DSP CONVERSE AT A GLANCE

OCTOBER-2024

LONG IN A WINDING ROAD ... SHIFT TO CORPORATE BONDS

There is a famous Rajnikant dialogue, which goes “if I say it once, it is the same as saying it 100 times”. However, we are not shy of repeating what we said last time. Stay long! The factors that we looked at last time – domestic demand more than supply aided by a fillip in LCR regulations, the continued FPI inflows & the gradually slowing global economy all provide tailwinds for a continued rally.

As the yields get lower, the reaction to one-off data points can be extreme. In the current cycle, the Central Banks are cutting from a position of economic strength to ensure that there is no longer term weakness and monetary policy is not so restrictive. However, to extrapolate one jumbo cut into extremes will lead to volatility as we have seen lately – the markets priced in a jumbo cut in the US followed by another 25bps cut into 2024, but that is now moderating after stronger than expected jobs data. We pointed out last time that traders tend to drive and reverse rallies, and this remains. Be that as it may, the cuts will come as the economies weaken, and this will result in yields moving lower.

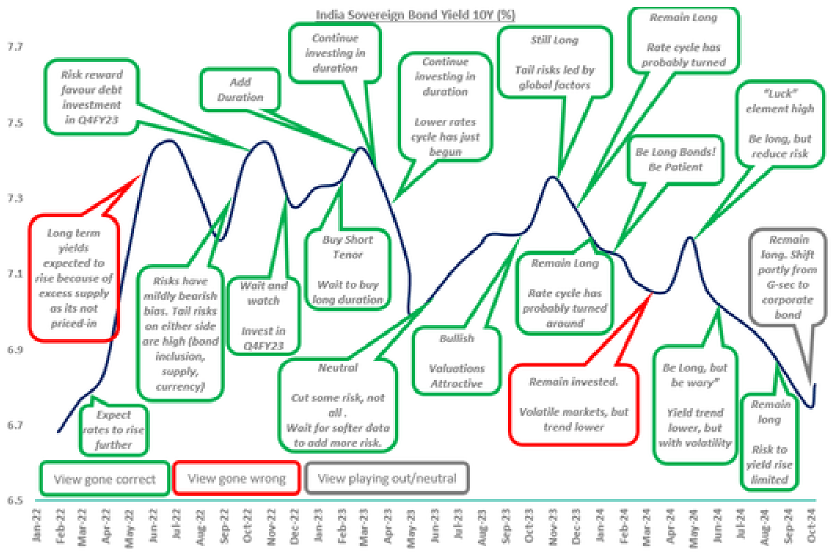
The US elections, geopolitics (see volatility in oil prices) and climatic conditions that cause headline inflation to remain elevated all pose risks. But India is in as sweet a spot as it can get – controlled fiscal, falling core inflation, solid demand.

OUR POSITION

We walk our talk. In each of our funds, we have stretched duration to the maximum practically possible.

We also are seeing rotation in different assets, as the rally spreads to corporate bonds. We have utilized all of this to deliver our performance. While we see merit in taking tactical calls now and then, our core position still remains one of long duration, including in funds that can take a position, 30Y + bonds. That is where the demand supply is favourable and even if the curve steepens when India rate cuts happen, we see more potential for capital gains by remaining long.

DSP remains the fund house for those who have a view to buy bonds and ride through any short-term volatility.



SNAPSHOT OF OUR VIEW

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

		Q3FY25 / Q4FY25 / Q1FY26 / Q2FY26 / H2FY26		SLIDES IN CONVERSE
	RATES VIEW	Yields to move lower, though with short term volatility and uncertainty.		
MONETARY POLICY	INFLATION	Core CPI comfortable at 3.3% Headline will spike due to base effect.		#13
MONETARY POLICY	GROWTH	Upcoming festive season sales important		#14
MONETARY POLICY	CURRENCY	FX reserves at record high of $700bn+	Much uncertainty on global macros External sector pressures remain low/Debt FPI flows continue	#15, #16
FISCAL POLICY	SUPPLY	Low supply in FY25 budget.	After bond buyback and lower T-bill, expect low supply in FY26 too	#25, #26, #27
FISCAL POLICY	DEMAND	PF/Insurance growth and LCR needs will outstrip Gsec supply growth.	Sugar Rush of bond inclusion fades	#25, #26, #27
FISCAL POLICY	FPI FLOWS	Further flows will come with bond inclusion, but then will taper down	Further flows will come but will not be meaningful	#27
GLOBAL DRIVERS	COMMODITIES	Commodity prices have turned volatile		NA
GLOBAL DRIVERS	GEO-POLITICS	Risk of China/US trade barriers / Middle East War Intensifies / US Elections		NA
GLOBAL DRIVERS	GLOBAL YIELD	Fed has cut, and will likely cut further at a gradual pace		#7, #29
OTHERS	RBI REGIME	RBI changed its stance post Fed cut		NA

TABLE OF CONTENTS

Didn’t RBI indicate that rate cuts to occur after CPI reaches 4%? SO why expect rate cuts now?

According to us, current RBI regime takes into considerations global dynamics, and not just domestic data. RBI's actions in recent past have been in sync with global central bank actions.

The recent change in stance, right after US rate cuts adds to our belief. For past few months RBI has not changed the stance stating that the 4% is the target for inflation - not 4.5%, not 5%. Yet, in this MPC there wasn’t a discussion about this golden number of 4%.

While analysts may want to look microscopically at inflation and growth dynamics, for us the drivers of rate cuts are simpler.

RBI will cut rates if (i) US FED keeps cutting, and (ii) if India's CPI remains under hygiene (< 5%) and (iii) if the soft patch in growth widens.

Refer Slide no. 13 & 19

Will US FED pause since US economy may not be as weak?

We believe that the trend of softer US data will continue. While stronger than expected Payrolls have made some rethink about the rate cuts timeline. But (i) Payrolls is a volatile (and probably unreliable) number, and (ii) the other macro indicators do not suggest strengthening of economy.

The DSP surprise index further strengthens our belief that the data is turning softer with lower volatility and uncertainty.

The data will continue to soften, but there will be intermittent surprises. We saw one in the payrolls number. But to expect FED to change its view on rate cuts after one reading of payroll is jumping the gun.

So, we expect FED to continue rate cuts, even if it is more measured then the market expects sometimes, and the same should influence RBI's decisions.

Refer Slide no. 7 & 38

Will the G-sec curve steepen?

It may, but as we said in our last DSP converse, a steeper curve does not mean that short end is a better investment.

For asset players (like us), the returns in price are more important than returns in yield (unlike bank traders where they run PV01 risk). Thus, while we continue to believe that 30y vs 10Y curve will flatten, but even if the curve steepens we will be better off in 30Y+ in case of bull steepening. And fall in yields is our view.

Why do we expect yields in long term to fall? Because (i) FPI inflows will continue to come, (ii) long end domestic demand remains firm and (ii) expected rate cuts will lead to further rally. We believe both these events are still not prices in.

In the medium term, we expect that 30Y could very well trade below 10Y yields.

Are corporate bonds better or Gsecs? (repeat)

Since last DSP CONVERSE, three events have occurred: (i) G-secs have rallied, and (ii) large size of corporate issuances have been absorbed by the market, (iii) RBI MPC has changed its stance.

These three events have changed our view on corporate spreads.

We believe that in the back of genuine demand for corporate bonds, an easy RBI policy will lead to spread assets rally.

While we remain constructive on G-sec yields too, but we prefer to gradually move to the corporate bonds.

Refer Slide no. 40

But the markets have already rallied. How much more can yields fall?

We do not know the levels, but the rally still has legs. Their has been a regime shift, and thus looking at past spreads is not the correct way.

The regime shift is because (i) India's g-sec supply continues to grow at smaller pace than domestic demand, and (ii) FPI flows have (and will) come in unprecedented numbers. We have witnessed rate cut cycles before, and we believe that the upcoming rate cuts are not a regime shift, but a usual driver to push yields lower.

Lastly, empirically prior to rate cuts the spread between the overnight rates and the 10-Y Gsecs has been narrower than current spreads.

Thus, the argument that bonds have rallied a lot may be based on “recency bias”. If we were to objectively look at data, then the bond yields are still attractive.

Refer Slide no. 34

Will the money markets rates ever come down?

It should.

However, irrespective of the direction of money market rates - It is a win-win for investors to remain invested in money markets. Why? Because if the rates do not come down, then being invested in money markets is good due to higher YTM. If the rates come down, then one can make capital gains. Its a win-win.

Nonetheless, we expect money market rates to trend lower. We certainly don't foresee any reason for money market rates to move higher. October MPC (and stance change) has reinforced the view that money market yields have seen the worst.

So we continue to invest completely in money market funds - and prefer to take longer duration wherever possible.

Refer Slide no. 30 & 32

October 2024

#INVESTFORGOOD

Remain long in volatile times

...shift partly from G-sec to corporate bonds

DSP CONVERSE

Our Framework

Monetary Policy

Inflation
- Aug CPI at 3.65% (P 3.6%)
- Core CPI comfortable at 3.3%
- Food prices remain volatile
- Base effect led higher transient CPI

Growth
- Domestic activity is slowing
- Monsoons/election/heatwave are likely causes
- Upcoming festive season sales important

Currency/CAD/BOP
- External sector pressures remain low
- RBI FX Reserves over USD 700bn
- Trade deficit elevated due to gold imports post duty cuts/festive demand

Fiscal Policy

Supply
- H2FY25 borrowing calendar shows no surprises
- H2FY25 SDL calendar also on expected lines

Demand
- Passive demand (domestic/FPI) to continue
- *Diluted* LCR guidelines may increase bank's buying by Rs 2-4 lac cr (~20% of Gsec borrowing).

Global Drivers

Global Yields
- US economy/ labor/ inflation softening
- FF Futures pricing in another 2 cuts in CY24
- Fed cutting to move from overly restrictive policy

Geopolitics
- US Election outcome
  - *Risk of trade barriers*
  - *Trump may be anti-Iran*
- Israel war may escalate
- Ukraine war in backseat

Commodities
- Prices have turned volatile
- China stimulus to be watched

Others

RBI Regime
- Changing stance, but cuts to be gradual
- Liquidity improved & overnight rate below repo
- Fine tuning o/n rate through VRR and VRRR

Regime shift expected?
- New MPC members remain unknown.
- Gov Das & DG Patra at end of their tenure

Positive

Neutral

Negative

Takeaway:
Domestic environment steady. Fed will further cut, only the pace may be gradual. Geopolitical uncertainty continues

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

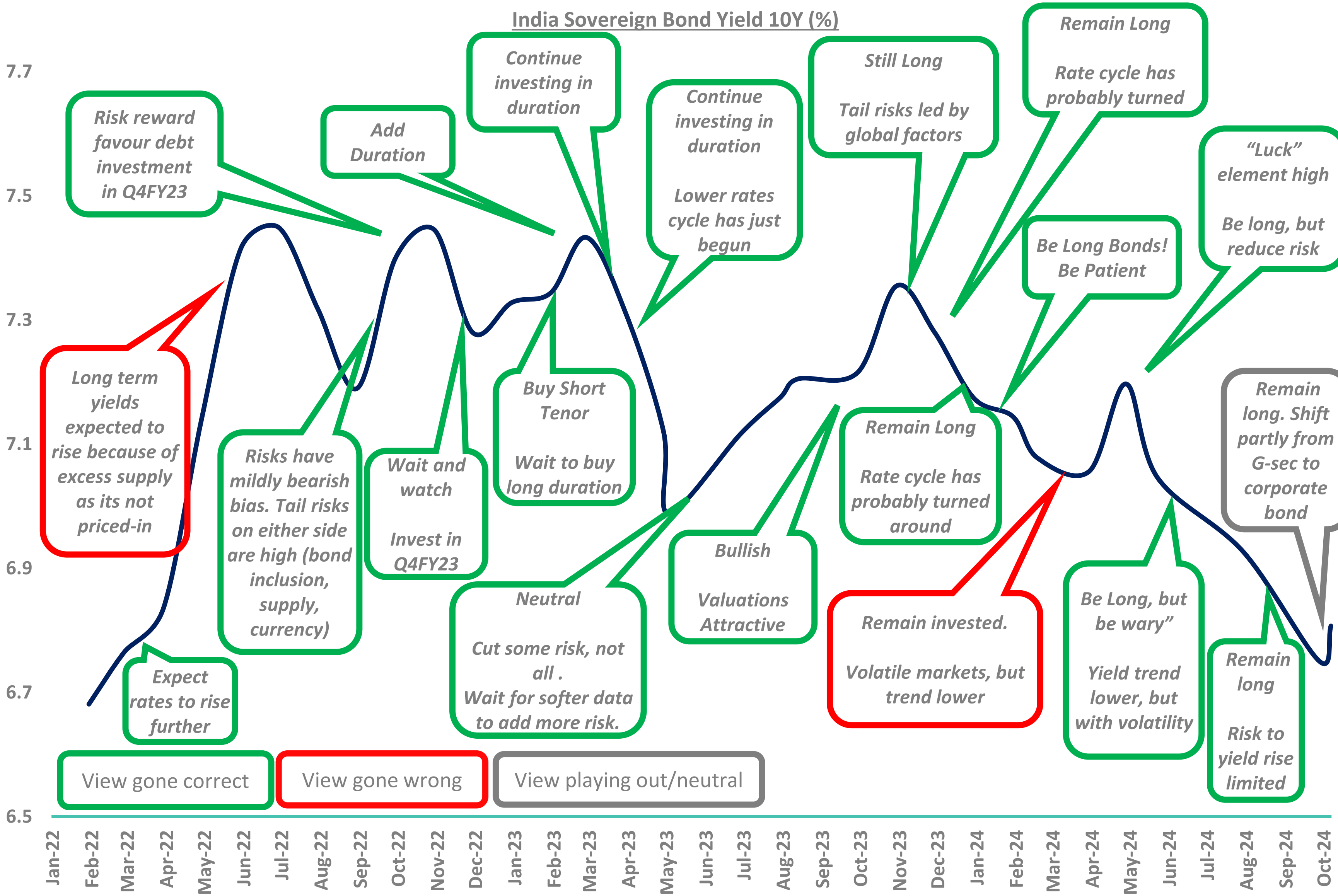
SUMMARY

Be Long.

1. Domestic macros support lower yields
2. Favorable demand/supply dynamics
3. US Fed rate cut cycle started

But be wary of binary risks from Israel war & US Elections

Let's revisit our rates call trajectory



DSP

Source – Bloomberg, Internal

To start with,

Recap of events since last DSP CONVERSE release

1. US Fed eases to become less restrictive

2. Domestic macros comfortable

3. RBI changes stance to neutral

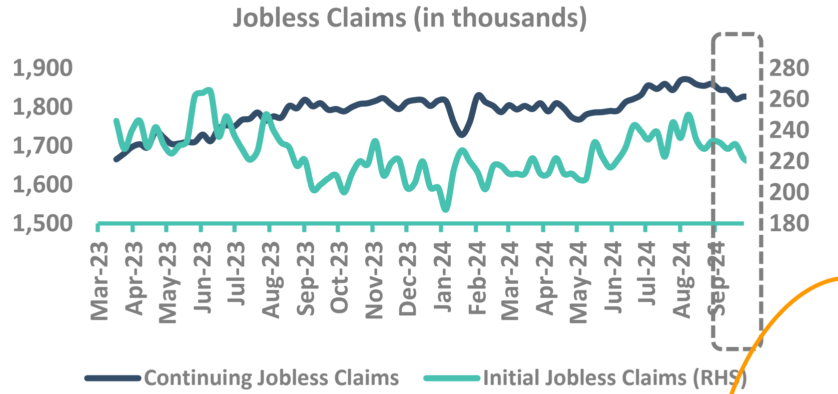
4. US election risks nearing

5. Israel war escalates to Lebanon/Iran

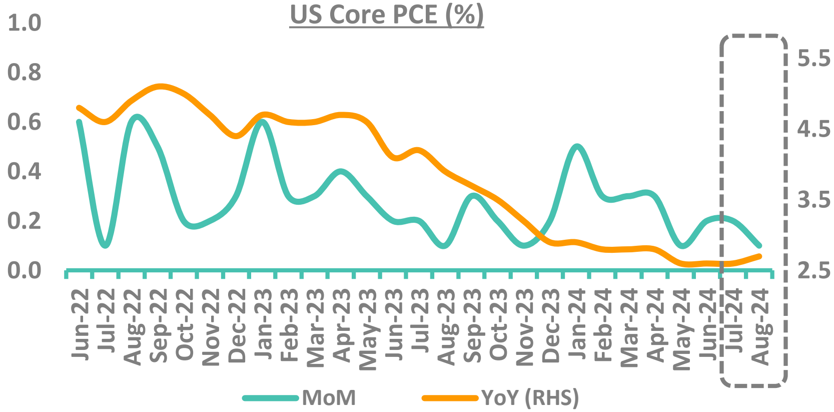
WHAT HAS CHANGED

US rate cut cycle has begun

➢ The US labor market tightness easing

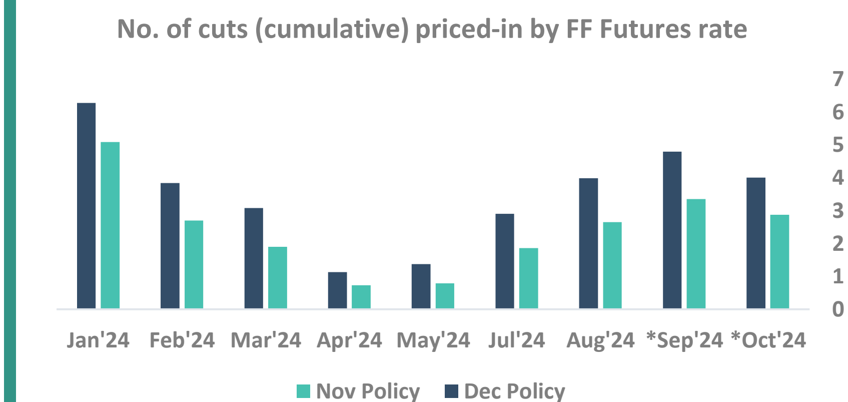


➢ Last mile inflation battle still ongoing



➢ US Fed remains on “data dependent” (but likely to cut) mode

- FOMC delivered a 50bps cut in September
- Pace and extent of FED cuts is data dependent
- Labor market continue to come into better balance
- Inflation has eased, but shows last mile wobbles
- The US FED rate cuts are fairly priced.



** For Oct & Sep we have taken into account a 50bps cut already announced in Sep to arrive at cumulative no. of cuts*

Takeaway:
Fed starts with a jumbo cut, and sets the path for gradual rate cuts over next year to move to “neutral”

Source – Bloomberg, Federal Reserve

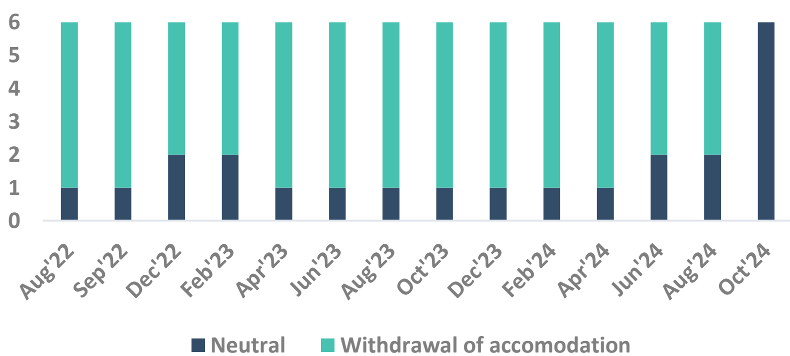
PCE: Personal Consumption Expenditure; FOMC: Federal Open Market Committee

Tweaks in Monetary policy and Fiscal policy

Monetary policy tweaks

- REPO rate unchanged at 6.5%, but Stance changed to "NEUTRAL".
- RBI's CPI Projections unchanged for FY25 at 4.5%
  - ✓ Higher sowing of kharif crops and adequate reservoir levels provide comfort
  - × Recent upturn in key commodity prices, especially metals and crude oil needs to be closely monitored.
- Real GDP growth projection unchanged for FY25
  - ✓ Healthy kharif sowing and sustained momentum in consumer spending in festive season bode well
  - × Downside risks from intensifying geopolitical conflicts

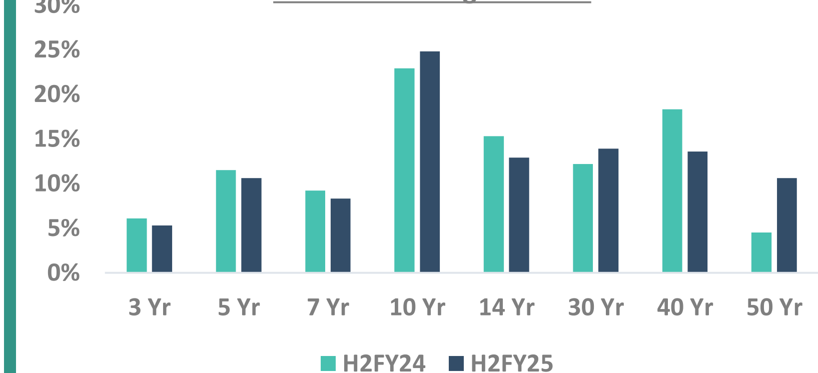
MPC Average Stance



Fiscal policy tweaks

- H2FY25 borrowing calendar : No surprises
  - ✓ Gross supply at 47.18% of total borrowing for FY25
  - ✓ Skewed towards 10Y and ultra-long duration, to match the expected demand in this segment
- Q3FY25 SDL borrowing calendar as expected at Rs. 3.2 lac crores
- T-bills borrowing cut, govt buying back FY26 bonds
  - ✓ Govt is utilizing FY25 surplus to FY26

G-Sec Borrowing Calendar



Source – RBI

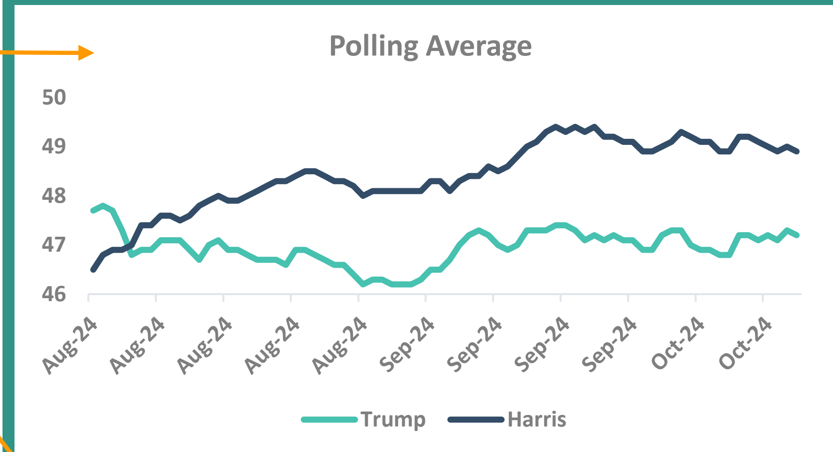
DSP

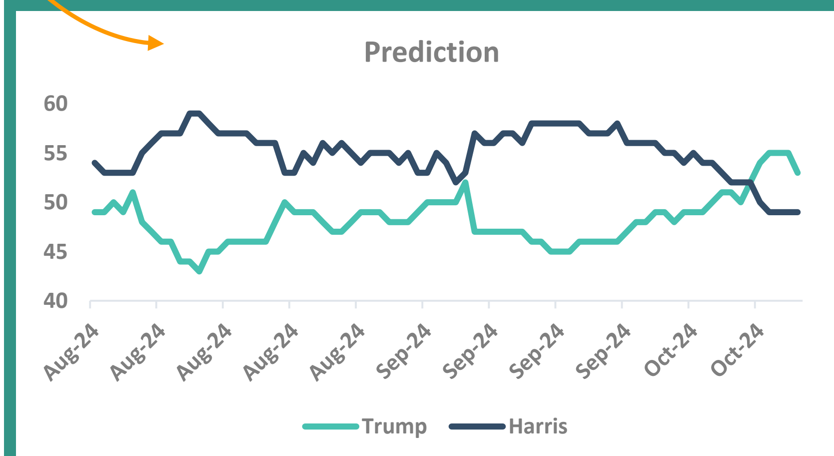
GDP: Gross Domestic Product

WHAT HAS CHANGED

US Elections - Indian debt markets may prefer Harris to Trump

- **The race is close and appears too tight to call**
  - Betting odds, and opinion polls are too close
- **Likely Trump win outcomes : Higher risk**
  - **Middle-east war** could escalate as Trump may be anti-Iran, encouraging Israel to escalate: (i) higher oil, and (ii) risk-off sentiment.
  - Increased **China tariffs** could lead to higher inflation and potential lower growth
  - **Weaker USD** as has been stated by Trump himself.
- **Likely Harris win outcomes : Continuity**
  - Continuation of Biden era politics – no major alteration in growth or inflation path.
  - Hawkish on China, pro Ukraine at a loss, more moderate on Israel.
- **Both candidates may run high fiscal deficit.**
- **Trump win runs risk of higher domestic yields.**





Takeaway:
A Harris win should be better for domestic yields, as compared to Trump win.

DSP

Source – Bloomberg, RBI, Internal

Now our **framework**

And

What we track

Our Framework

Monetary Policy

Inflation
- Aug CPI at 3.65% (P 3.6%)
- Core CPI comfortable at 3.3%
- Food prices remain volatile
- Base effect led higher transient CPI

Growth
- Domestic activity is slowing
- Monsoons/election/heatwave are likely causes
- Upcoming festive season sales important

Currency/CAD/BOP
- External sector pressures remain low
- RBI FX Reserves over USD 700bn
- Trade deficit elevated due to gold imports post duty cuts/festive demand

Fiscal Policy

Supply
- H2FY25 borrowing calendar shows no surprises
- H2FY25 SDL calendar also on expected lines

Demand
- Passive demand (domestic/FPI) to continue
- *Diluted* LCR guidelines may increase bank's buying by Rs 2-4 lac cr (~20% of Gsec borrowing).

Global Drivers

Global Yields
- US economy/ labor/ inflation softening
- FF Futures pricing in another 2 cuts in CY24
- Fed cutting to move from overly restrictive policy

Geopolitics
- US Election outcome
  - *Risk of trade barriers*
  - *Trump may be anti-Iran*
- Israel war may escalate
- Ukraine war in backseat

Commodities
- Prices have turned volatile
- China stimulus to be watched

Others

RBI Regime
- Changing stance, but cuts to be gradual
- Liquidity improved & overnight rate below repo
- Fine tuning o/n rate through VRR and VRRR

Regime shift expected?
- New MPC members remain unknown.
- Gov Das & DG Patra at end of their tenure

Positive

Neutral

Negative

Takeaway:
Domestic environment steady. Fed will further cut, only the pace may be gradual. Geopolitical uncertainty continues

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

MONETARY POLICY

Growth slowing – could be transient signs, but data dependency high

Inflationary pressures seems contained

RBI stance change but cuts to be gradual

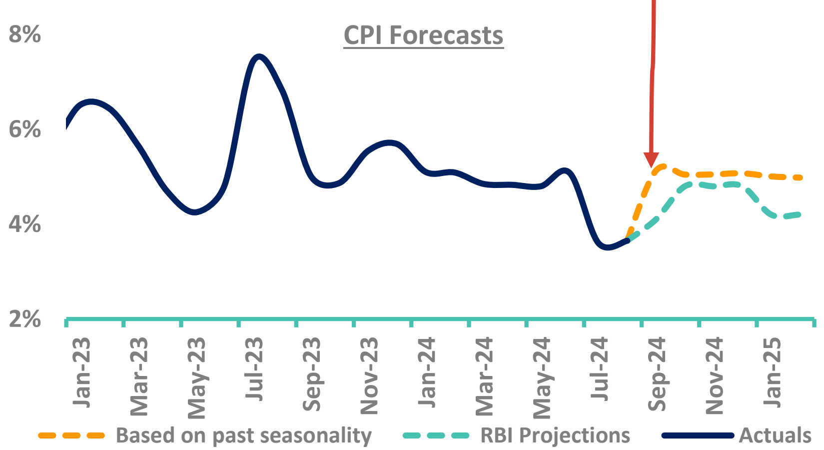
Core CPI remains comfortable. Risks seem contained

CPI risks remain muted

- Aug CPI increases marginally to 3.65% vs 3.60% in Jul
- Remains below 4% mark for 2nd consecutive month
- Food prices continue to decline month-on-month
- Monsoon risks seem to have faded, if withdrawal ok
- Good prospects for Rabi as reservoir level high

Core inflation is steady at 3.3%

But expect higher CPI due to base effect



Do yields track inflation projection? No.

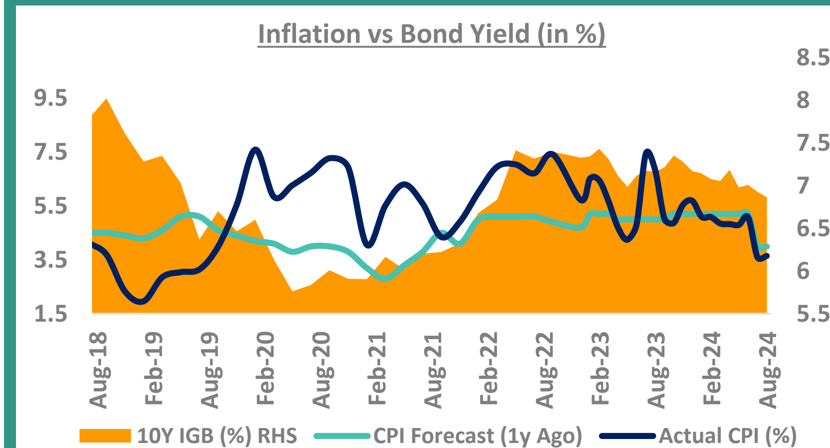
- Orange area (chart) is 10Y yields, Blue line is CPI

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 significantly lately

DSP

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

Source – Bloomberg, RBI, Internal

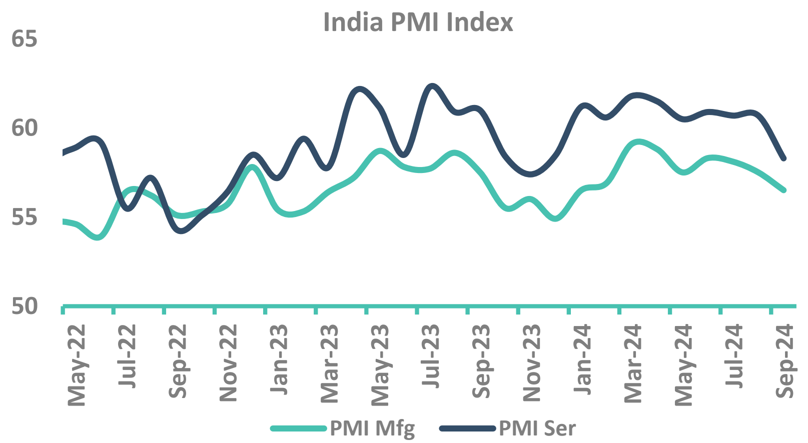
Domestic growth slowing: remain watchful

Watch out for domestic growth

- May be impact of seasonal factors and elections
- GST collection for Sep at 1.73 lac crores, up 9% YoY (lower than 10-11% seen in past)
- Early demand trends are mixed

Credit growth moderated further to 13% yoy

- Unsecured PL and loan to NBFCs have moderated
- Housing loan and services growth remain strong
- Credit to industry has remained stable

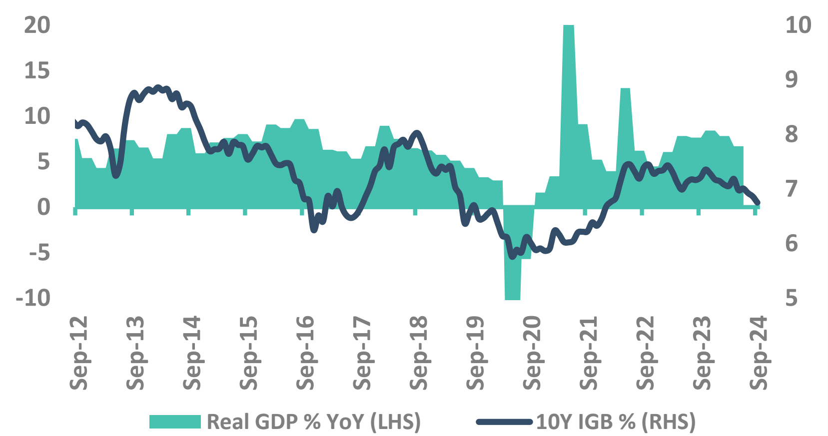


How closely do yields track growth?

- 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.
- Q1FY25 GDP Growth came in at 6.7%.



Takeaway:
Domestic growth seems to be slowing, but seasonal factors also played a role. Watch for festive season demand.

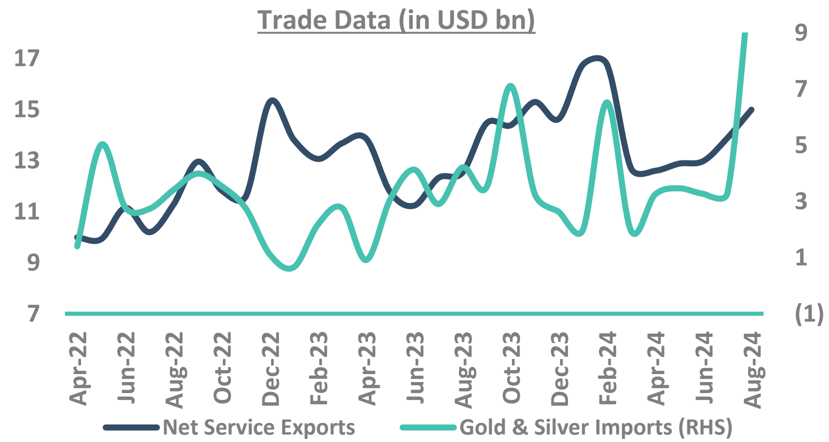
DSP

Source – Bloomberg, PIB, Internal

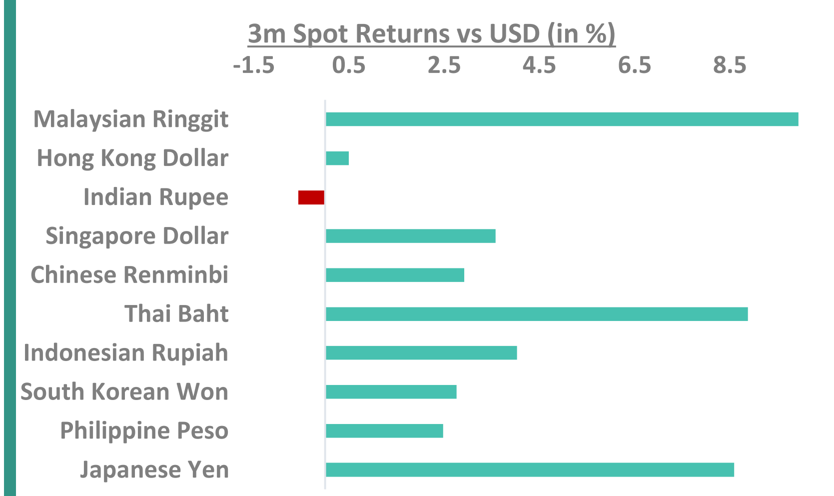
GDP: Gross Domestic Product; PMI: Purchasing Managers' Index; GST: Goods and Service Tax; IGB: India Government Bond

External sector metrics remain comfortable

- **FX reserves at record high level**
- **Aug trade deficit at a 10m high of $29.7bn**
  - Led by doubling of Gold imports and contraction of exports
  - Services trade surplus continues to hold steady



- **Rupee is Stable as compared to its Asian counterparts**
- **Active FPI Inflows already there and passive flows have also started**



Takeaway:
External Sector metrics remain comfortable as of now. Risks from volatile commodity prices and re-emergence of geopolitical tensions

DSP

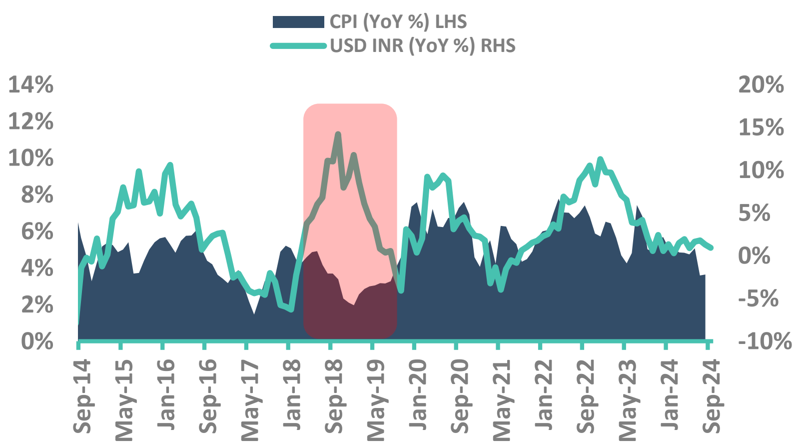
Source – Bloomberg

BoP: Balance of Payment; MTM: Mark to Market; EM: Emerging Markets; UST: US Treasury

Rupee depreciation risks are modest, flows supportive

Rupee and Inflation have a strong correlation

- There is a strong co-relation between rupee movement and CPI (barring 2018-2019)
- Reaffirms that India bears risk of imported inflation
- With rupee risks controlled, Inflation risks are also controlled

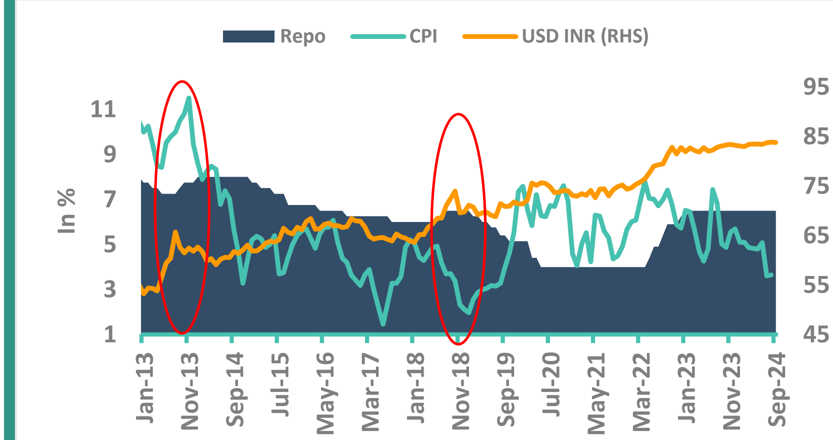


RBI has in past acted swifter to protect currency than inflation

- In 2013 and 2018 RBI increased rates when rupee depreciated
- In 2018, in inflation was within RBI's target levels

We don't see rupee depreciation risk

- Bond Inclusion flows have started
- Equity FPI flows (India being the sweet spot)
- Easing US yields to result into flows in emerging markets



Takeaway:

INR appears relatively stable – supportive flows and large RBI reserves

DSP

MPC – Monetary Policy Committee; CPI: Consumer Price Inflation; USD – US Dollar; Source: Bloomberg

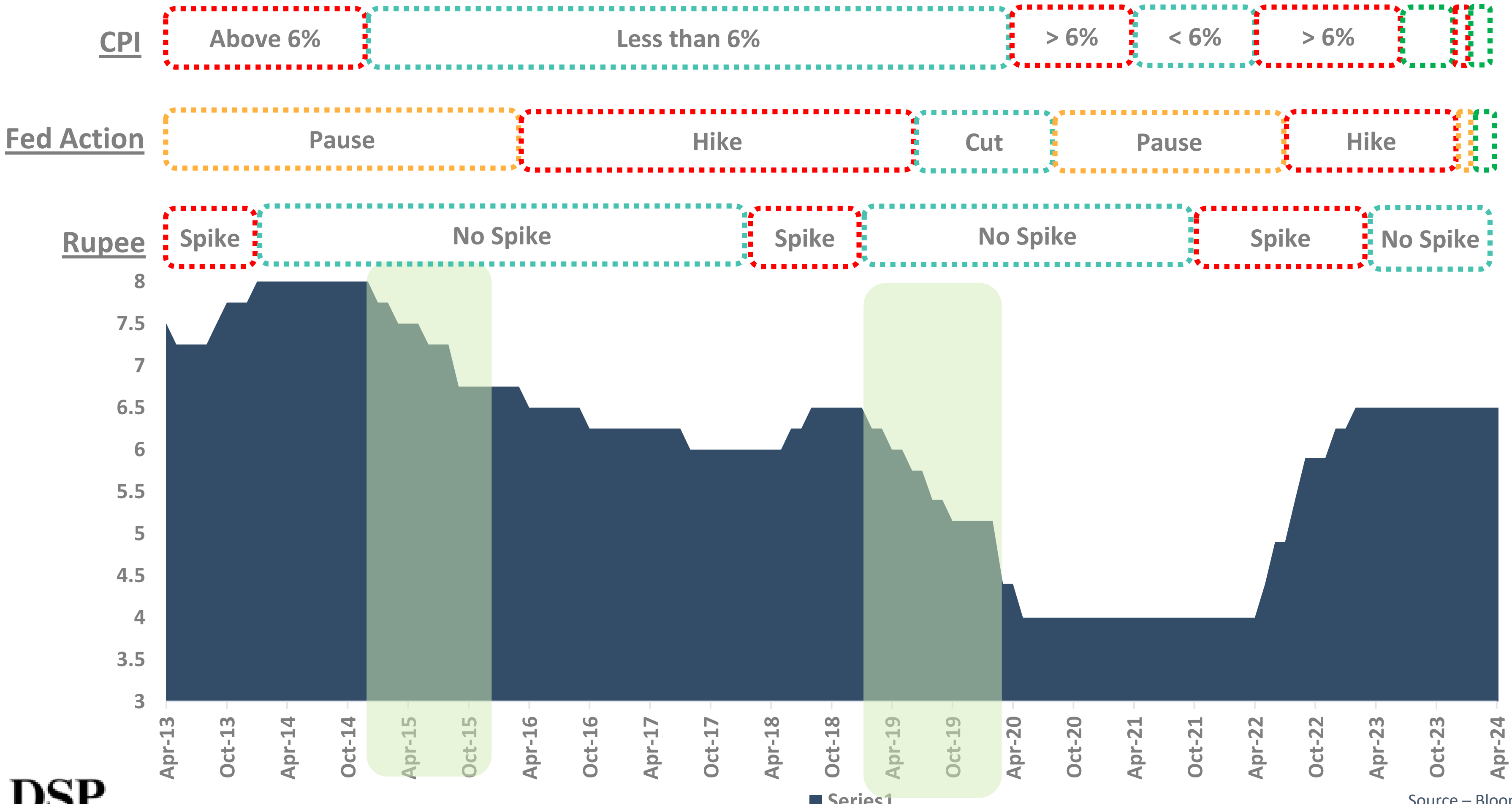
What makes RBI Cut Rates?

In our view, those reasons are now all present!

Expect RBI cuts: Fed cuts were the final hurdle for RBI 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 already cut rates by 50 bps
  - ✓ Forex reserves of $700bn+ & expected normalization of trade deficit to keep rupee stable
  - ✓ Inflation risks seem contained



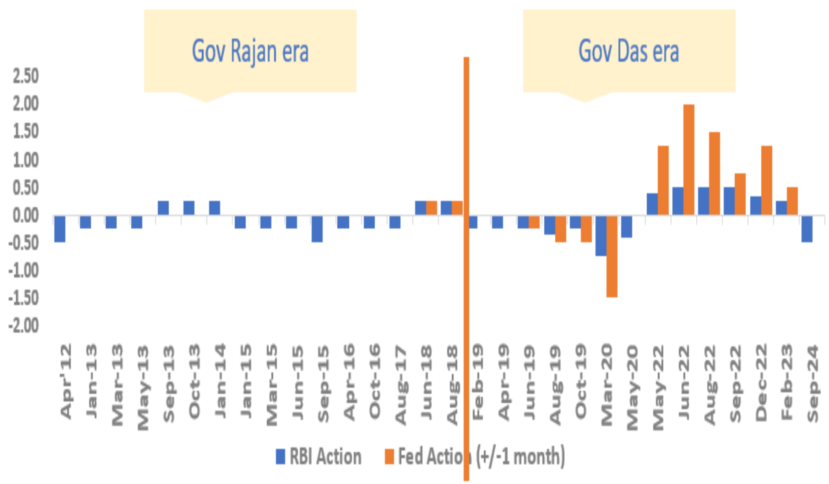
Source – Bloomberg

DSP

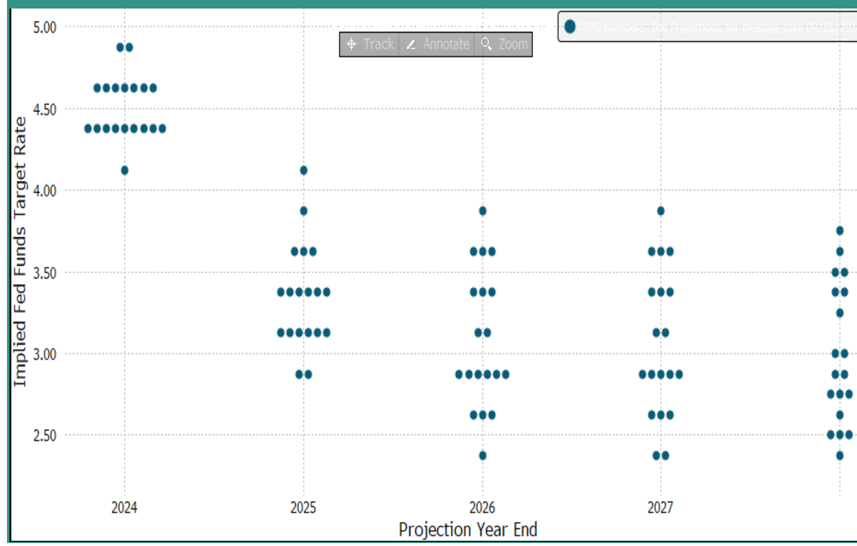
FPI: Foreign Portfolio Investment; CPI: Consumer Price Inflation; Fed: Federal Reserve; RBI: Reserve Bank of India

RBI actions followed FOMC – expect the same going ahead

- **Fed announced a cut of 50 bps in Sep policy**
  - In Gov Das' regime RBI action has echoed Fed actions
  - RBI actions have often echoed nearest Fed's policy
  - RBI revised its stance in Oct policy to "Neutral",
    - Following cut by Fed in Sep



- **Fed dot plot indicates another 50bps cut by the end of CY**
- **Longer-term rate cut projections remain intact**
- **Implies RBI rate cuts' should follow**



Takeaway:
RBI MPC has shades from FED FOMC. RBI revised its stance post fed cut

DSP

Source – Bloomberg, Federal Reserve

RBI: Reserve Bank of India; US FED: US Federal Reserve; FOMC: Federal Open Market Committee; MPC: Monetary Policy Committee

Core CPI remains comfortable

Growth hits a soft patch

FPI flows to support Rupee

US FED has started rate cuts

No barriers to RBI rate cuts anymore

FISCAL POLICY

Generally, it drives the long bond yields

It is reflected in demand/supply equation

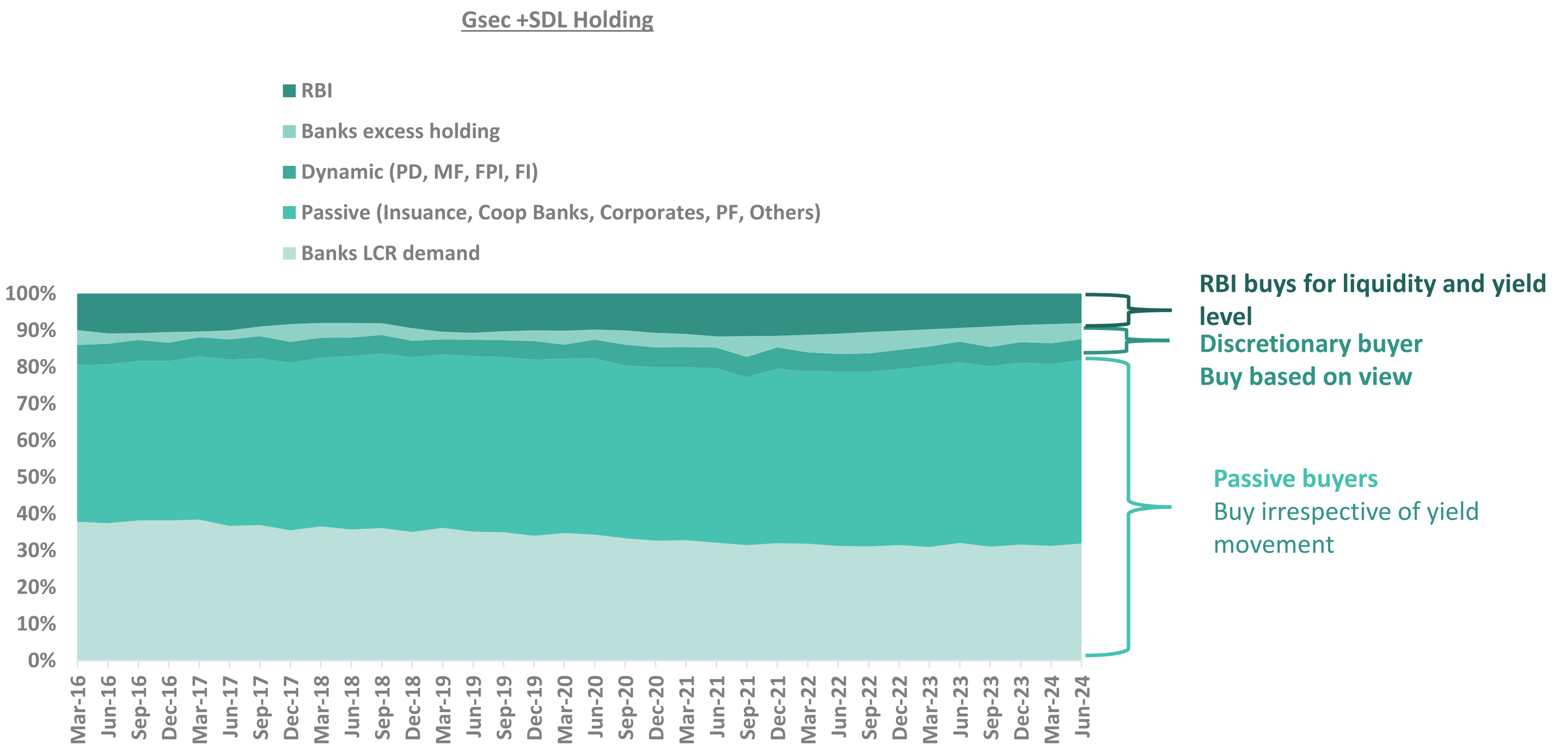
Fiscal policy is favouring bonds right now

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



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

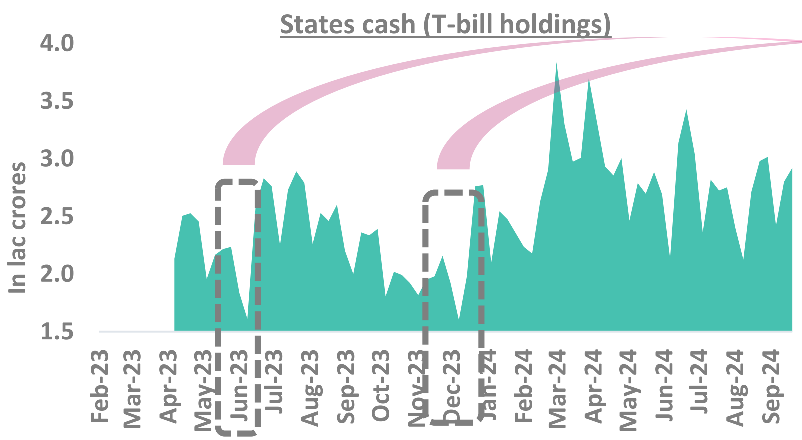
Source – DBIE

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

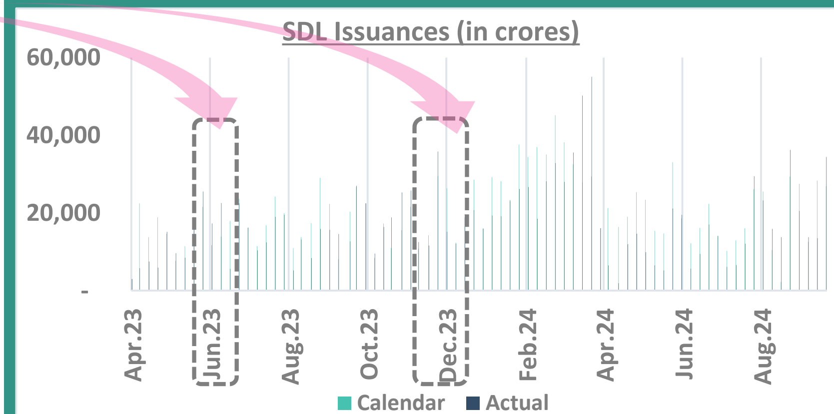
Comfortable demand/supply dynamics for FY25

SDL supply only increases when states cash dip

- ➢ **States cash balance remains comfortable**
- ➢ **Center has front-loaded devolution of tax (June and Oct)**
  - Expect state cash balances to increase further
- ➢ **Issuance is expected to be lower than calendar**



- ➢ **Actual SDL borrowing in line with expectations**
  - Borrowing higher than the calendar only when state cash balances dipped
  - YTDFY25 issuance 23% lower than calendarized
- ➢ **With high states cash balances SDL issuance impact is expected to be limited**



Takeaway:
SDL demand-supply to remain well-matched in FY25

DSP

Source – DBIE, RBI

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

Banks SLR holdings has increased again

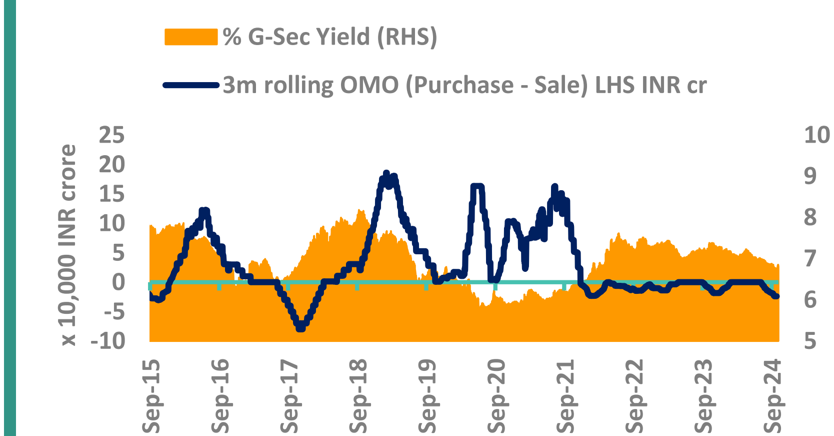
- **Banks SLR holdings has again increased to 29.77%**

- **The current pace of purchases is expected to continue**
  - As natural NDTL growth will still lead to demand
  - Proposed LCR guidelines will prompt further buying of SLR securities

Banks SLR (in %)(SCBs Investment-Deposit Ratio)

- **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**
  - Liquidity conditions have improved now
  - Overnight rates below REPO despite VRRRs



Takeaway:
Proposed LCR guidelines may prompt banks to buy more SLR securities

DSP

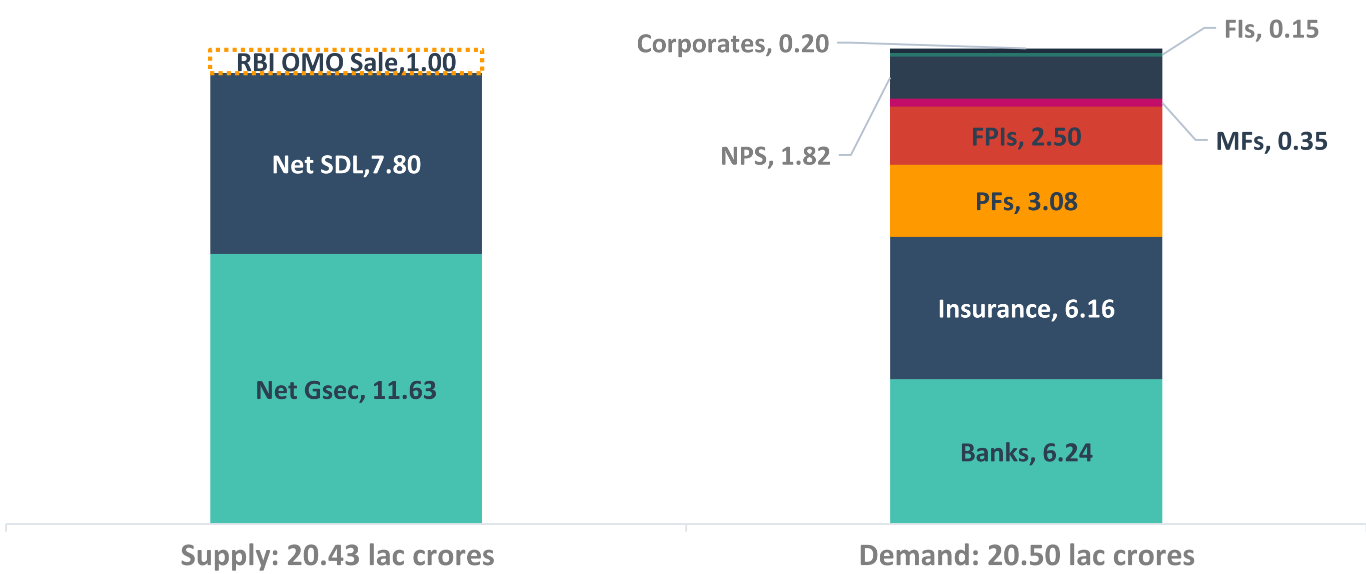
Source – Bloomberg, DBIE, Internal

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.

- **Additional RBI OMO Sales & bank's demand of Rs. 2 lac crores contingent on proposed LCR framework**



Takeaway:
Demand-Supply favourable in FY25.

DSP

Source – Internal, CGA

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

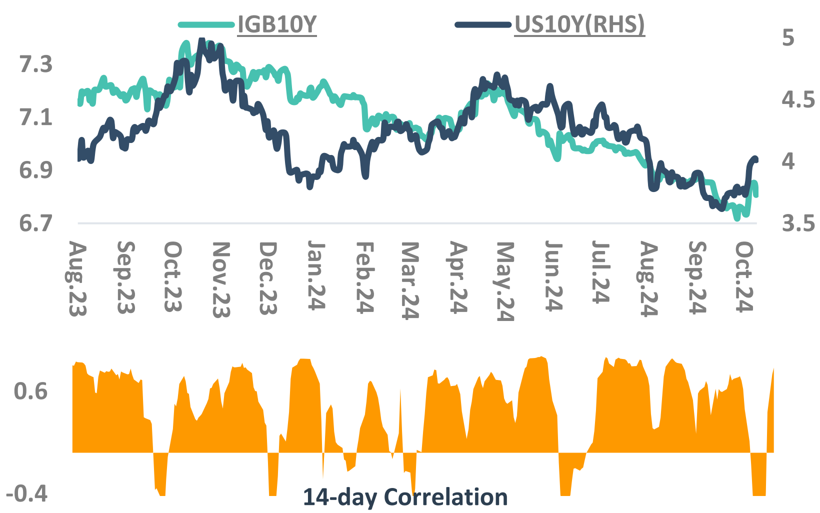
Indian yields tracking Global yields

But with lopsided beta

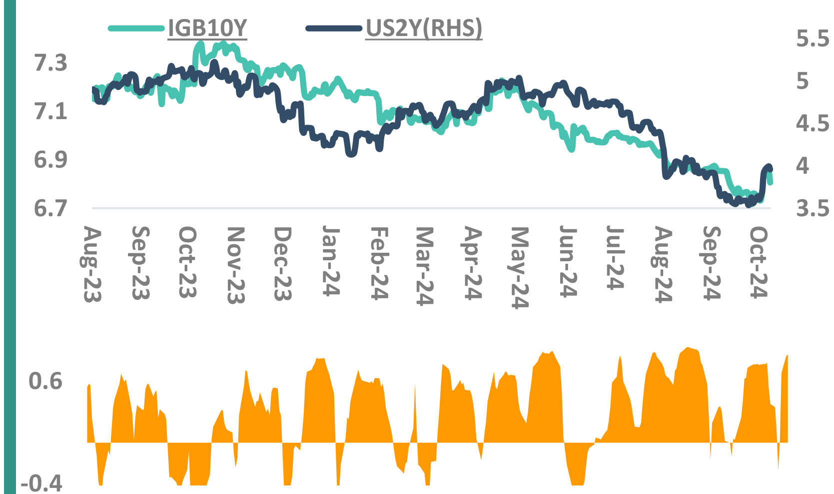
GLOBAL DRIVERS

Impact of US yields on Indian yields

- **So far Indian 10Y yields tracked US 10Y**
  - Except for times when UST has risen sharply
- **Correlation only broke due to RBI actions**
  - Higher yields -> OMO announcement (Oct'23)
  - Lower yields -> Liquidity infusion - VRR (Dec'23)



- **Going forward, India 10Y to track US 2Y**
  - Rate cut expectations in US gets priced-in in US2Y
  - Rate cuts expectations in US to mirror in India, thus getting priced-in in India 10Y



Takeaway:
Expect India 10Y to closely track US2Y

DSP

Source – Bloomberg, Internal

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 reversal is aided liquidity; but drain expected as festive season starts

Fx inflows / outflows

Dollar buy by RBI has supported liquidity

RBI Liquidity Management Tools

VRR, VRRR, OMOs, CRR change; Fx buy/sell

Continued fine tuning operations by RBI

Demand-Supply

Supply

Reduced T-bill borrowing by INR 65k cr (across 6m/1y)

Supply contained in 3m and 1 Yr segment by Banks and NBFCs

Demand

Market demand continues to remain strong

MPC Action

MPC's change in stance to "Neutral" positive for liquidity sentiment

Takeaway:

We remain long across our money market funds at current spreads. As rate cut expectations build in, expect spreads to compress.

DSP

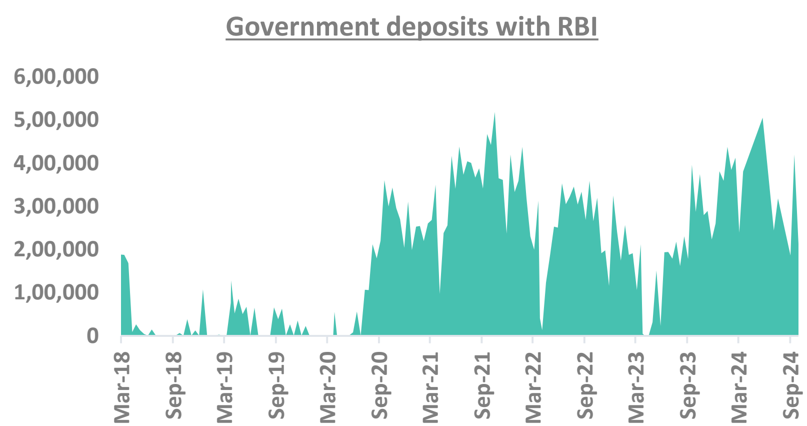
CIC: Currency in Circulation; CD: Certificate of Deposits; OMO: Open Market Operations; VRR: Variable Rate Repo; VRRR: Variable Rate Reverse Repo; RBI: Reserve Bank of India: GOI: Govt of India

Liquidity to continue to remain in surplus

➢ Core liquidity remains high at ~INR 4.8 lakh cr

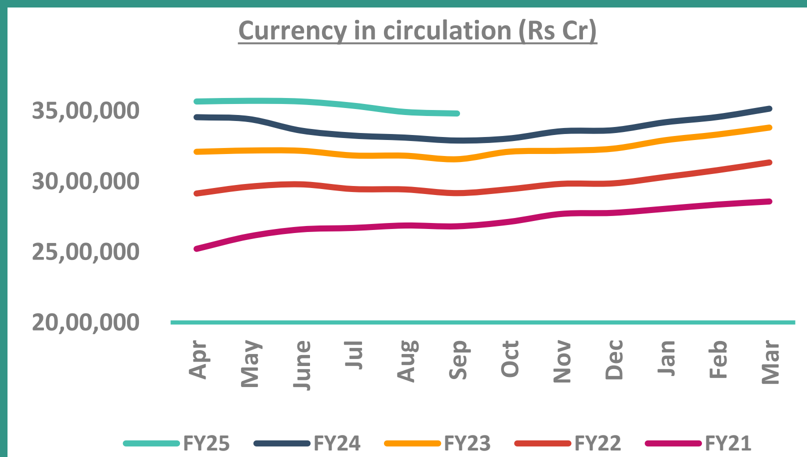
- Multiple drives impacted liquidity positively
  - Fx intervention by RBI of ~INR 87k crore during Q2FY25
  - CIC reversal of ~INR 70k crore
  - However, OMO Sales by RBI of ~INR 24k crore during the quarter drained the liquidity to that extent

➢ Expect liquidity to remain in surplus despite near-term liquidity draining events like CIC outflow



➢ We are entering the festive season wherein CIC leakage will be there; yet expect liquidity to remain comfortable

- Jan-May saw a CIC build up of ~INR 2lakh cr, which contributed negatively to the liquidity
- Since then, reversal of ~INR 70k which aided liquidity
- However, CIC Leakage to commence as we enter the festive season.
  - ✓ Historically about ~INR 75k crore leakage in this quarter

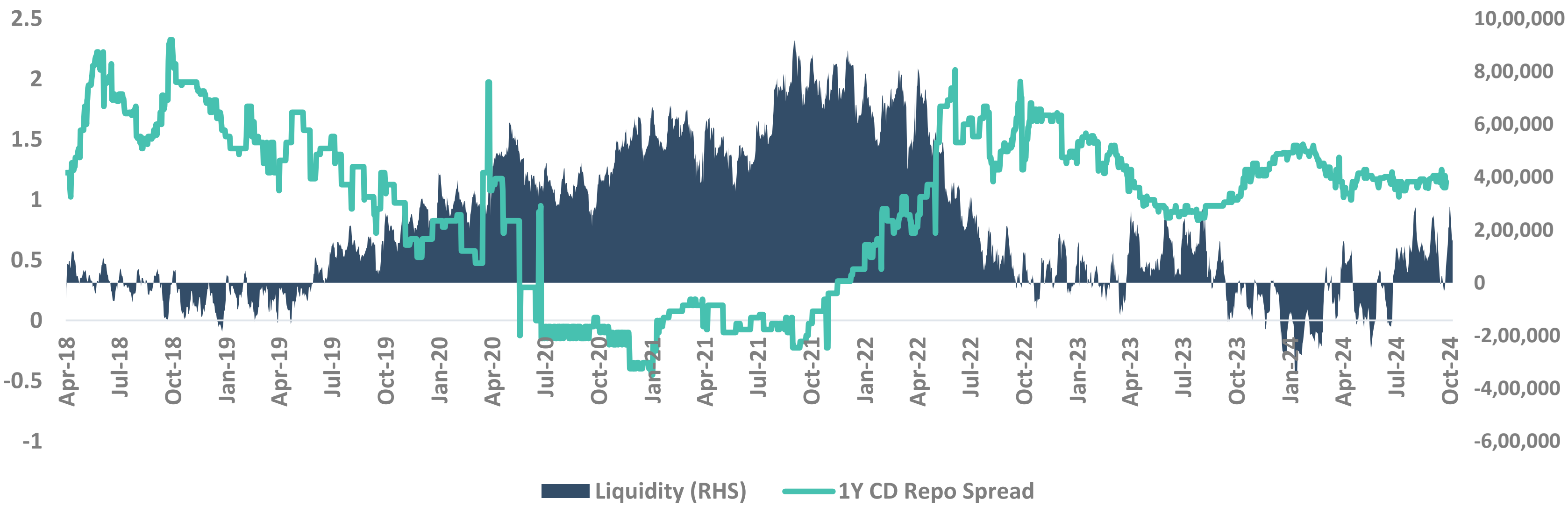


Takeaway:
Expect liquidity to remain in surplus, expect money market rates to move further down

Expect CD-Repo spreads to compress further

- **Reduced T-bill borrowing by INR 65k crore (in 6m/12m tenor) vis-à-vis same quarter last year**
  - Resulted in 1Y T-Bill rates falling from ~6.65% to 6.55%. Expect T-bill rates to hover around repo rate due to lower supply
  - Govt. announced buyback of 2025/2026 IGBs of INR 25k crore

- **1Y CD spread over policy rate still attractive at ~105bps**
  - 1YCD-Repo spreads have shrunk from highs of 140bps as of March 2024 to ~105bps now. However, with rate cut expectations building in, expect the spreads to further narrow



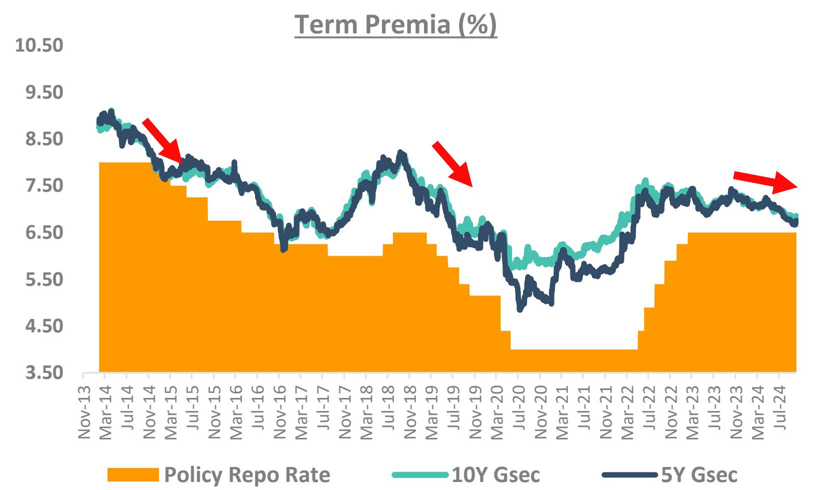
Takeaway:
Lower T-bill supply along with rate cut expectations going forward to bring money market rates further down

CD: Certificate of Deposits; T-bill: Treasury Bill

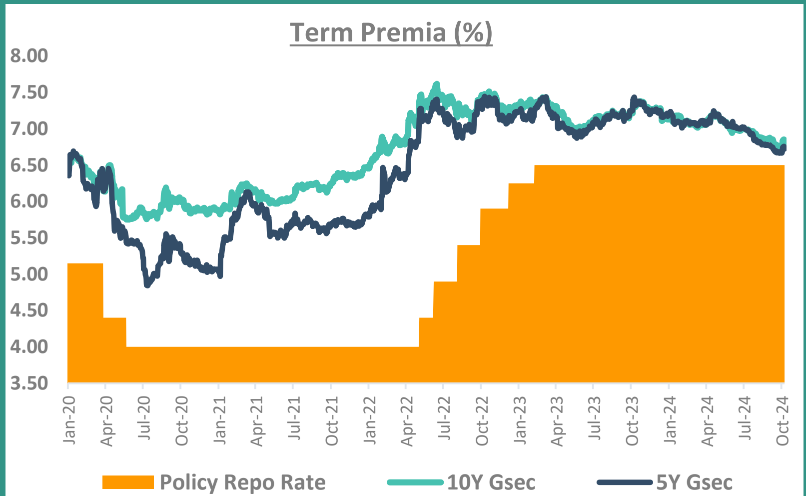
Source – Bloomberg, Internal

Term premia low, but the next move is with rate cuts

- **Term premium falls sharply before rate cuts**
  - It still can move lower as rate cuts start
- **Why do we prefer slope, not absolute levels?**
  - The slope removes the underlying demand/supply dynamics and thus can be compared across time
- **Even at current levels, demand is strong**



- **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



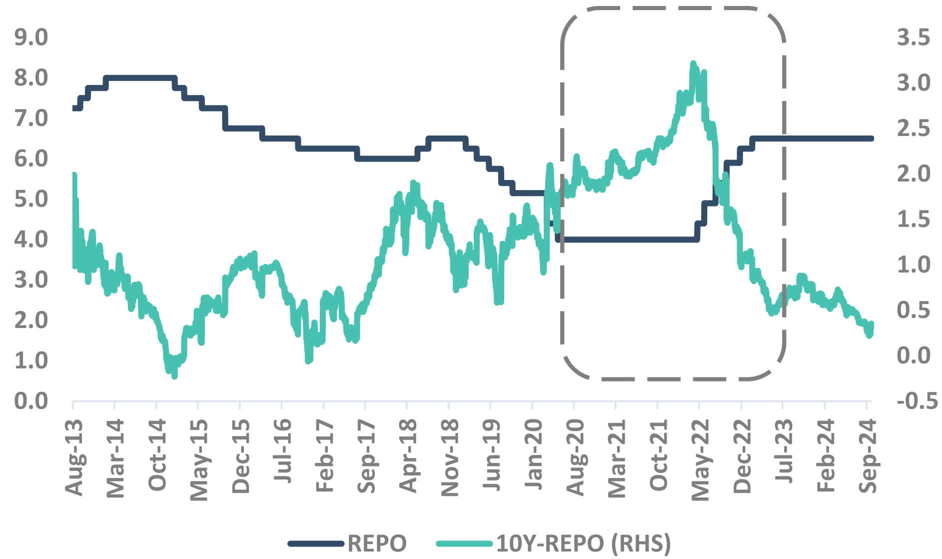
Takeaway:
Term premia is still attractive given favorable demand supply dynamics

DSP

Source – Bloomberg

Recency bias: Is 10Y-Repo Spread low?

- The 10Y yield and repo spreads are not low
- Incorrect to compare with covid era spreads: Recency bias
- Covid was exceptional times, and barring covid, the spreads are not low
- With the govt. borrowing reduced and bond inclusion flows, the spread is not bad.



Takeaway:
While recently spreads have reduced, past data suggests that current yield levels are not extremely low

DSP

Source – Internal, Bloomberg

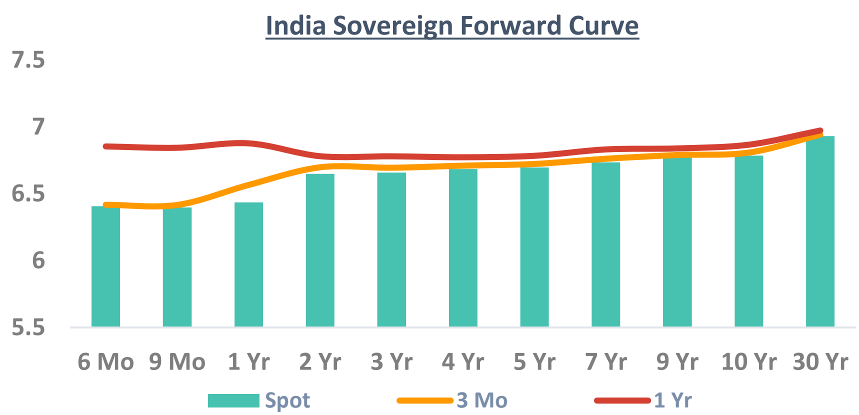
CHECKLIST

DSP FI Framework checklist

Drivers	1Y	5Y	10Y	>10Y	Remarks
Monetary Policy	**Positive**	**Positive**	**Positive**	**Positive**	
Inflation	Positive	Positive	Positive	Positive	Headline below 4%, Core CPI continues to be comfortable
Growth	Neutral	Neutral	Neutral	Neutral	Growth hits a soft patch, festive season demand important
CAD/BOP/ Currency	Neutral	Neutral	Neutral	Neutral	External sector pressures low
Fiscal Policy	**Positive**	**Positive**	**Positive**	**Positive**	
Supply	Positive	Neutral	Positive	Positive	Lower FY25 supply dynamics. Tbills supply cut.
Demand	Neutral	Positive	Neutral	Positive	Banks SLR holding increase. LCR guidelines to further increase bank's demand
FPI Flows	Neutral	Positive	Positive	Neutral	FPI flows continue
Global	**Neutral**	**Neutral**	**Neutral**	**Neutral**	
Global yields	Positive	Positive	Positive	Positive	Fed has cut, and will likely cut further at a gradual pace
Geopolitics	Negative	Negative	Negative	Negative	Geopolitical risks on the horizon
Commodities	Neutral	Neutral	Neutral	Neutral	Risks balanced, but volatility increased
Others	**Neutral**	**Neutral**	**Neutral**	**Neutral**	
RBI Regime	Neutral	Neutral	Neutral	Neutral	RBI changed its stance post Fed cut
Total	**Positive**	**Positive**	**Positive**	**Positive**	

DURATION DECISION

DSP Duration decision:



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

Large gap between the spot 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.

- **Short-term yields (2Y-5Y) may rally more than long term (7Y+)**
  - *The forward curve is inverted, we think that it is unlikely to realize*
- **Yet, long term yields may end up making more money**
  - *The duration of 30Y is 4x the duration of 4Y bond*
  - *i.e. for every 40bp fall of 4Y, the 30Y bond needs to fall only 10bp*
    - *Even if curve bull steepens by 30bp, long bonds give similar value*

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

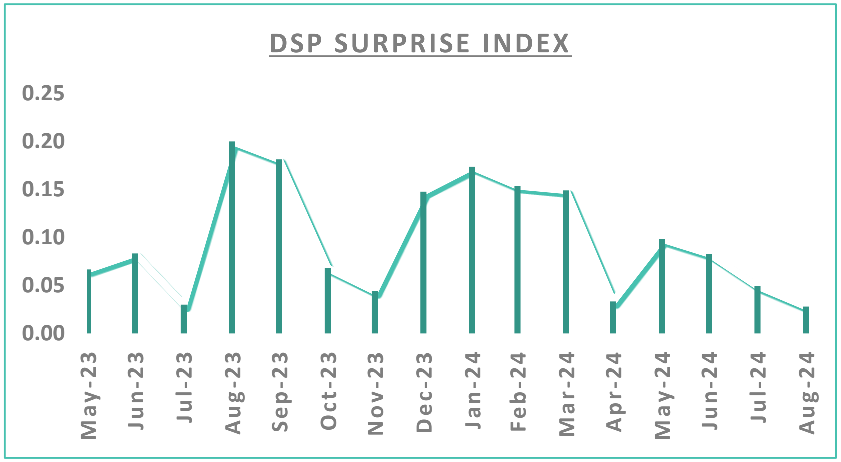
Source – Bloomberg; as on 9/Oct/24

DSP "SURPRISE" Index

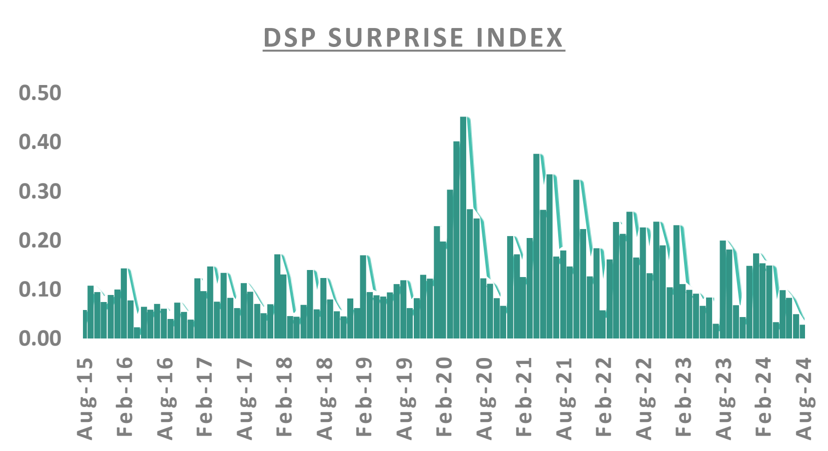
WHAT'S NEW

DSP Surprise Index: No more uncertainty in US data

- **In last 1-Year**
  - The index spiked in Aug'23, Dec'23 and May'24
  - During these times, the markets were most volatile
- **However, the Index has fallen in last quarter**
  - Signifies that the uncertainty in US data has left
  - Since it coincides with softer US data, the slowdown in US seems more certain now



- **DSP Surprise Index to identify high risk times**
  - During these times, "random" and unpredictable risks are higher than usual.
- **DSP Surprise Index identifies when the markets are surprised by data (US)**
  - Chose 8 indicators from inflation, growth and labor.
  - Currently, we are in low uncertainty phase
- **Interpretation**
  - During high DSP Surprise Index times, we would prefer to rationalize our risks.
  - During low DSP Surprise Index times, we would prefer to run conviction trades



Takeaway:
US data continues to move as expected, and there are much fewer surprises!

DSP

Source – Bloomberg, Internal

We have discussed duration and yield movement.

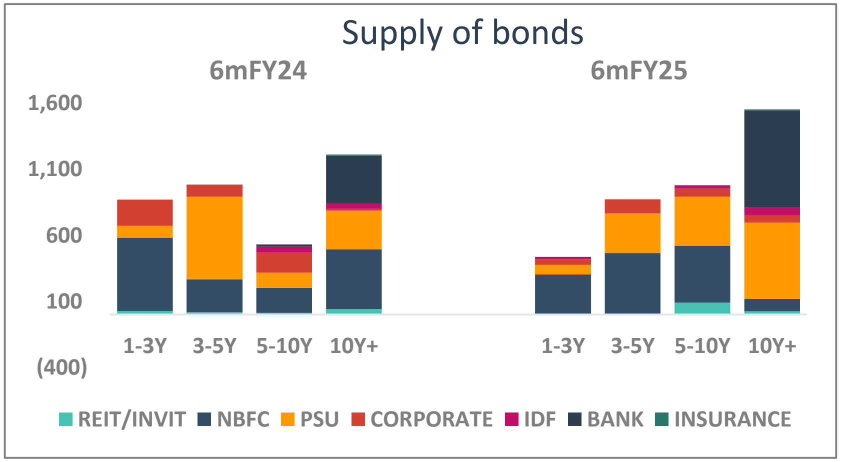
How do we choose corporates and credit?

DSP Asset Allocation: Shift from GSec to Corporate Bonds

➢ **Demand-supply mismatch in 10y+ AAA bucket**
- Supply front loaded by banks in H1FY25
- No substitute for issuance by HDFC and Reliance in FY24

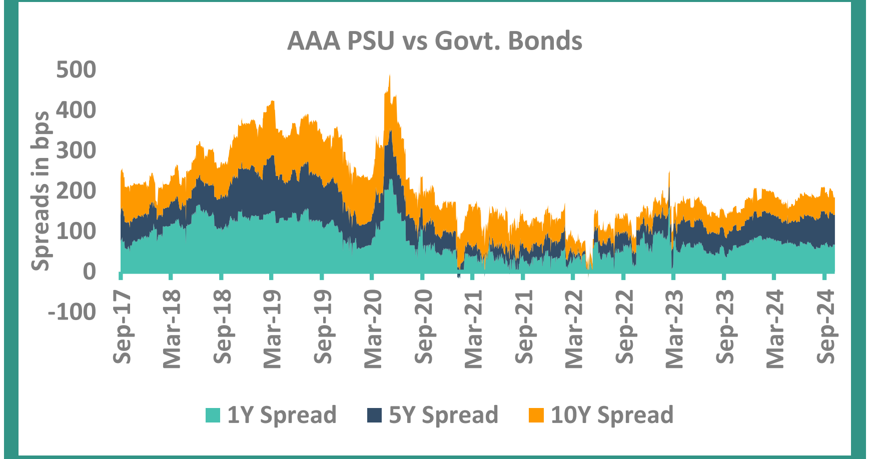
➢ **3y-5y AAA spreads to reduce/stabilize**
- RBI stance change& increasing probability of rate cuts
- Better flows to Mutual Funds/Corporates

➢ **1y-3y NBFC supply to remain elevated**
- Will continue to provide higher YTM however capital gains will be limited



➢ **AAA PSU bond spreads have started to shrink in past quarter**

- 3Y PSU spreads have narrowed to 68 bp from 72 bp and NBFCs continue to be around 100-110 bp.
- 10y PSU spreads narrowed from 42-48 bp to 37-42 bp
- 15y PSU spreads narrowed from 35-36 bp to 30 bp



Takeaway:
AAA PSU spreads look attractive and expected to compress further in the upcoming quarters

DSP

PSU: Public Sector Undertaking, NBFC: Non-Bank Financial Companies, IDF: Infrastructure Debt Fund

Source – Bloomberg, CCIL, Internal

DSP Credit Investment Process – Focus on Governance

CREDIT PROCESS

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. Some slowdown in CV sales.
Capital Goods	🟢	🟠	🟠	Infrastructure thrust 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 trends 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	🟢	🟠	🔴	Asset quality has weakened in the unsecured segment led by heat-wave, elections and over-leveraging in some pockets.
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 favorable 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?

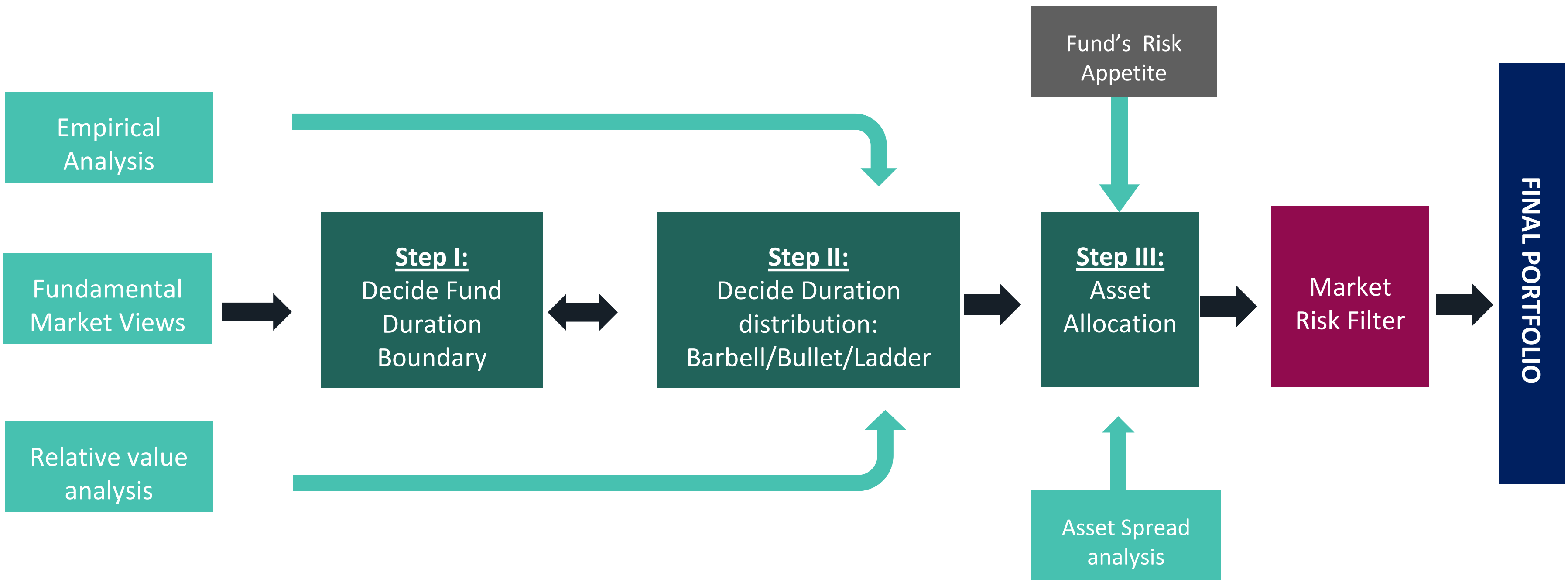
Now

Our Portfolio creation framework

DSP Portfolio Creation: Multi-step process

PORTFOLIO CREATION

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.

DSP

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 October 8, 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