December 2019 – The month of Twists and Turns

The month started on a positive note as market saw some position building going into the policy. RBI’s decision to hold rates came as negative surprise and as a result, market saw a steep sell off. The near-term demand-supply worry (higher SDLs & Bond supply) along with rising risk of fiscal slippage were the cause of concern and hence traders trimmed position post the monetary policy given lower visibility of future rate actions. In absence of any major trigger, market continued to trade negative for a while.

Mid-month, the CPI print release was way above market expectations and hence market sold off completely post the data release. The fear of Fiscal Slippage as well Surplus Liquidity saw market turned duration cautious.

There was some news report of the government sticking to the fiscal deficit targets, but market was in no mood to believe the same in light of poor GST collections and slow-paced divestment program of the government. Further crude oil prices & US Treasuries “UST” yields continued to rise, and hence Indian bond market continued to be trade cautious.

The big positive came for the market with RBI announcing, “Special Open market Operations (OMOs)” – “Operation Twist”. RBI announced to Buy Longer dated Government Securities from the market and sell less than one-year Government Securities from its balance sheet. The choice of the paper (most liquid – 10-year benchmark Government Security) for Purchase, was further construed to be a Big Positive for markets. This caused Curve to flatten and duration assets started seeing demand in the market.

The bond curve saw yield curve Bear Flattened as the 5-year Government Securities closed the month at 6.46% vs. 6.19% (November) while 10-year G-Secs closed the month at 6.55% vs. 6.46% (November).

AAA Corporate bonds yield especially the 1 - 3 yrs maturity saw yields rise sharply during the month. Yields rose by 15 - 25 bps in the 1 - 3 yrs maturity while 10yrs maturity bonds saw yields rise – 5 - 10 bps. The Surplus liquidity into the system as well as lower supply in corporate bonds has seen market participants chase yields but only in high yield space.
The December policy was different from previous policies in sense that inflation risks were back on “Monetary Policy Committee “MPC” radar along with growth. The RBIs commitment to revive growth comes from its forward guidance wherein it clearly highlighted that the MPC decided to continue with an accommodative stance as long as it is necessary to revive growth”. This gives a clear message that accommodative stance may continue till there is meaningful growth revival. That said, expectations of fiscal slippage & upward revision in inflation projections kept RBI on hold in the last policy. We expect RBI to remain on hold in 4Q FY20 and assign low probability of further rate actions (15 – 25 bps) in 1Q FY21 - based on the evolving growth trajectory and uncertainty around it. At the same time, we believe till the time the monetary policy stance remains accommodative, RBI may continue to provide more than adequate liquidity.

The overall investors as well as traders positioning in markets is now very light. The underlying term premia (10yr G-Sec yields – Repo Rate) in bond market has increased in last month due to lack of clarity on future rate cuts. The supply of G-Secs/ State Development Loans (SDLs) & Corporate bonds is at record high for FY20.

While we expect yields to trade in a range due to additional borrowing fear on one hand while RBIs Special Operation on the other hand, we recommend investors may consider to stay invested in shorter maturity G-Secs and AAA PSUs/ Privates, while remaining cautious on longer maturity corporate bonds and G-Secs. We will focus on Short duration + Spread play in terms of Core portfolio construct. We would run 3 - 5 yr G-Sec rates & 2 - 3 yr AAA corporate bond segment as our Core portfolio, while longer duration would be tactically added to the portfolio only through G-Secs. We remain cautious on longer maturity corporate bonds and G-Secs.

We also expect new 10yr bond yield to remain range bound from near term (3 months) perspective as market starts pricing in a pause in current fiscal & Durable Liquidity Support in form of OMOs/ FX Swap only to take care of any major demand – supply mismatches.

Common Source: Bloomberg, RBI, Centre for Monitoring Indian Economy Pvt. Ltd., Reuters, NIMF Internal Research

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   - An open-ended liquid scheme

2. **Nippon India Money Market Fund (formerly Reliance Money Market Fund)**
   - An open-ended debt scheme investing in money market instruments

3. **Nippon India Short Term Fund (formerly Reliance Short Term Fund)**
   - An open-ended short-term debt scheme investing in instruments such that the Macaulay Duration of the portfolio is between 1 to 3 years

4. **Nippon India Banking & PSU Debt Fund (formerly Reliance Banking & PSU Debt Fund)**
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- Income over short term
- Investment in debt and money market instruments

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• Investment in debt & money market instruments with portfolio Macaulay duration between 1-3 years

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