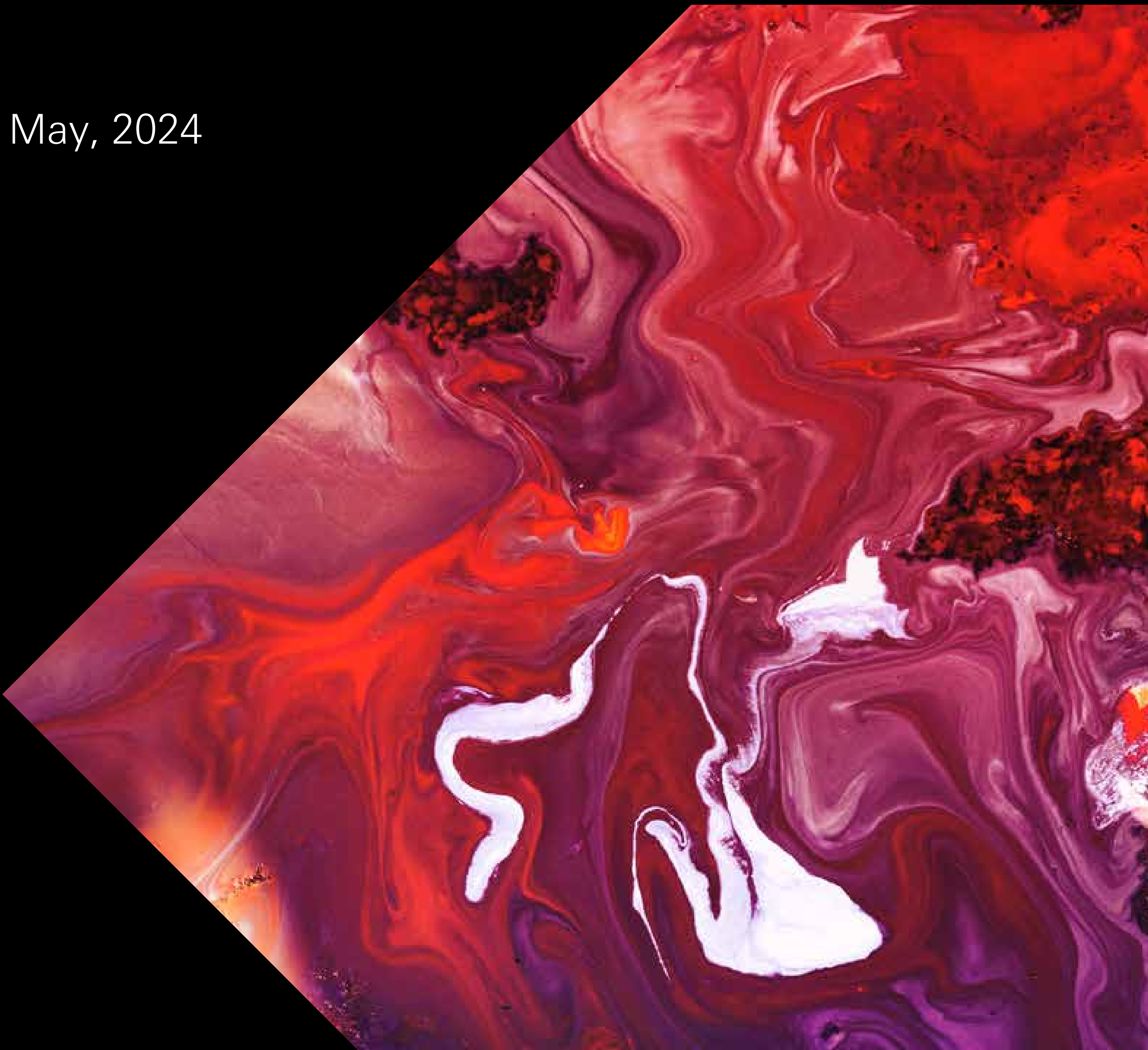
HSBC Mutual Fund

Debt Market Review

May, 2024

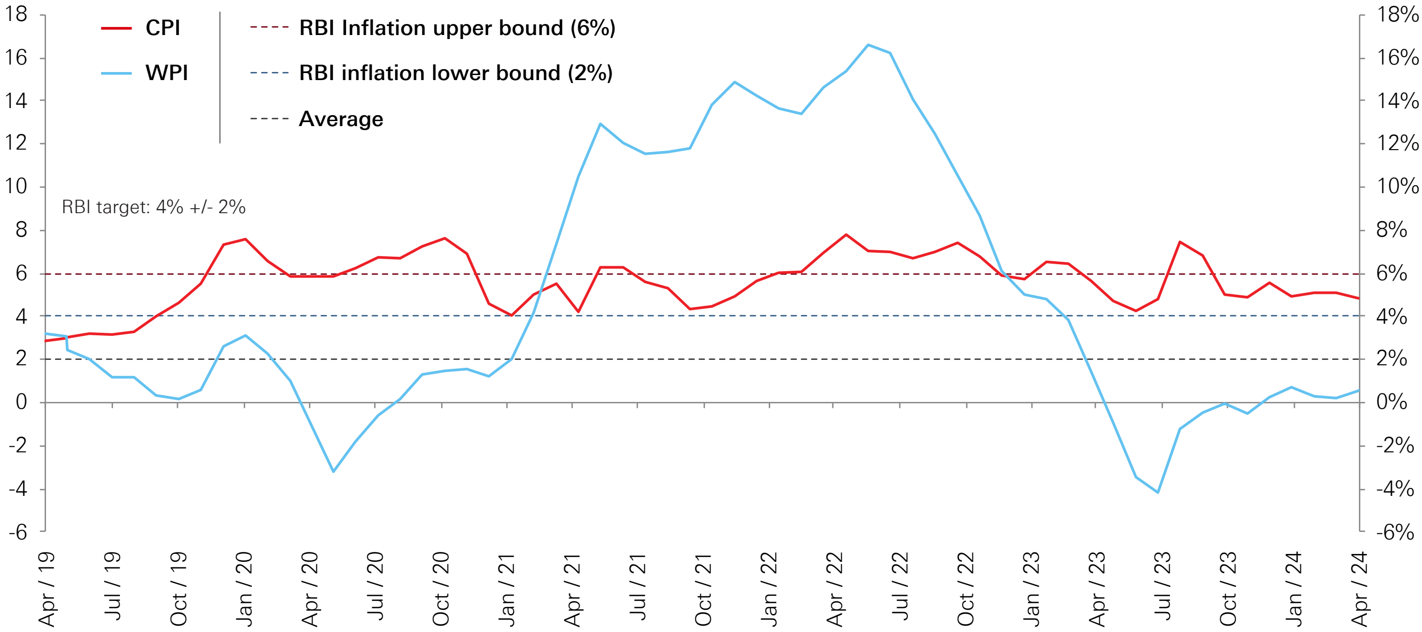


The FOMC minutes were published on May 22, 2024. The key takeaway for the market was that FOMC would wait for more evidence before deciding on when to commence easing. Markets are now pricing in a 60% probability of a rate cut in Sep 2024. The BOE kept policy rates unchanged, amid indications of moderation in inflation and will continue to monitor incoming data.

US Treasury yields remained volatile during the month and traded in the 4.35%-4.65% band. The 10 year vs 2 year spread remained inverted at ~ 40 bps. Crude prices remained range bound, trading in the USD 81/barrel to USD 84/barrel band.

On the domestic front, CPI inflation for Apr 2024 came in broadly unchanged at 4.83%, with Core inflation remaining benign at 3.2%. Food inflation has remained elevated, with the outlook going forward contingent on monsoon. GDP growth for Q4 FY2024 printed much higher than expected at 7.8%, driven by investment and growth. The Q3 number was revised up to 8.6%, taking the full year GDP growth to 8.2%. GVA growth for Q4 FY2024 came in at 6.3%, taking full year GVA growth to 7.2%. Nominal GDP growth for FY2024 comes out to 9.6%.

Inflation target and trend



Source: CRISIL, MOSPI, RBI, Data as on 31 May 2024, **Past performance may or may not be sustained in future and is not a guarantee of any future returns.**
Note - The details provided above is as per the information available in public domain at this moment and subject to change. Please consult your financial advisor for any investment decisions

RBI transferred a record surplus of INR 2.1 trillion to the Govt. (significantly higher than last year's transfer amount of INR 870 billion). This was against a Budget estimate of around INR 1 trillion of surplus transfer from RBI and PSU Banks. This surplus creates a buffer of 0.4% of GDP for the Government, providing them with three options: (a) reduce deficit, (b) increase capital expenditure, or (3) mix of both.

The revised estimate for the Fiscal deficit for FY2024 came out at 5.6%, 20 bps lower than Revised Budget Estimate (RE) of 5.8%. Additionally, deficit for States for FY2024 came in at INR 8.1 trillion, resulting in a State Fiscal deficit of 3.1% of the GSDP (Gross State Domestic Product).

In another positive move, Global Rating Agency S&P Ratings upgraded India's sovereign rating outlook to positive from stable, while reaffirming the overall rating at 'BBB-'. The change in outlook was attributed to India's robust growth, fiscal prudence and consolidation and improved quality of Government expenditure. This also creates possibility of a rating upgrade over the next 2 years. Although this might not have an immediate impact, but it is positive from a medium-term perspective.

Liquidity has remained in deficit during the month; however, it turned marginally positive on month end due to GOI spending. As per the recent available data, GOI balance is estimated to be around INR 5.2 trillion. The high Government surplus is on account of built up of cash balance during the election period due to no additional spending and due to higher-than-expected RBI dividend. Markets have seen some measures taken by the Government and RBI to provide liquidity to the system: (a) RBI has continued to conduct VRR auctions to manage liquidity, (b) GOI reduced the T-Bill borrowing for this quarter by INR 600 billion, (c) Government has conducted buy back auctions of near-term maturing G-Sec, but unfortunately these auctions have not taken off so far. They have only been able to garner about INR 230 billion, and (d) RBI did not accept any bids in the Sovereign Green Bond auction in the last weekly auction.

Liquidity is expected to improve over the coming months due to various factors: (a) Net G-Sec supply this month is almost zero due to maturity of two G-Sec securities, (b) The coupon payments for G-Sec and SDLs this month is substantially high which will infuse liquidity, (c) T-Bill borrowing will be lower, with weekly auctions reduced to INR 120 billion, (d) FPI inflows on account of index related buying will begin this month, and (e) Government might want to accelerate spending given that they are sitting on high cash balance. This also aligns with our expectation that markets will first see easing of liquidity by RBI, prior to any policy rate easing.

G-Sec yields rallied during the month, with the 5-10 year segment lower by 10-15 bps and the longer end lower by 15-17 bps. G-Sec outperformed both SDL and Corporate bonds during the month while OIS levels moved broadly in line with G-Sec.

Outlook

While US markets have braced for “higher for longer” rates, we have seen in the past, that reactions to favorable data in such an environment can be sharp. Any softness in growth, employment or inflation data over the next few months will allow the markets to quickly start pricing in aggressive future policy easing. In our view, the RBI is also likely to gradually shift the liquidity deficit into surplus over the course of the next 3-6 months, flipping overnight rates from the top to the bottom of the rate corridor. The yield curve is likely to steepen as liquidity eases. This along with a potential 50 bps of policy easing in first half of CY2025 may push overnight rates lower by 75-100 bps.

We have a positive outlook for interest rates, based on various favorable factors: (a) Record RBI dividend to the Government, (b) reduced Fiscal deficit number of 5.6%, (c) favorable G-Sec supply demand dynamics, (d) FPI index related inflows, (e) revised outlook in India by S&P, (f) soft core inflation along with expectations of a better than normal monsoon, and finally (g) soft signals by Government and RBI on liquidity.

Accordingly, 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 trading at favourable levels, investors can look at bond funds in the 2-5 year maturity segment. **HSBC Short Duration Fund** and **HSBC Corporate Bond Fund** are positioned in these segments
- To play the duration theme going forward, investors may consider allocation to longer duration products such as **HSBC Dynamic Bond Fund** and **HSBC Gilt Fund** to take advantage of such a market movement
- And for the next level of alpha seeking investors, adding an element of measured credit risk to active duration strategy (through products such as **HSBC Medium Duration Fund**), can become a rewarding proposition

Scheme name	Potential Risk Class
HSBC Dynamic Bond Fund HSBC Corporate 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 Short 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)	A-II		
Relatively High (Class 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	

Product Labels

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

This product is suitable for investors who are seeking#

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 Short Duration Fund (Short Duration 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.

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)

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.

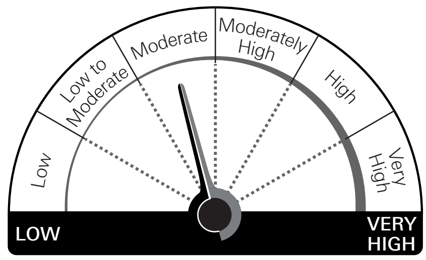
(Benchmark: Nifty All Duration G-Sec Index)

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)

Riskometer



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 29 February 2024.

HSBC Mutual Fund

Source: Bloomberg, MOSL & HSBC MF estimates as on 30 May 2024 or as latest available

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial advisor for any investment decisions.

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HSBC Mutual Fund, 9-11th Floor, NESCO - IT Park Bldg. 3, Nesco Complex, Western Express Highway, Goregaon East, Mumbai 400063. Maharashtra.

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Mutual Fund investments are subject to market risks, read all scheme related documents carefully. CL1492