DSP CONVERSE AT A GLANCE

MAR-2024

BE LONG BONDS: VOLATILE YIELDS, BUT TREND IS LOWER

As we have always said - during inflection, markets are volatile. In the middle of a bull cycle, any retracement is usually bought into. However, during inflection the markets are wary - for 2 reasons: Firstly, a segment still believes that the yields will not retrace, and wait for conclusive sign. Sometimes they are right, sometimes not. Secondly, and more importantly, is **recency bias**. Only recently 10Y yields were at 7.40%. So, 7.05% yield may seem like a big rally. After all, 35bp move in 5 months is a big move for Indian markets.

Yet, we maintain that the yields will continue to fall. Why?

Because when yields were 7.40% - it was an outlier, and was driven by UST > 5%, and RBI OMO threat. 10Y yields usually found a support in 7.15%-7.25%. Thus, the rally is 10bp-20bp; it does not reflect the underlying change in data in past few months, namely (i) US FED has opened up to rate cuts in future, (ii) India's core inflation has trended to 3.3%, (iii) FPI money is coming in droves, (iv) election fears largely vanished, and (iv) most importantly, India's budget showed fiscal consolidation and lower borrowing in FY25.

So, it may seem that Indian yields have rallied a lot, but the party may not end soon. Next quarter will (i) see bond inclusion flows, and (ii) Rate cuts coming nearer. Markets will be volatile so tighten seat belt, cuz this "yield roller coaster" is going down.

OUR POSITION

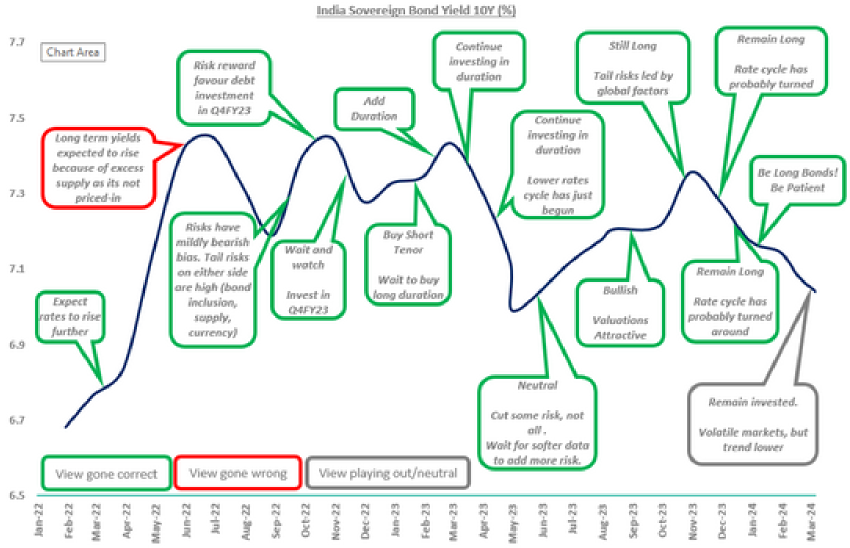
We remain long duration across funds. We continue to wait for our view to play out even further.

We like 20Y+ bonds due to demand from bond inclusion and PF/Insurance. However, we are wary of H1FY25 G-sec issuance calendar to be released in Mar end. So we remain hedge a bit in 10Y.

DSP remains the fund house for those who have a view to buy bonds.

Risks?
Risk of transient yield uptick as UST rises.

As yields move lower, risks of RBI announcing **OMO sale** increase. With index inflows still a few months away, and India 10Y above 7% we believe there is still time for this risk to play.



SNAPSHOT OF OUR VIEW

View complete DSP Converse presentation at dspim.com->Tools and Resources->Insights->Converse

		Q4FY24	Q1FY25	Q2FY25	H2FY25	FY26	SLIDES IN CONVERSE
	RATES VIEW	Yields to move lower, though with some volatility.					
MONETARY POLICY	INFLATION	Core inflation lower at 3.3% Headline inflation is volatile.					#12
MONETARY POLICY	GROWTH	Growth in "neutral zone"	Signs of growth sputtering in future - but no strong evidence yet.				#13
MONETARY POLICY	CURRENCY	Normalized trade deficit, FX reserve above $600bn	Much uncertainity on global macros, risk appetite and capital flows				NA
FISCAL POLICY	SUPPLY	Low supply in FY25 budget					#21, #23
FISCAL POLICY	DEMAND	Bank may reduce SLR holding, HTM regulations	PF/Insurance growth will outstrip Gsec supply growth.				#19, #22
FISCAL POLICY	FPI FLOWS	Further flows will come.					#23
GLOBAL DRIVERS	COMMODITIES	Oil and other commodities have retraced to neutral zone. Future course difficult to ascertain.					NA
GLOBAL DRIVERS	GEO-POLITICS	Escalation of Ukraine, US-China and Gaza seem to have abated.					NA
GLOBAL DRIVERS	GLOBAL YIELD	Global economy faltering		Difficult to project macros too much in future			#8, #25
OTHERS	ELECTIONS	After State election results, risks to general elections abated. However, risks still remain					NA
OTHERS	RBI REGIME	Liquidity irrelevant as RBI manages the overnight at repo rate Rupee risks abataed, probably will cut rates along other central banks					#27

We have added this section to showcase the frequent questions that we are asked on DSP CONVERSE in specific, and fixed income markets in general.

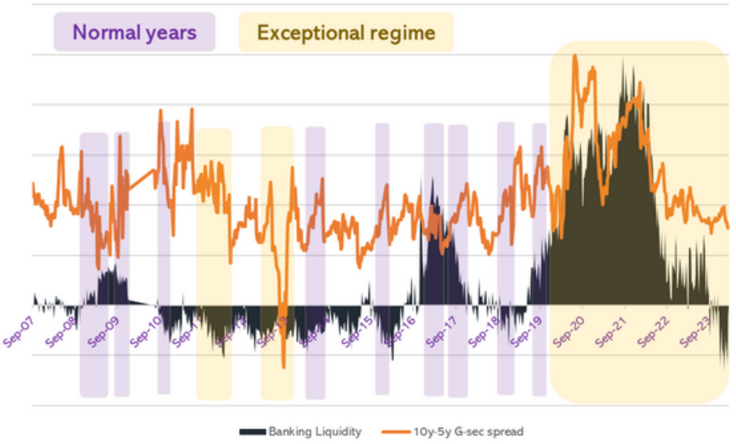
1 If liquidity eases, curve steepens. Should we invest in shorter tenor bonds?

No. The first statement is not always correct, and arises from anchoring bias and recency bias. We don't agree with the second statement as well.

Let's look at the first statement. A cursory look at empirical charts may give the impression that easier liquidity leads to steeper curve. But this has only occurred lately and is not the norm,

Only in exceptional years did liquidity lead steeper curve.

- Year 2013 when 300bp hike in 1 day distorted the curve.
- Years 2020 to 2023 were exceptional years when covid actions and their reversal led to wild swings in liquidity.



The time between 2005-2016 (barring 2013, 2008) were "normal" regimes. During these "normal regimes" excess liquidity led to flatter curve and vice versa. Contrary to what has happened in the past few years.

Why does market act differently in "normal regimes"? Two reasons.
First, during liquidity surplus, banks have cash to take risk and add long bonds (theoretically it shouldn't matter as G-secs are repo-able, but there is empirical evidence).
Second, easier liquidity coincides with dovish policy. Thus, preference of market is capital gains - hence add duration.

Are we back to "normal regimes"?

Somewhere in between. Remember when RBI sucked out liquidity late last year, the G-sec curve steepened as the banks sold excess gilts. That's a "normal regime". However, there are still bouts of the old regime - a drop in liquidity has at times led to rally in short tenor. With time, we will move further into the "normal regime.

So, the right question to ask is "Shall we invest in short tenor or long tenor on liquidity anticipation?"

For real money: Blindly long tenor - according to me. Traders may play with shorter tenor on PV01, but we play on cash. Why?

Because liquidity infusion will lead to rally, and curve could bull flatten, or bull steepen. Bull flattening obviously helps long tenor bonds as one gains from lower yield and lower spread. Bull steepening is more nuanced but likely helps long tenor bonds. Why?

Because profit/loss in 1 bp move in 30Y bond = 4bp move in 4Y bond. What does it mean? Even if 30Y bond moves from 7.15 to 7.05 and 4Y Gsec from 7.07 to 6.67, you will make more money in 30Y. Or if 30Y bond moves 20bp to 6.95, and 4Y by 80bp to 6.27. While the curve may have steepened by 70bp, but you make more money in the bond whose yields have fallen less- the 30Y one.

Long story short - We prefer long bonds.

Note: Some have discussed about volatility/returns ratio. I fear this justification is being undisciplined. Why? If one has used this metric in the past to evaluate performances then it's fine. However if one is suddenly using this metric to justify a trade it is cherry picking. Most probably one has made a view, and then picking reasons. But then, to each his own.

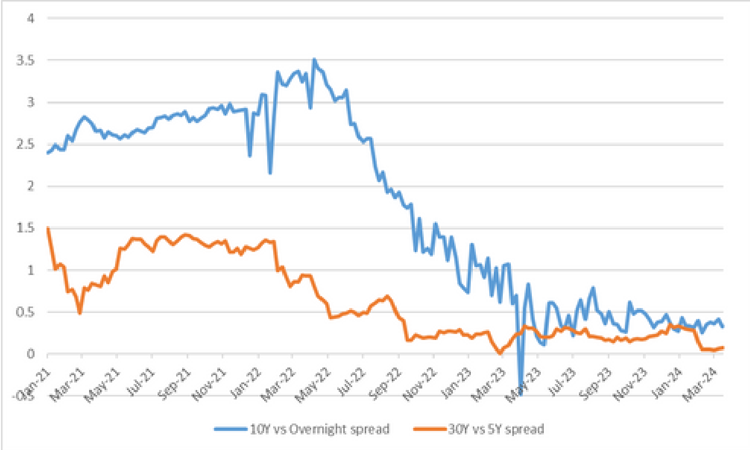
2 Domestic demand is growing at historical pace. So why harp about it?

We have been consistently saying that in India the annual G-sec regulatory demand growth from PF/Insurance and Banks is more than 12%, while G-sec issuances are much lesser. This has, and will, lead to favorable demand /supply pulling the yields lower.

Many of you have asked, what is so new about it? Demand has been there for years, so why should it impact more this year? Right on the first part, wrong on the second part. Let us give empirical evidence.

Evidence #1: Lower 10Y vs overnight rate spread. India's PF, EPFO, NPS, Life Insurance, General Insurance and Banks' NDTL (deposit) growth has been strong. After a post covid spike in 2020 G-sec supply has narrowed. So have the 10Y spreads vs overnight rates. From 250bp to just 50bp. Why? because the domestic demand in dated papers is much more than the domestic supply.

Evidence #2: Lower 30Y vs 5Y spread . PF/Insurance are natural buyers of long bonds. And their growth has been the highest. Unsurprisingly, the 30Y vs 5Y spread has since 2021 crashed to 10bp from 150bp!!! This is despite the increase in share of 20Y+ maturities from 21% in FY17 to 35% in FY24, whereas the share of 5Y has reduced from 21% to 18%. Put it in perspective. The long bonds supply 7 years back was same as short bond supply. Today it is twice. Yet spreads have compressed.



And this trend will continue. The spread compression with overnight will continue i.e irrespective of quantum of rate cuts, the bonds will rally. Moreover, the demand for long bonds is heavy. RBI does not have any long bonds to sell from its kitty (its balance sheet has only (20y bonds). Unless RBI increases the share of issuances of long bonds further, the curve will keep on flattening.

But, will RBI increase the share of long bonds even further? That's the last question we answer.

3 Will RBI increase the share of long bonds even further?

Prima facie it seems that they should. After all give supply where the demand is.

Unfortunately the answer is not so simple.

During my Primary Dealership days, I remember the meetings with RBI. During those years the demand for longer maturity was less and market participants wanted more issuances of shorter tenor bonds.

But RBI refused, and rightly so. Because short term bonds run a rollover risk at maturity. If RBI were to increase the supply in shorter tenor, then at maturity of those bonds if yields had risen (for whatever reasons) Govt would have to raise fresh money at much higher yields.

It was better to take pain in short term (issuances at mildly high yield), and protect against future risk (risk of rollover at much higher yield).

Today its the mirror argument - RBI is expected to do the opposite i.e. increase long bonds supply. But, what is the harm of increasing long bonds supply? Does it not reduce the rollover risk further?

Any extreme is not good. While higher long term issuances may seem prudent right now when the country is chugging along so well, but it adds another future risk if things turn bleak.

Risk would materialize if India's nominal growth reduces significantly after a few years. Imagine after 20 years India's nominal growth hits 8% (like China). The interest burden on outstanding bonds at 7% would create a drag on govt expenditure.

Yes, this scenario is not expected. But in a time horizon of 30y-40y one can't rule out. And prudent risk management says that do not put all eggs in same basket.

And when 35% of FY24 issuances is in 20Y+ bucket, increasing it further may not be amenable to RBI. Or it may. There is no such precedent or research in India.

If RBI does not increase long bond issuance, then RBI risks 10Y vs 30Y inversion. To be sure, such inversions are commonplace world over. But in India it adds risks in insurance and PF sectors balance sheets.

We don't know what according to RBI is lesser evil. They may increase the share of long bonds this year. But then, what will RBI do in FY26? After all the gap between fiscal consolidation (supply) and insurance/PF growth (demand) should continue the trend.

There is no easy answer. At least, none that we know.

How are we playing this?

We remain invested in 30Y and 40Y. If there is no increased issuances in long tenor, we benefit immediately. If the issuances increase the yields may spike but it will be transitory. The natural demand will soon narrow the long bond spreads.

We will treat this as noise, and play structurally.

Mar 2024

DSP

#INVESTFORGOOD

Be long bonds: Volatile yields, but trend is lower

DSP CONVERSE

Our Framework

Monetary Policy

Inflation
- Feb print unchanged at 5.1%
- Core moderates below 3.5%
- Fuel price cut of 2/ltr

Growth
- Domestic activity is resilient so far
- Continued caution in Q3 commentary
- Overall credit growth remains strong at ~20% YoY

Currency/CAD/BOP
- External sector pressures remain low
- INR risks have abated – Debt FPI flows started
- Trade deficit moderates in Jan to a 9m low of $17.5bn

Fiscal Policy

Supply
- FY24 G-sec auction behind us
- Q4 SDL auctions lower than calendar
- Healthy NSSF deposit accretion

Demand
- Banks SLR holding has reduced marginally
- FPI demand to continue

FPI
- FPI bought ~INR70k crores since Oct'23
- Inclusion in Bloomberg EM Index
- FTSE review in Mar may add further demand

Global Drivers

Global Yields
- US Data remains resilient
- Fed Funds Projected Rates now pricing 3 rate cuts

Geopolitics
- China/US in limbo
- Ukraine Russia conflict is in backburner
- Israel-Palestine Conflict so far remains contained

Commodities
- Price risks are evenly balanced

Others

RBI Regime
- Cautious but nimble
- Cautious on last mile dis-inflation
- To remain "nimble" in liquidity management
- Fine tuning o/n rate through VRR and VRRR

Misc.
- Low risk of General election results

Positive

Neutral

Negative

Takeaway:
Domestic environment steady, US pricing of rate cut expectations to drive bond yields

DSP

CAD – Current Account Deficit; BoP – Balance of Payment; SLR – Statutory Liquidity Ratio; SDL – State Development Loans; RBI: Reserve Bank of India; G-Sec: Government Securities; FPI: Foreign Portfolio Investment; NSSF: National Small Savings Fund; VRR: Variable Repo Rate; VRRR: Variable Reverse Repo Rate; o/n: Overnight

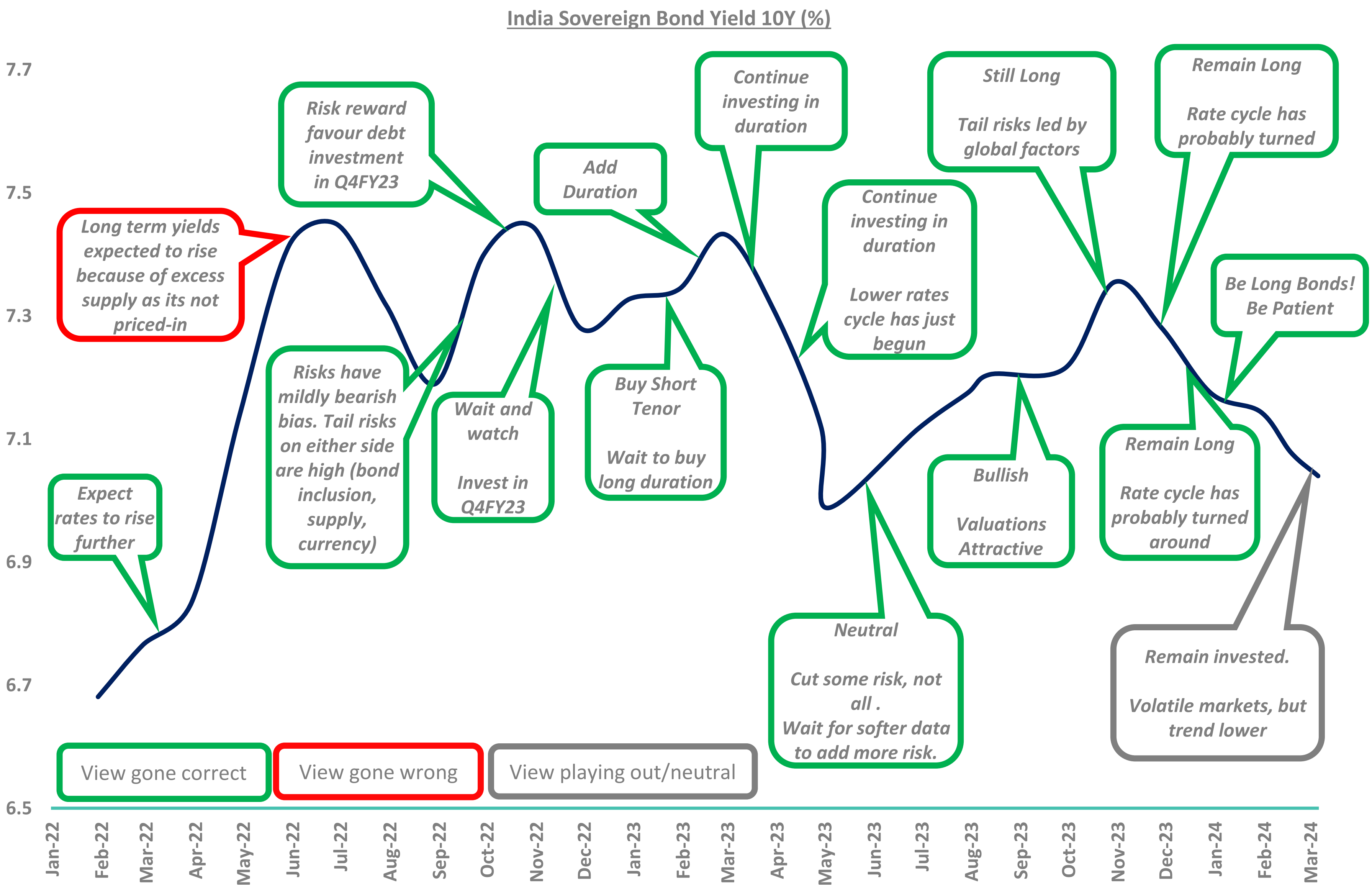
SUMMARY

Be Long! Why?

Domestic macros supportive of lower yields

However, globally data resilient and rate cuts priced in

Let's revisit our rates call trajectory



TRAJECTORY

DSP

Source – Bloomberg, Internal

To start with,

Recap of events since last DSP CONVERSE release.

RBI Policy

US Fed removes reference to "additional policy firming" but needs "greater confidence" to cut

US Data showing resilience

RBI's maintains status quo

- **REPO rate unchanged at 6.5%**

- **Stance retained at "focused on withdrawal of accommodation"**
  - ✓ By a majority of 5 out of 6 members

- **Inflation Projections unchanged for FY24 and lower by 20bps for Q4**
  - ✓ Rabi sowing has surpassed last year's level
  - ✗ Considerable uncertainty prevails on the food price outlook and crude oil prices, however, remain volatile
  - ✗ Remain vigilant to ensure that we successfully navigate the last mile of disinflation as 4.0% target yet to be reached

- **FY25 Real GDP projection at 7.0%. Revised up for Q1/Q2/Q3FY25**
  - ✓ Sustained profitability in manufacturing and underlying resilience of services to support growth
  - ✓ Household consumption expected to improve and prospects of fixed investment remain bright
  - ✗ Headwinds from geopolitical tensions, geo-economic fragmentation and volatile financial markets

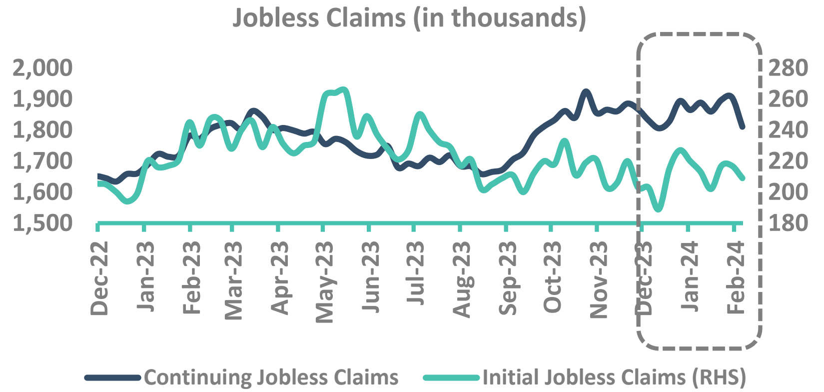
DSP

RBI: Reserve Bank of India; GDP: Gross Domestic Product

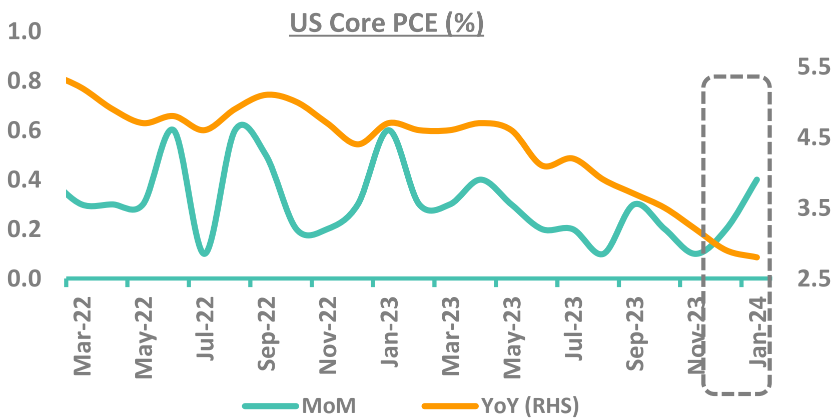
WHAT HAS CHANGED

US data shows resilience and Fed not to rush into cutting rates

➢ The US jobs market showing resilience



➢ And the same is true for inflation as well



➢ US Fed needs "greater confidence" to cut rates

- Economic activity expanding at solid pace vs concerns around slowdown in previous policy
- Removes reference to "additional policy firming"
- Raised the bar for a March cut
- Fed fund projected rates now pricing-in 3 rate cuts till Nov'24 vs 6 rate cuts during last converse

Fed Fund Projected Rates				
Fed Policy	As of last converse		As of 14th Mar	
	Implied Rate	No. of cuts/hike	Implied Rate	No. of cuts/hike
Mar'24	5.143	-0.743	5.328	-0.008
May'24	4.858	-1.881	5.302	-0.111
Jun'24	4.544	-3.140	5.166	-0.653
Jul'24	4.295	-4.135	5.048	-1.128
Sep'24	3.985	-5.138	4.855	-1.898
Nov'24	3.865	-5.855	4.732	-2.389

Takeaway:
Fed not to rush into cutting rates

DSP

Source – Bloomberg, Federal Reserve

PCE: Personal Consumption Expenditure; FOMC: Federal Open Market Committee

Now our framework

And

What we track

Our Framework

Monetary Policy

Inflation
- Feb print unchanged at 5.1%
- Core moderates below 3.5%
- Fuel price cut of 2/ltr

Growth
- Domestic activity is resilient so far
- Continued caution in Q3 commentary
- Overall credit growth remains strong at ~20% YoY

Currency/CAD/BOP
- External sector pressures remain low
- INR risks have abated – Debt FPI flows started
- Trade deficit moderates in Jan to a 9m low of $17.5bn

Fiscal Policy

Supply
- FY24 G-sec auction behind us
- Q4 SDL auctions lower than calendar
- Healthy NSSF deposit accretion

Demand
- Banks SLR holding has reduced marginally
- FPI demand to continue

FPI
- FPI bought ~INR70k crores since Oct'23
- Inclusion in Bloomberg EM Index
- FTSE review in Mar may add further demand

Global Drivers

Global Yields
- US Data remains resilient
- Fed Funds Projected Rates now pricing 3 rate cuts

Geopolitics
- China/US in limbo
- Ukraine Russia conflict is in backburner
- Israel-Palestine Conflict so far remains contained

Commodities
- Price risks are evenly balanced

Others

RBI Regime
- Cautious but nimble
- Cautious on last mile dis-inflation
- To remain "nimble" in liquidity management
- Fine tuning o/n rate through VRR and VRRR

Misc.
- Low risk of General election results

Positive
Neutral
Negative

Takeaway:
Domestic environment steady, US pricing of rate cut expectations to drive bond yields

DSP

CAD – Current Account Deficit; BoP – Balance of Payment; SLR – Statutory Liquidity Ratio; SDL – State Development Loans; RBI: Reserve Bank of India; G-Sec: Government Securities; FPI: Foreign Portfolio Investment; NSSF: National Small Savings Fund; VRR: Variable Repo Rate; VRRR: Variable Reverse Repo Rate; o/n: Overnight

Resilient domestic economic activity

Expansion in urban demand while rural still not completely out of woods

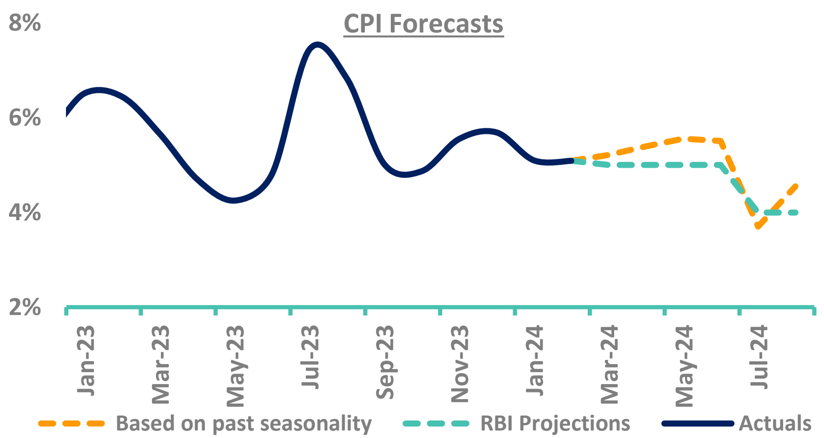
Inflationary risks seem contained

RBI to be nimble in liquidity management

Core moderates further. Risks seem contained

- **Feb CPI unchanged at 5.1%**
  - Increased sequentially by 0.16%
    - ✓ Led by higher food and beverages inflation
    - ✓ While pulses and spices contracted
  - Fuel price cut of 2/ltr announced

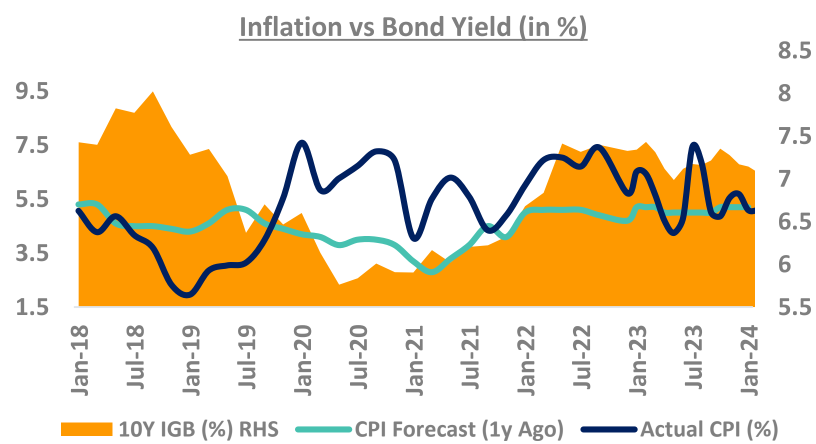
- **Core continues to provide comfort**
  - At 3.4% in Feb (lowest in more than 4yrs)



- **Do yields track inflation projection? No.**
  - Orange area (chart) is 10Y yields, Blue line is CPI

- **Can forecasters predict Indian CPI? No.**
  - Green line is forecasters CPI 1-Yr ahead prediction
  - Blue line is where inflation actually came
  - Guess the error of margin!

- **CPI forecast corelated (not causality) to yields**
  - Low predictive power, high current corelation



Takeaway:
Domestic inflation risks seem contained. Volatility in CPI has not impacted yields (especially in 2023)

CPI: Consumer Price Inflation; RBI: Reserve Bank of India; IGB: India Government Bond

Source – Bloomberg, RBI, Internal

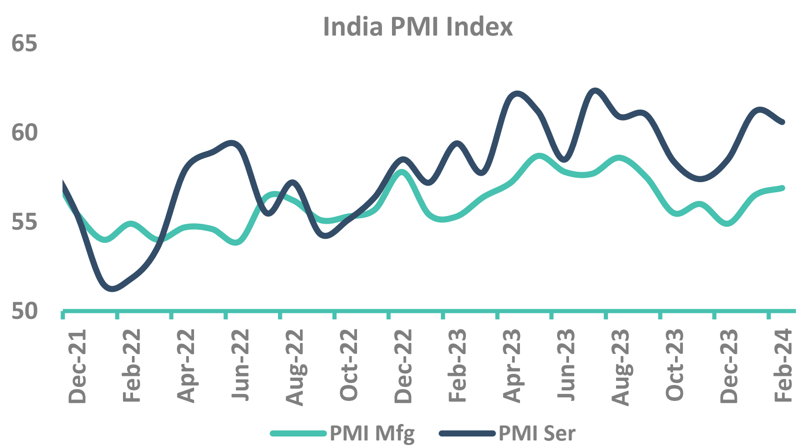
Domestic growth resilient so far: But watch out for trends

➢ Watch out for domestic growth

- PMI is in expansionary mode
- Feb GST collection at 1.68 lac crores (up 12.5% YoY)
- Continued caution in Q3 commentary as well

➢ Overall credit growth remains strong at ~20%

- Even as the unsecured loan growth has slowed down

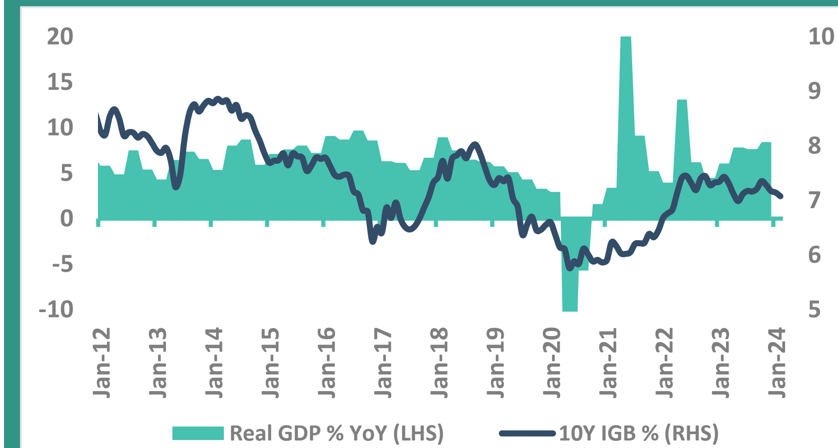


➢ How closely do yields track growth?

- Yields have usually tracked GDP growth, with correlation stronger when growth slows, barring
  - ✓ 2013, rupee depreciation and debt outflows
  - ✓ 2017, during demonetization

➢ FY24, growth may not be big driver for yields

- FY23 GDP growth at 7.2% -in line with RBI projections.
- Q3FY24 GDP Growth came in at 8.4%.



Takeaway:
Domestic growth seems to be resilient so far but watch out for emerging trends

DSP

Source – Bloomberg, PIB, Internal

GDP: Gross Domestic Product; PMI: Purchasing Managers' Index; GST: Goods and Service Tax; IGB: India Government Bond

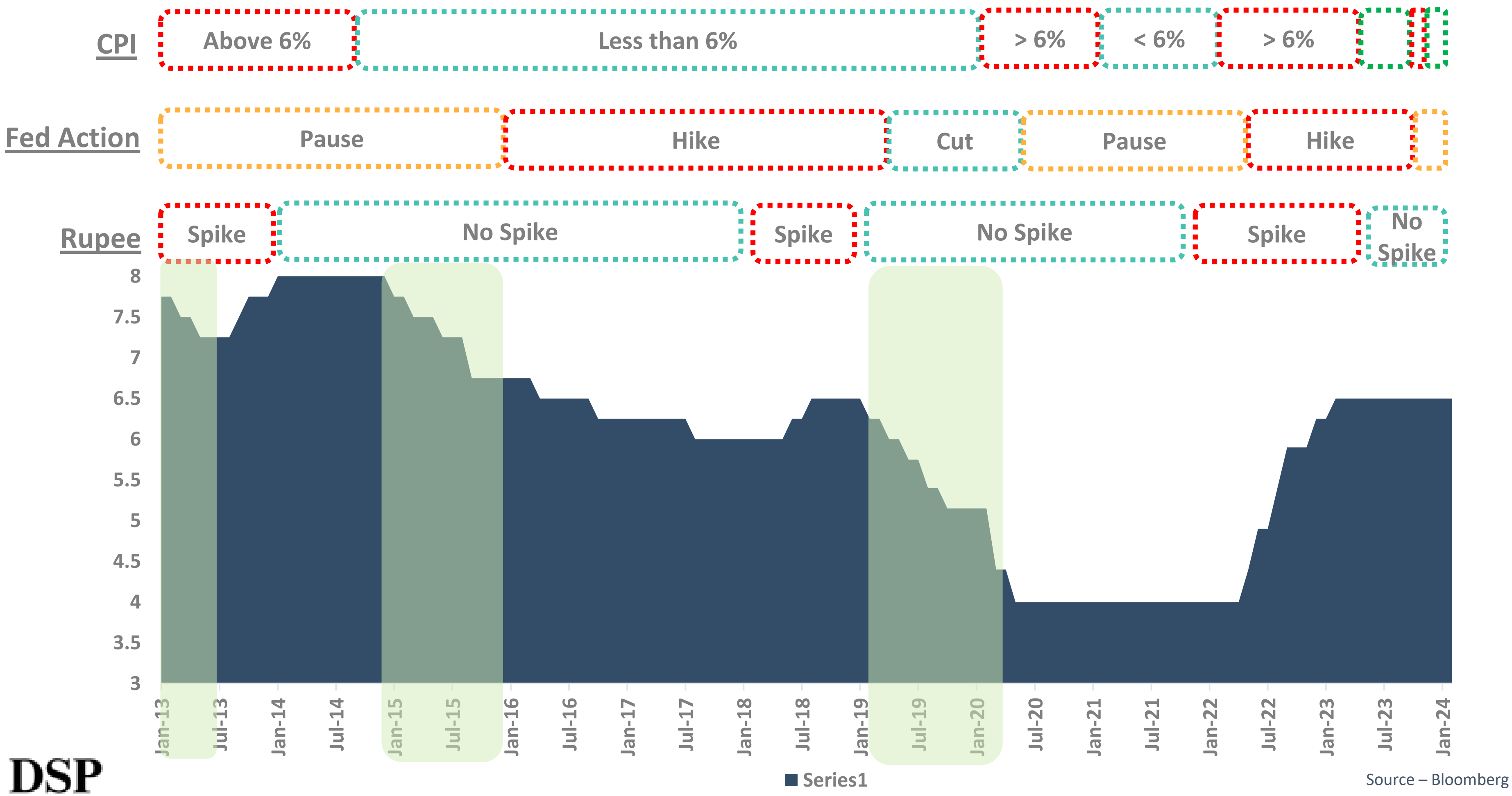
What makes RBI Cut Rates?

MONETARY POLICY

Rate cuts: Waiting for evidence from Fed cuts

- **Checklist for cut:**
  - ✓ Fed Pause/Cut
  - ✓ Stable Rupee
  - ✓ CPI less than 6% (except in 2013 when RBI didn't have 6% target)

- **How is the Checklist now:**
  - • Fed has turned dovish, yet we await cuts
  - ✓ Given the FPI flows, forex reserves at $600bn+ and normalization of trade deficit, rupee to remain stable
  - ✓ Inflation (although expected to remain volatile), RBI to look-through one-off shocks



Source – Bloomberg

DSP

FPI: Foreign Portfolio Investment; CPI: Consumer Price Inflation; Fed: Federal Reserve; RBI: Reserve Bank of India

Core moderates further

Growth remains resilient

FPI flows to support INR

After state election results, low risk in general elections

Let's turn to Fiscal policy

Generally, it drives the long bond yields

It is reflected in demand/supply equation

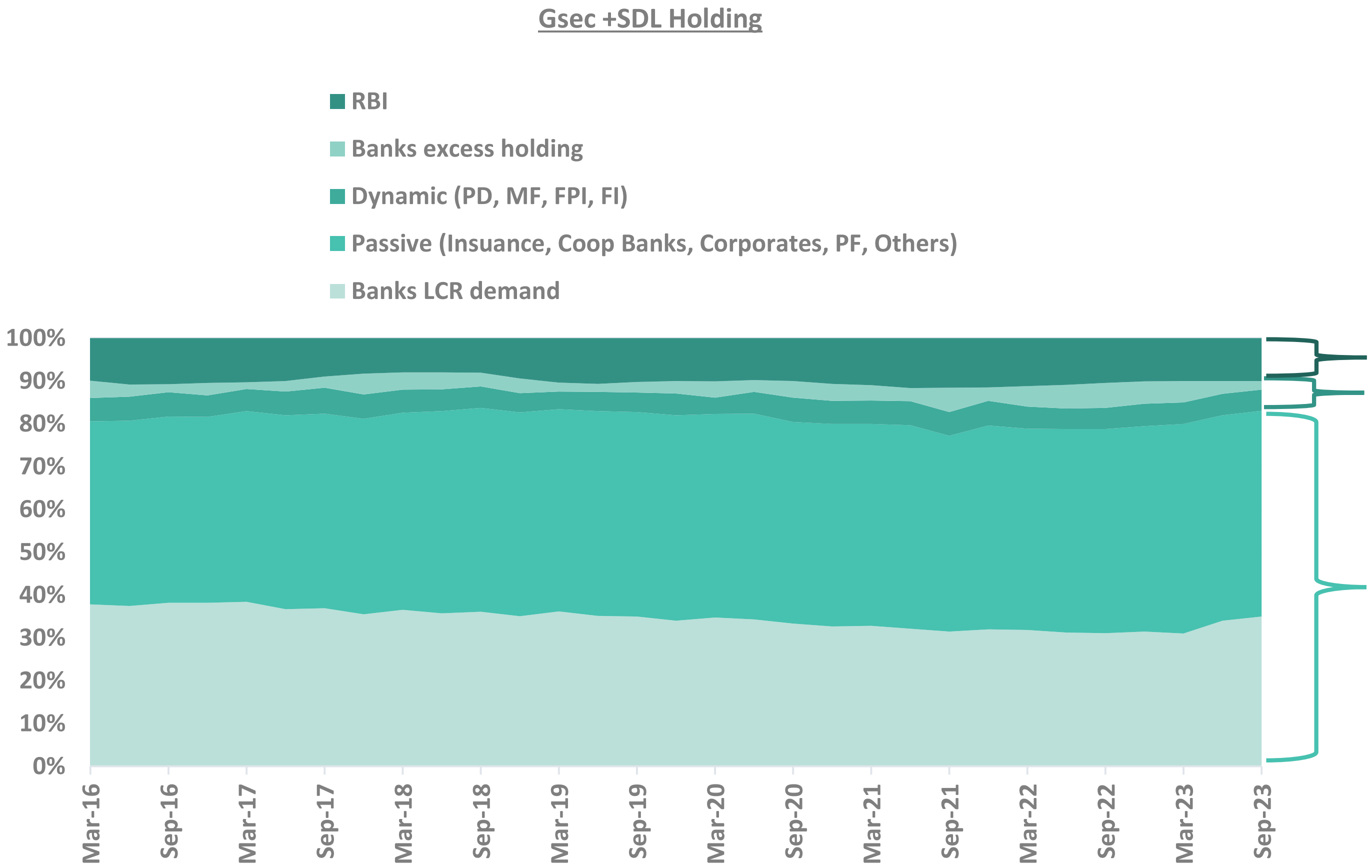
Fiscal policy is favouring bonds right now

Only a small part of bond buyers are discretionary buyers

They drive yields

Supply fluctuation is borne by these buyers

Gsec market is still driven by lumpy institution purchases



RBI buys for liquidity and yield level

Discretionary buyer
Buy based on view

Passive buyers
Buy irrespective of yield movement

Takeaway:
Increase in supply impacts the discretionary buying. Banks excess holding, passive buyers have been absorbing the supply

FISCAL POLICY

DSP

Source – DBIE

LCR – Liquidity Coverage Ratio; SDL – State Development Loans; PF – Provident Funds; PD – Primary Dealerships; MF – Mutual Funds; FPI – Foreign Portfolio Investors; FI – Financial Institutions; RBI: Reserve Bank of India; G-Sec: Government Securities

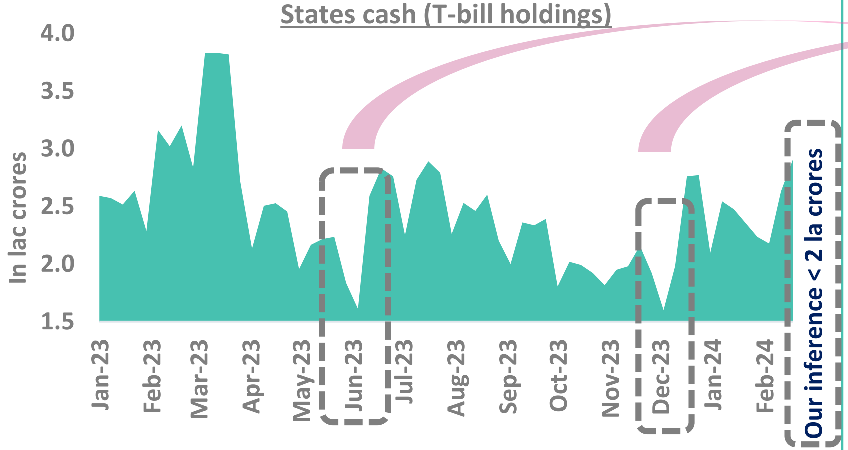
Comfortable demand/supply dynamics for FY25

FISCAL POLICY

SDL supply only increases when states cash dip

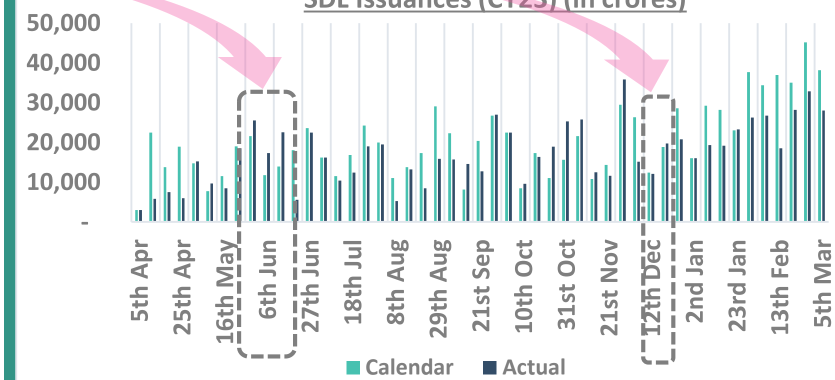
- ➢ **States cash balance remains above 2 lac crores**
- ➢ **Center has front-loaded devolution of tax**
- ➢ **Issuance is expected to be lower than calendar**

States cash (T-bill holdings)



- ➢ **Actual SDL borrowing in line with expectations**
  - Borrowing higher than the calendar only when state cash balances dipped below 2 lac crores
  - YTDFY24 issuance now 15% lower than calendarized
- ➢ **With high states cash balances SDL issuance impact is expected to be limited**

SDL Issuances (CY23) (in crores)



Takeaway:
SDL supply may remain muted in FY24

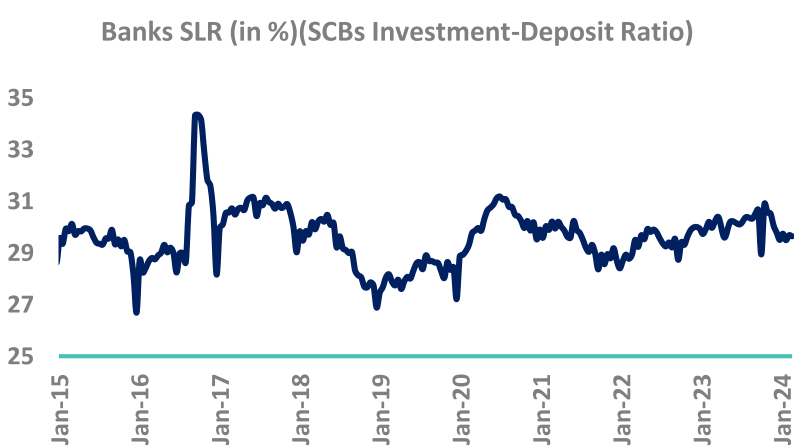
DSP

Source – DBIE, RBI

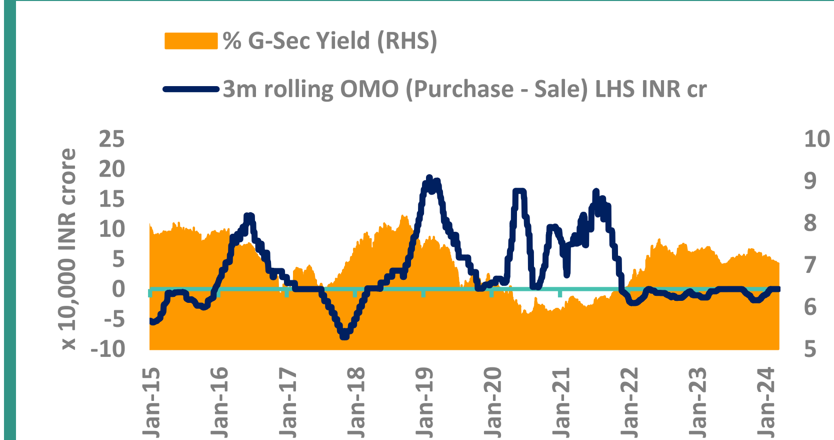
T-bill: Treasury Bill; SDL: State Development Loans

Banks have reduced holding

- **Banks SLR holding dips lower to 29.65%**
  - Banks SLR holding slips low in December
  - Partly due to G-sec redemptions
- **The current pace of purchases is expected to continue**
  - As natural NDTL growth will still lead to demand



- **Yields usually track RBI OMO purchases**
  - Yields have strong correlation with RBI OMO
  - Demand/Supply mismatch is filled in by RBI
- **RBI softened its liquidity management stance. However,**
  - Liquidity continues to remain tight despite VRR operation by RBI
  - Further intervention necessary to bring liquidity to neutral



Takeaway:
Bank's demand could shift to carry assets like SDLs and Corporate Bonds with the change in HTM regulations

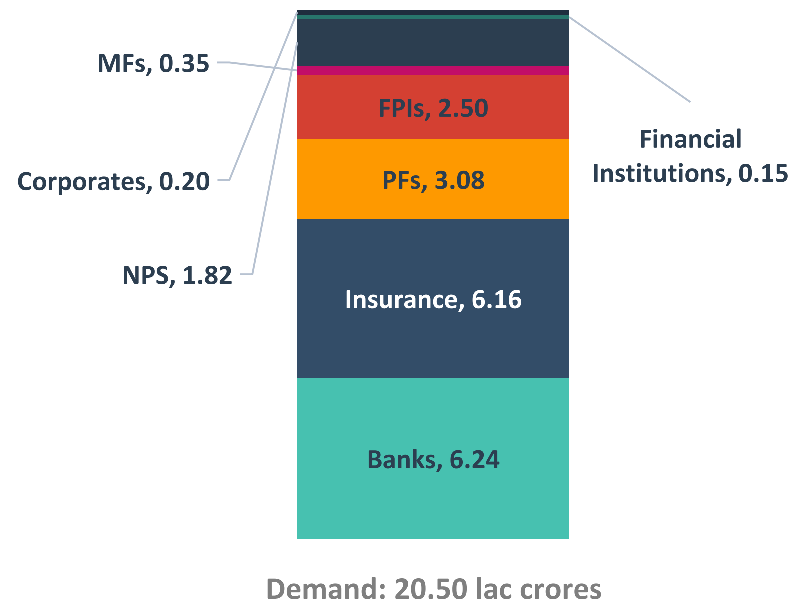
Source – Bloomberg, DBIE, Internal

OMO – Open Market Operations, SLR – Statutory Liquidity Ratio; G-Sec – Government Securities; RBI: Reserve Bank of India; SCB: Scheduled Commercial Bank; CIC: Currency in Circulation

FPI buying to drive excess demand in FY25

➢ Demand to outpace supply in FY25

- ✓ G-sec *plus* SDL supply is higher only by 4% over FY24
- ✓ Global Index inclusion to support passive/active FPI buying
- ✓ Natural demand to come from other passive buyers like Insurance, PF, NPS, etc.



Takeaway:
Estimated excess demand of ₹ 0.75 lac crores.

Source – Internal, CGA

FISCAL POLICY

G-Sec: Government Securities; OMO: Open Market Operation; RBI: Reserve Bank of India; FPI: Foreign Portfolio Investment; NPS: National Pension System; MF: Mutual Fund; SDL: State Development Loans; SLR: Statutory Liquidity Ratio; PF: Provident Fund; EPFO: Employees' Provident Fund Organisation; NSSF: National Small Savings Fund

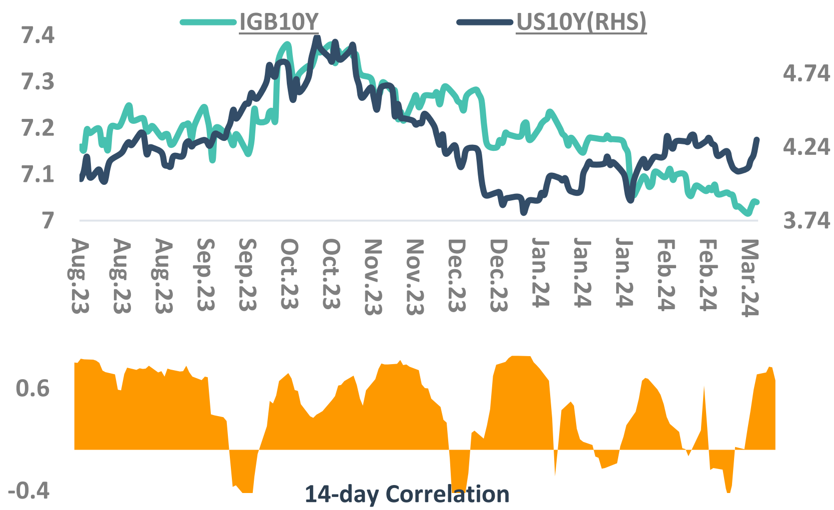
Indian yields tracking Global yields

But with lopsided beta

Impact of US yields on Indian yields

- **So far Indian 10Y yields tracked US 10Y**
  - Except for times when UST has risen sharply

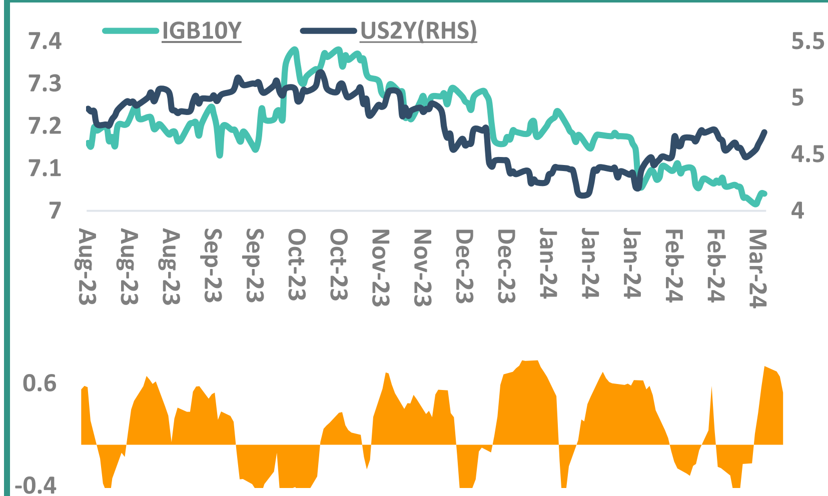
- **When correlation broke, RBI has acted**
  - Higher yields -> OMO announcement (Oct'23)
  - Lower yields -> Liquidity infusion - VRR (Dec'23)



- **Expect correlation, but with lopsided beta**
  - If UST yield rise, IGB yields may rise somewhat
  - If UST yield fall, IGB yields may fall significantly

- **Risk/Reward to play for lower yields**

- **FOMC to give near term trajectory**
  - We go long duration in FOMC, aware that there may be transient spikes in UST yields



Takeaway:
Expect correlation, but with lopsided beta

Source – Bloomberg, Internal

DSP

Fed: Federal Reserve; CPI: Consumer Price Inflation; RBI: Reserve Bank of India; IGB: India Government Bond; FOMC: Federal Open Market Committee; UST: US Treasury

Money Market Assessment Framework

System Liquidity

Currency in Circulation (CIC)

CIC drain out close to Rs. 95k crore since Jan-24

Foreign exchange inflows / outflows

RBI has been absorbing dollar flows since Dec-23

RBI Liquidity Management Tools – VRR, VRRR, OMOs, CRR change; Fx buy/sell

'Nimble' fine tuning operations by RBI has kept liquidity around neutral zone

Demand-Supply

Supply

Decent supply continues in 3m and 1 Yr segment by Banks and NBFCs

Demand

Market demand at elevated rates is strong

Temporary volatility could be seen for rest part of Financial year

MPC Action

MPC remained focused at achieving stable and low inflation on a durable basis

MPC gave comfort to provide liquidity support through fine tuning operation

Takeaway:

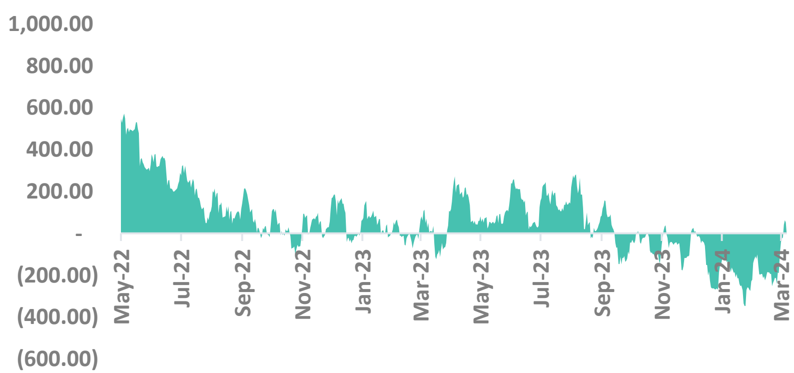
Money market yields have rallied since the peak, driven by banking system liquidity moving into neutral zone. We remain long in our money market funds as durable liquidity is in surplus and demand supply dynamics turn favourable next quarter.

DSP

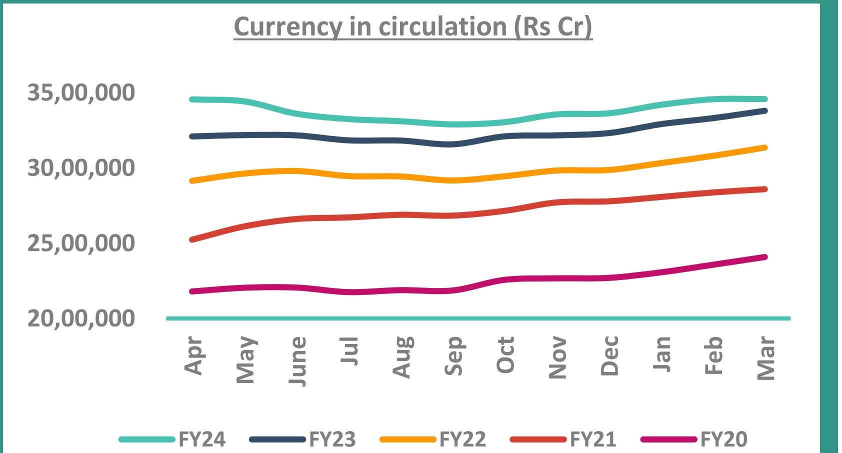
CIC: Currency in Circulation; CD: Certificate of Deposits; OMO: Open Market Operations; VRR: Variable Rate Repo; VRRR: Variable Rate Reverse Repo; RBI: Reserve Bank of India: GOI: Govt of India

Banking system liquidity in neutral zone

- **Banking system liquidity has moved to neutral zone after a long spell of almost 6 months**
- **Expected to move into positive zone after quarter end spending**
  - Will drive money market rates lower
- **Durable liquidity comfortable at ~INR 1.6 lac crores**
  - RBI managing Banking system liquidity dynamically



- **Expect system liquidity to improve aided by govt spending and FX operations**
  - We saw a CIC drag of ₹ 94k crore from January 24 onwards
  - Typically, from Jan-May it increases roughly by INR 2-2.5lakh crore, due to seasonal factors
  - RBI absorbing FX flows since Dec-23. Swap maturity in Mar to partly absorb CIC increase



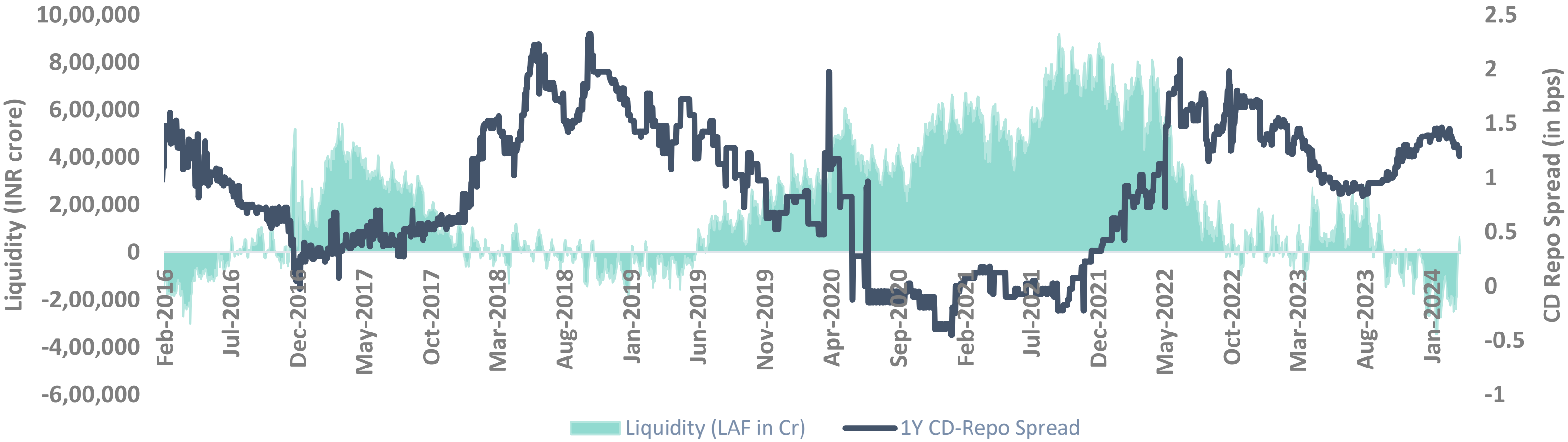
Takeaway:
Expect banking liquidity to move into positive zone by April

G-Sec – Government Securities; CIC: Currency in Circulation

Source – Bloomberg, RBI, *Internal Estimates

Money market yields have rallied with improving liquidity position

- Durable liquidity and banking system liquidity will be in positive zone in coming weeks
- Demand supply dynamics to turn favorable next month
- Expect money market spreads over repo rate to compress in April driven by significantly improved liquidity conditions and favorable demand from MFs



Takeaway:
We continue to remain long across our money market funds

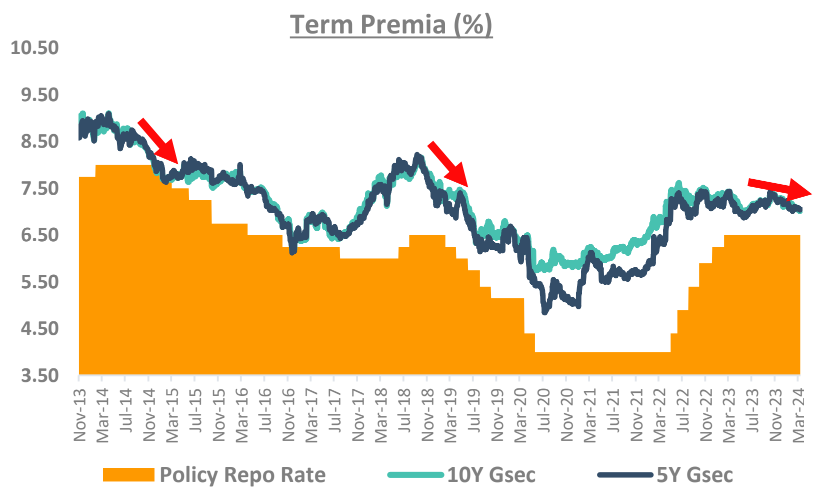
DSP

CD: Certificate of Deposits

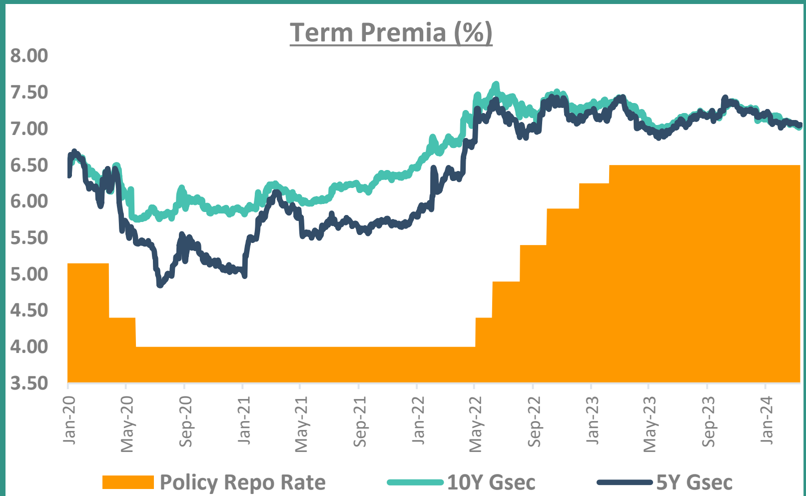
*Internal Estimates

Term premia is *still* not low

- **Term premium falls sharply before rate cuts**
  - This time, the slope of the fall is much less
  - If rate cuts get priced, the spread of 50bp will be high
- **Why do we prefer slope, not absolute levels?**
  - The slope removes the underlying demand/supply dynamics and thus can be compared across time
- **Even absolute levels are attractive**
  - Even absolute levels are attractive from prior regimes preceding rate cuts



- **Term premia: function of demand/supply and rate expectation**
  - During covid term premia high
    - Supply high: Govt increased fiscal deficit
    - Repo rates were expected to rise
  - Post covid term premia fall is natural
    - Supply low: reduced FY25 supply, FPI flows
    - Rates are expected to fall
- **The trend of high demand, low supply strong**
  - Unlikely that govt will leave fiscal consolidation



Takeaway:
Term premia is still attractive given favorable demand supply dynamics

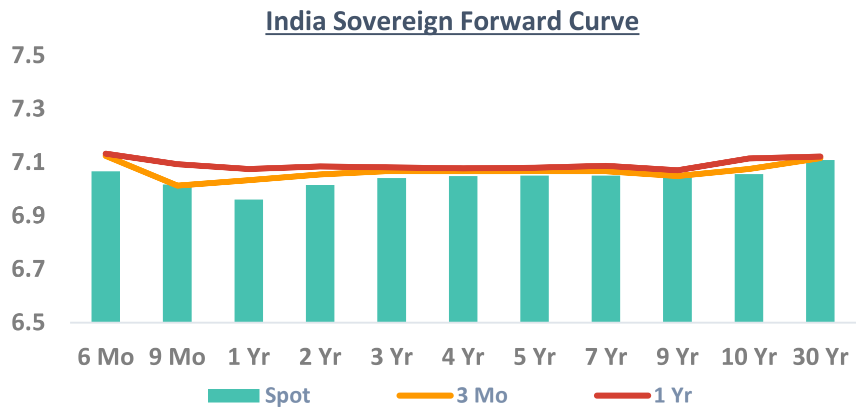
Source – Bloomberg

CHECKLIST

DSP FI Framework checklist

Drivers	1Y	5Y	10Y	>10Y	Remarks
Monetary Policy	**Neutral**	**Neutral**	**Neutral**	**Neutral**	
Inflation	Neutral	Neutral	Neutral	Neutral	CPI unchanged vs Jan. Core continues to moderate. Risks seem contained
Growth	Neutral	Neutral	Neutral	Neutral	Resilient growth so far; rural still not completely out of woods
CAD/BOP/ Currency	Neutral	Neutral	Neutral	Neutral	External sector pressures low
Fiscal Policy	**Neutral**	**Positive**	**Positive**	**Very Positive**	
Supply	Neutral	Positive	Positive	Positive	Favourable FY25 demand supply dynamics
Demand	Neutral	Neutral	Neutral	Positive	Banks have reduced holding, yet sufficient to absorb supply
FPI Flows	Neutral	Neutral	Positive	Neutral	FPI flows have already started since the index inclusion announcement
Global	**Positive**	**Positive**	**Positive**	**Positive**	
Global yields	Positive	Positive	Positive	Positive	Fed is talking about rate cuts but not to rush into it
Geopolitics	Neutral	Neutral	Neutral	Neutral	Geopolitical risks have abated
Commodities	Neutral	Neutral	Neutral	Neutral	Risks balanced
Others	**Positive**	**Positive**	**Neutral**	**Neutral**	
RBI Regime	Neutral	Neutral	Neutral	Neutral	RBI will be influenced by Fed action
Miscellaneous	Positive	Positive	Neutral	Neutral	RBI remains cautious but nimble
Total	**Positive**	**Positive**	**Positive**	**Positive**	

DSP Duration decision:



The chart shows how much expected yield fall/rise is already priced in the current curve.

Large gap between the current yield and forward yield shows that yield change is priced in – and thus yield change will not give capital gain/loss.

Similarly small gap means that the market is not pricing change in yields.

Segments that has value

- ***Upto 1 Yr:*** Tight Liquidity
- ***30 Yr:*** High accrual. Demand from long term investors to cap any uptick in yields

Maturity	1Y	5Y	10Y	>10Y
What's expected (Total)	**Positive**	**Positive**	**Positive**	**Positive**
Is expectation (above row) priced in ?	No	No	No	No

Source – Bloomberg; as on 14/Mar/24

We have discussed duration and yield movement.

How do we choose corporates and credit?

ASSET ALLOCATION

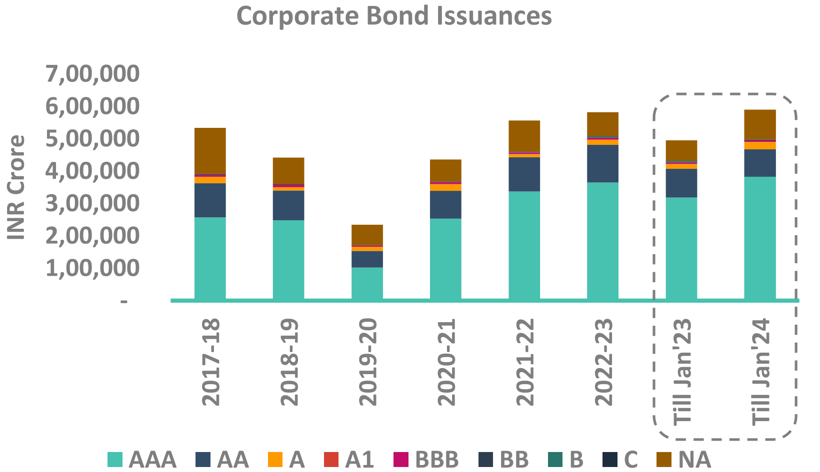
DSP Asset Allocation: Tight liquidity and supply to keep spreads high

➢ Supply has remained manageable so far

- Issuance till Jan'24 at 19% higher YoY (5.9 lac crores)
- Led by 20% higher supply in AAA rated issuances
- Supply in Feb higher at ~94k crores

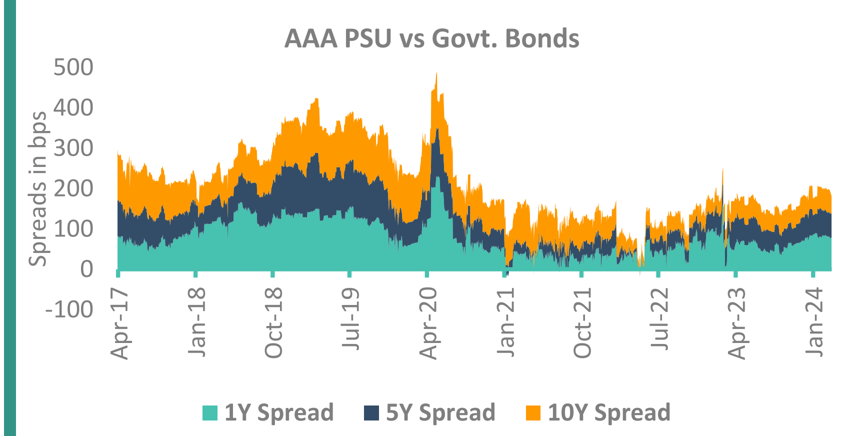
➢ Higher issuance by NBFCs led by increased risk weights

- 2-3Y NBFC Spreads are at high of 110-120 bps
- Attractive levels to remain invested/spreads should narrow with expected liquidity easing in next quarter



➢ The corporate bond spreads steady

- AAA PSU supply well bided in market by long only investors
- Issuances concentrated by large issuers like NABARD and some bank bonds
- 2-5Y NBFCs provides steady accrual at ~100bps spread
- Long only investor demand well matched with the supply



Takeaway:
Tight liquidity and continued supply to keep spreads at elevated levels for NBFCs and AAA PSU corporate bonds are well supported at all tenors.

Source – Bloomberg, CCIL, Internal

DSP

PSU: Public Sector Undertaking, NBFC: Non-Bank Financial Companies

DSP Credit Investment Process – Focus on Governance

Credit evaluation

- Macroeconomic & Industry Outlook
- Promoter /Management Reference Check
- Business Profile & Market Strategy
- Financial Statement Analysis
- Fund Raising Strength

Decision

- Internal Credit Rating Model
- Credit Committee: Limit approvals
- Fund Manager: Investment Decision

Monitoring

- Material Events
- Early Warning Indicators
- Management Guidance
- Movement in Spreads
- Change in Investor profile

Information sources: Financial results, Management Discussion, Rating Agency Feedback, Sell Side Research, Equity analyst feedback, Lender's feedback, etc.

DSP Credit view on sectors

Sector	Cash Flow Strength	Balance Sheet Strength	Outlook	Remarks
Automobile and Auto Components	🟢	🟢	🟠	Growth depends on the segments e.g. SUV (doing better) vs small cars. Lately, rural demand has pushed up 2W sales
Capital Goods	🟢	🟠	🟠	Infrastructure spending by the Government has supported companies.
Chemicals	🔴	🔴	🔴	For export-oriented businesses, inventory destocking as supply chains normalize and global slowdown are impacting profitability. Chinese oversupply is also to be watched. However, the longer-term story is intact- steady demand and India as a manufacturing base.
Construction, Metals	🟢	🟠	🟠	Commodity cycle has by and large been stable. Spread and volume trends are evolving, but are within acceptable credit parameters.
Consumer Durables	🟢	🟢	🟠	Commercial demand has been strong given the pickup in infra segment. Retail remains largely stable with churning in the market share
Consumer Services	🟠	🟠	🟠	Initial commentary on festive demand has been weaker than expected – inventories need watching.
FMCG	🟢	🟢	🟠	Volume growth has been weak only overall. But balance sheet and cashflows are strong
Financial Services	🟢	🟠	🟠	Regulatory action on few tier-II NBFCs
Media, Entertainment & Publication	🔴	🟠	🟠	Exposure only towards are large private conglomerate and comfort out of its parentage as well as leadership position
Oil, Gas & Consumable Fuels	🟢	🟢	🟠	As end fuel prices are fixed, profitability of OMCs depend on price of oil which has been volatile, but on the lower side. Companies have built in strong cushions in the past year, and refining margins have been high. Capex for PSUs well as Government action on fuel prices need monitoring.
Power	🟢	🟠	🟠	Power demand supply remains favorable, especially in peak load demand, resulting in a favorable cycle for power companies and equipment suppliers (e.g. transmission grid). Key risk remains political as States still do not appear to be charging proper prices for electricity - a fundamental flaw in India. However, with Central Government initiatives, receivables for power companies have declined.
Realty	🟢	🟠	🟠	Strong real estate cycle has positively impacted residential companies. Floor-wise denotification and return to office trends is likely to be favourable for commercial real estate.
Telecommunication	🟢	🟢	🟠	Virtually a two company story in India, we expect credit profiles of those two to remain solid.

Done with our market view framework?

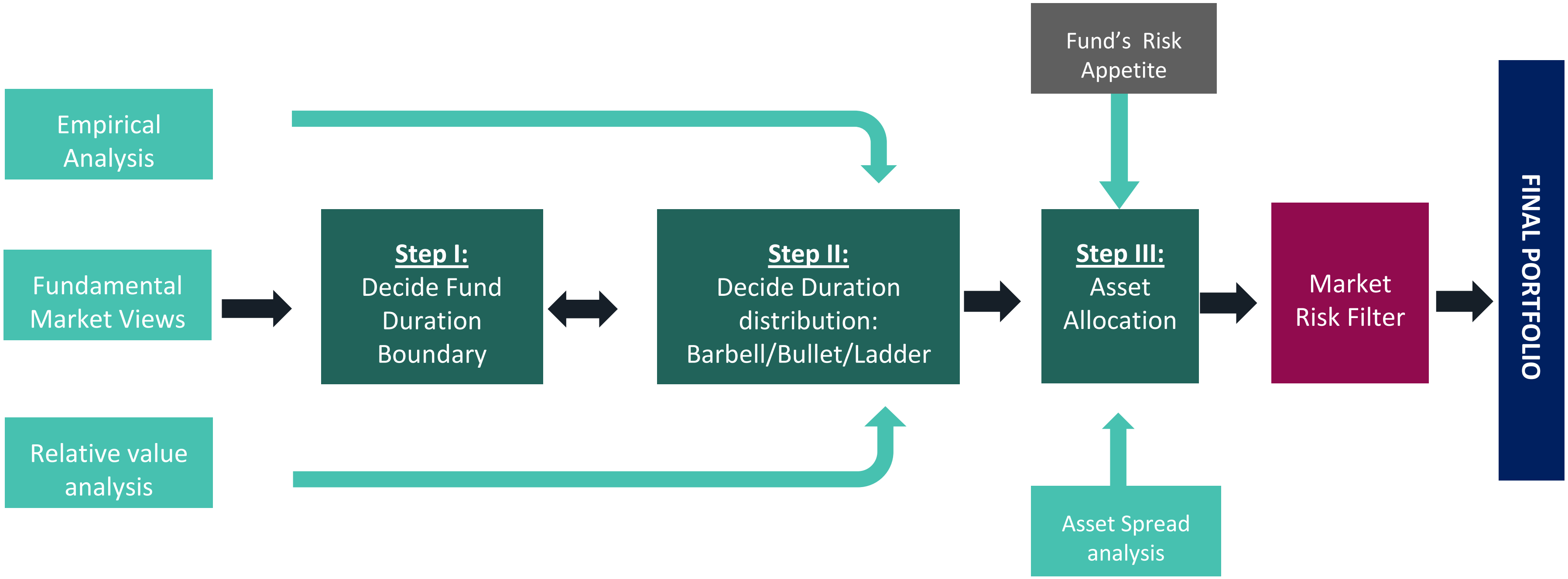
Now

Our Portfolio creation framework

PORTFOLIO CREATION

DSP Portfolio Creation: Multi-step process

DSP Fixed Income Funds follow a defined methodology for fund portfolio construction



- We apply market risk filter which can help the Fund Managers not to take extreme risks. Thus, Value at Risk is limited by ensuring the positions are balanced.

Investment approach / framework/ strategy mentioned herein is currently followed & same may change in future depending on market conditions & other factors.

Key Risks associated with investing in Fixed Income Schemes

Interest Rate Risk - When interest rates rise, bond prices fall, meaning the bonds you hold lose value. Interest rate movements are the major cause of price volatility in bond markets.

Credit risk - If you invest in corporate bonds, you take on credit risk in addition to interest rate risk. Credit risk is the possibility that an issuer could default on its debt obligation. If this happens, the investor may not receive the full value of their principal investment.

Market Liquidity risk - Liquidity risk is the chance that an investor might want to sell a fixed income asset, but they're unable to find a buyer.

Re-investment Risk: If the bonds are callable, the bond issuer reserves the right to "call" the bond before maturity and pay off the debt. That can lead to reinvestment risk especially in a falling interest rate scenario.

Rating Migration Risk - If the credit rating agencies lower their ratings on a bond, the price of those bonds will fall.

Other Risks

Risk associated with

- floating rate securities
- derivatives
- transaction in units through stock exchange Mechanism
- investments in Securitized Assets
- Overseas Investments
- Real Estate Investment Trust (REIT) and Infrastructure Investment Trust (InvIT)
- investments in repo of corporate debt securities
- Imperfect Hedging using Interest Rate Futures
- investments in Perpetual Debt Instrument (PDI)

Disclaimer & Product Labelling

In this material DSP Asset Managers Private Limited (the AMC) has used information that is publicly available, including information developed in-house. Information gathered and used in this material is believed to be from reliable sources. The AMC however does not warrant the accuracy, reasonableness and / or completeness of any information. The data/statistics are given to explain general market trends in the securities market, it should not be construed as any research report/research recommendation. We have included statements / opinions / recommendations in this document, which contain words, or phrases such as "will", "expect", "should", "believe" and similar expressions or variations of such expressions that are "forward looking statements". Actual results may differ materially from those suggested by the forward looking statements due to risk or uncertainties associated with our expectations with respect to, but not limited to, exposure to market risks, general economic and political conditions in India and other countries globally, which have an impact on our services and / or investments, the monetary and interest policies of India, inflation, deflation, unanticipated turbulence in interest rates, foreign exchange rates, equity prices or other rates or prices etc. **The stock(s)/issuer(s) mentioned in this presentation do not constitute any research report/recommendation of the same and schemes of the Fund may or may not have any future position in these stock(s)/issuer(s). The portfolio of the schemes is subject to changes within the provisions of the Scheme Information document of the schemes. There is no assurance of any returns/potential/capital protection/capital guarantee to the investors in schemes of the DSP Mutual Fund. Past performance may or may not sustain in future and should not be used as a basis for comparison with other investments. This document indicates the investment strategy/approach/framework currently followed by the schemes and the same may change in future depending on market conditions and other factors.** All figures and other data given in this document are as on Mar 14, 2024 and the same may or may not be relevant in future and the same should not be considered as solicitation/ recommendation/guarantee of future investments by the AMC or its affiliates. Investors are advised to consult their own legal, tax and financial advisors to determine possible tax, legal and other financial implication or consequence of subscribing to the units of schemes of DSP Mutual Fund. For complete details on investment objective, investment strategy, asset allocation, scheme specific risk factors please refer the scheme information document and key information memorandum of the schemes, which are available at AMC and registrar offices and investor service centres/AMC website- www.dspim.com For Index Disclaimer click Here

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

DSP

MUTUAL FUND

#INVESTFORGOOD