# Investment Strategy

Private and Confidential

# Executive Summary

**Global / US**

- Economic growth likely to surprise on upside, supporting earnings
- However, inflationary pressures are rising along with probability of Fed tapering
- High growth stocks are most vulnerable to valuation de-rating if above fructifies
- But bond yields are being range-bound, giving mixed signals
- European equities relatively well placed in improving growth environment

**India - Equities**

- Indian Equities have outperformed as expected (as Covid curve receded)
- Markets have remained resilient despite short term blip in economic activity
- **Maintain Equal Weight (medium term)** as eventually economic activity shall catch up
- Local economic cycle far from peak, providing confidence of good future growth
- However, brace for some correction led by global factors – ‘buying opportunity’
- Prefer **exposure to Recovery themes & Banking Equities** (on dips, if not already done)

**India – Fixed Income**

- RBI’s G-SAP 1.0 & 2.0 – likely to influence interest rate curve to flatten
- Prefer medium duration portfolios as rates are likely to edge up gradually in medium term

**Gold**

- Contrary to expectation, Gold has rallied as Real Yields have declined while Dollar too has fallen. Continue to maintain mild Under Weight bias

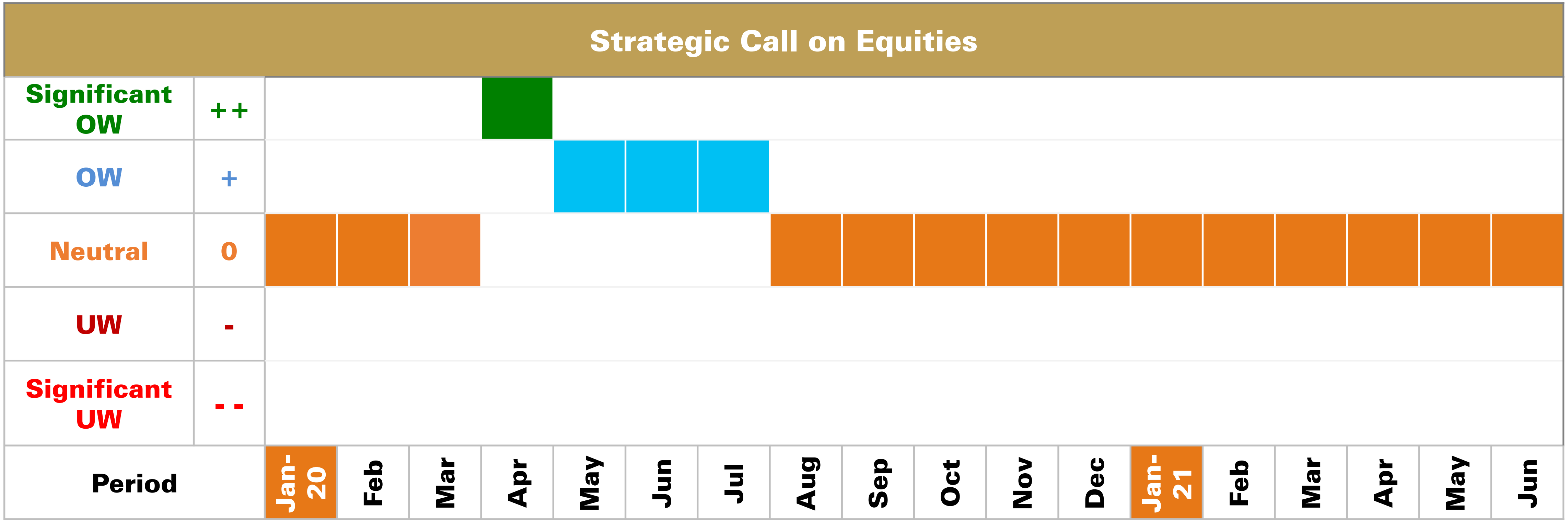
# Asset Allocation Positioning

| Asset Class | Short Term | | | | | Long Term | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | - - | - | 0 | + | ++ | - - | - | 0 | + | ++ |
| **Equities** | | | ■ | | | | | ■ | | |
| Large Cap & Diversified | | | ■ | | | | | ■ | | |
| Mid & Small Cap | | | ■ | | | | | ■ | | |
| Global Equities* | | | | ■ | | | | ■ | | |
| **Debt** | | | ■ | | | | | ■ | | |
| Low Duration Debt | | | ■ | | | | | ■ | | |
| Short & Medium Term | | | ■ | | | | | | ■ | |
| Credit Fund | | ■ | | | | | ■ | | | |
| Duration | | | ■ | | | | ■ | | | |
| **Gold** | | ■ | | | | | ■ | | | |

| Legend | |
|---|---|
| ++ | Strong Overweight |
| + | Overweight |
| 0 | Equal weight |
| - | Underweight |
| - - | Strong Underweight |
| ◆ | Previous Position |

Note: *Prefer mild tilt towards Cyclicals

# Strategic Indian Equity Allocation (recent history)



Covid curve peak + Vaccines

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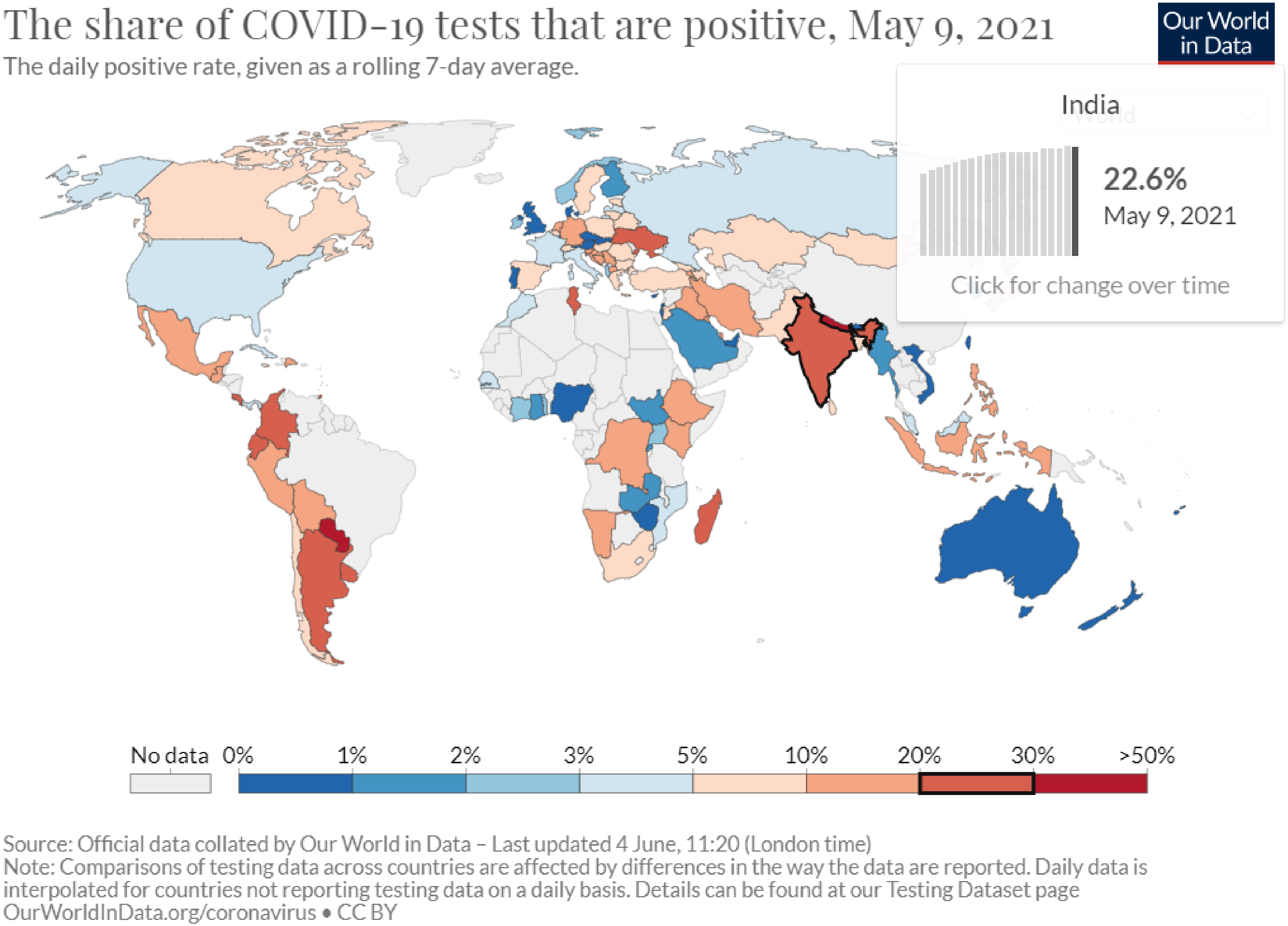
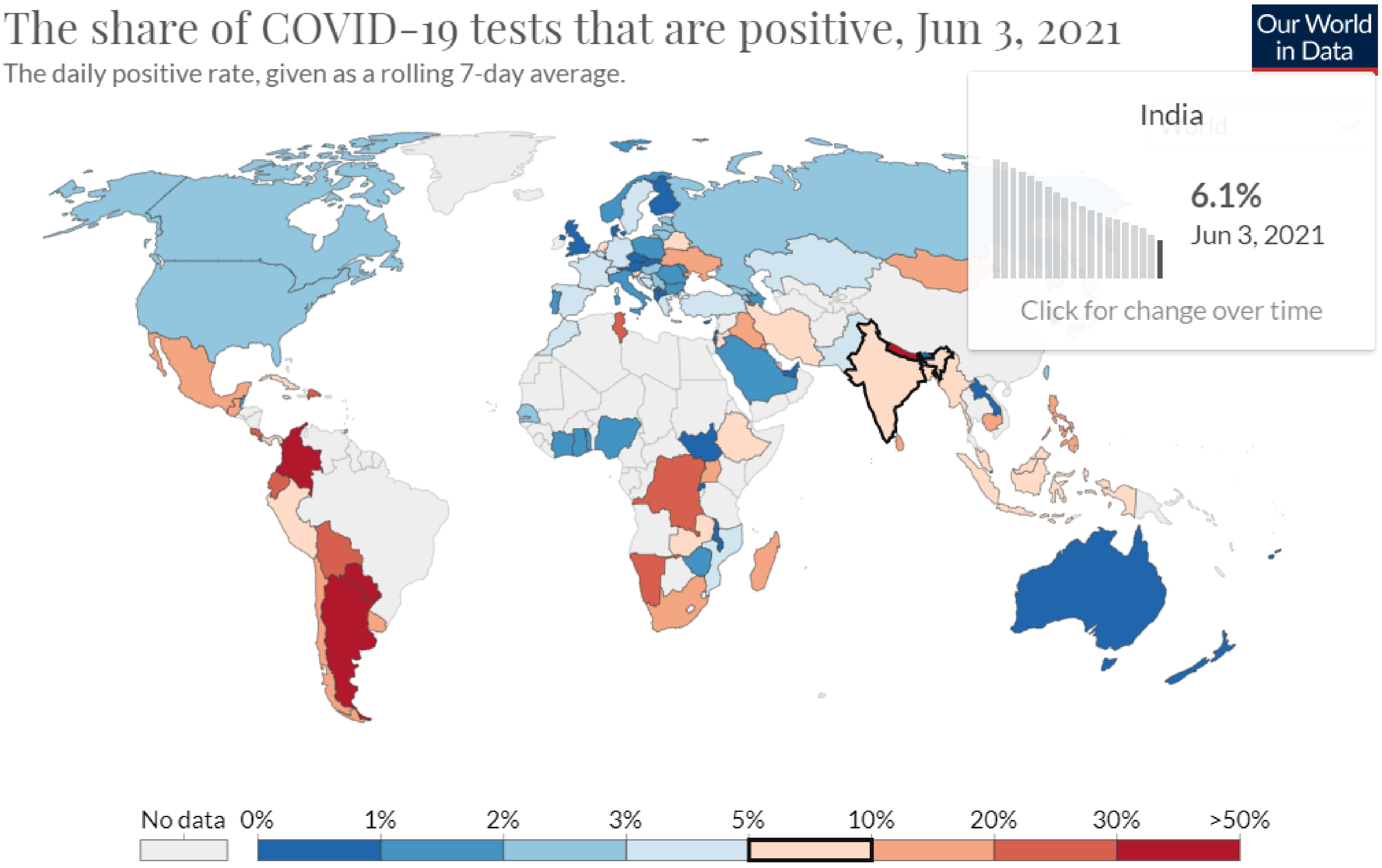
Reopening & Growth resuming

# India – Covid Test Positivity Rate – May 9, 2021

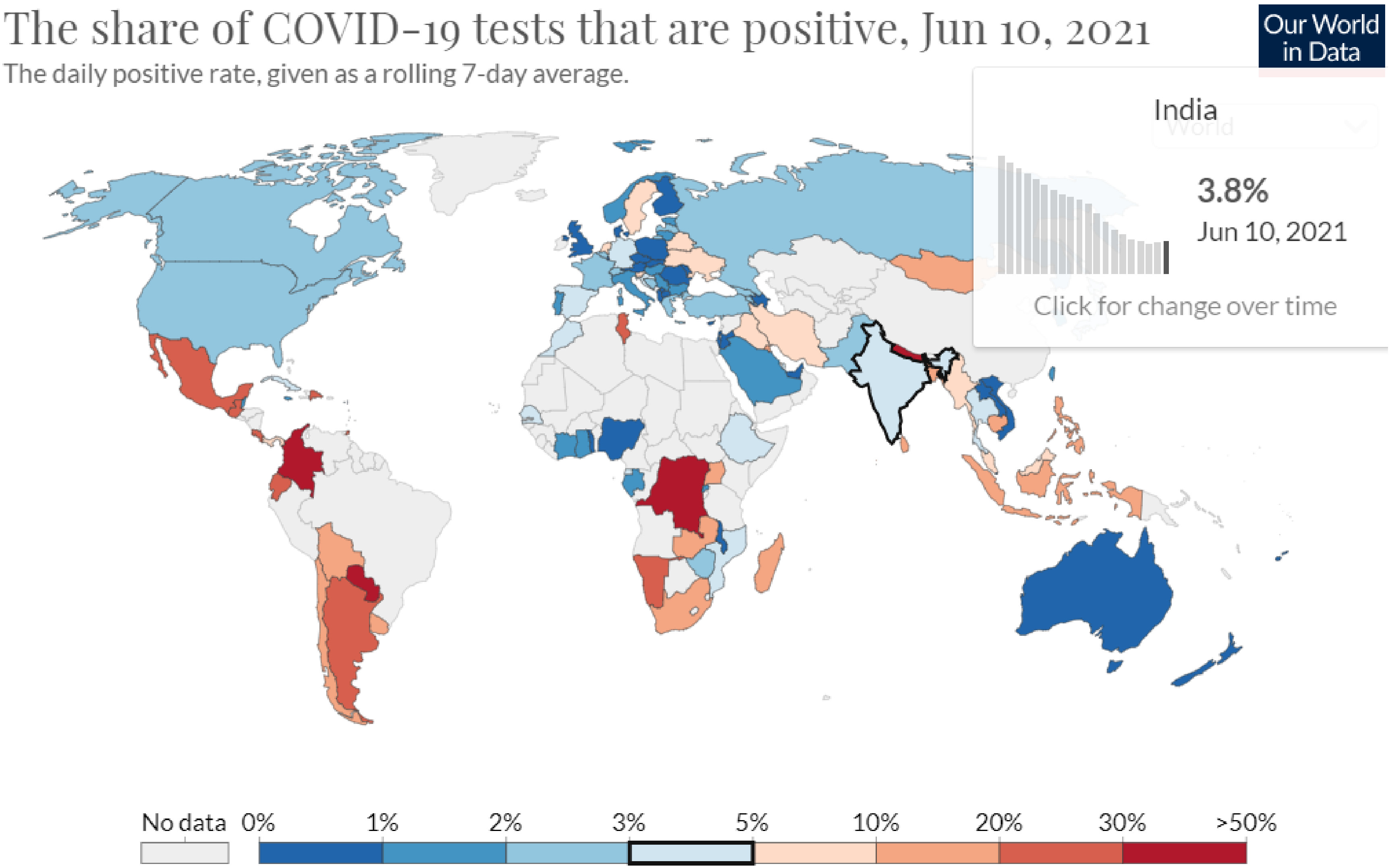


# India – Covid Test Positivity Rate – Jun 3, 2021




Source: Official data collated by Our World in Data – Last updated 4 June, 11:20 (London time)
Note: Comparisons of testing data across countries are affected by differences in the way the data are reported. Daily data is interpolated for countries not reporting testing data on a daily basis. Details can be found at our Testing Dataset page
OurWorldInData.org/coronavirus • CC BY

# India – Covid Test Positivity Rate – Jun 10, 2021




Source: Official data collated by Our World in Data – Last updated 11 June, 13:30 (London time)
Note: Comparisons of testing data across countries are affected by differences in the way the data are reported. Daily data is interpolated for countries not reporting testing data on a daily basis. Details can be found at our Testing Dataset page
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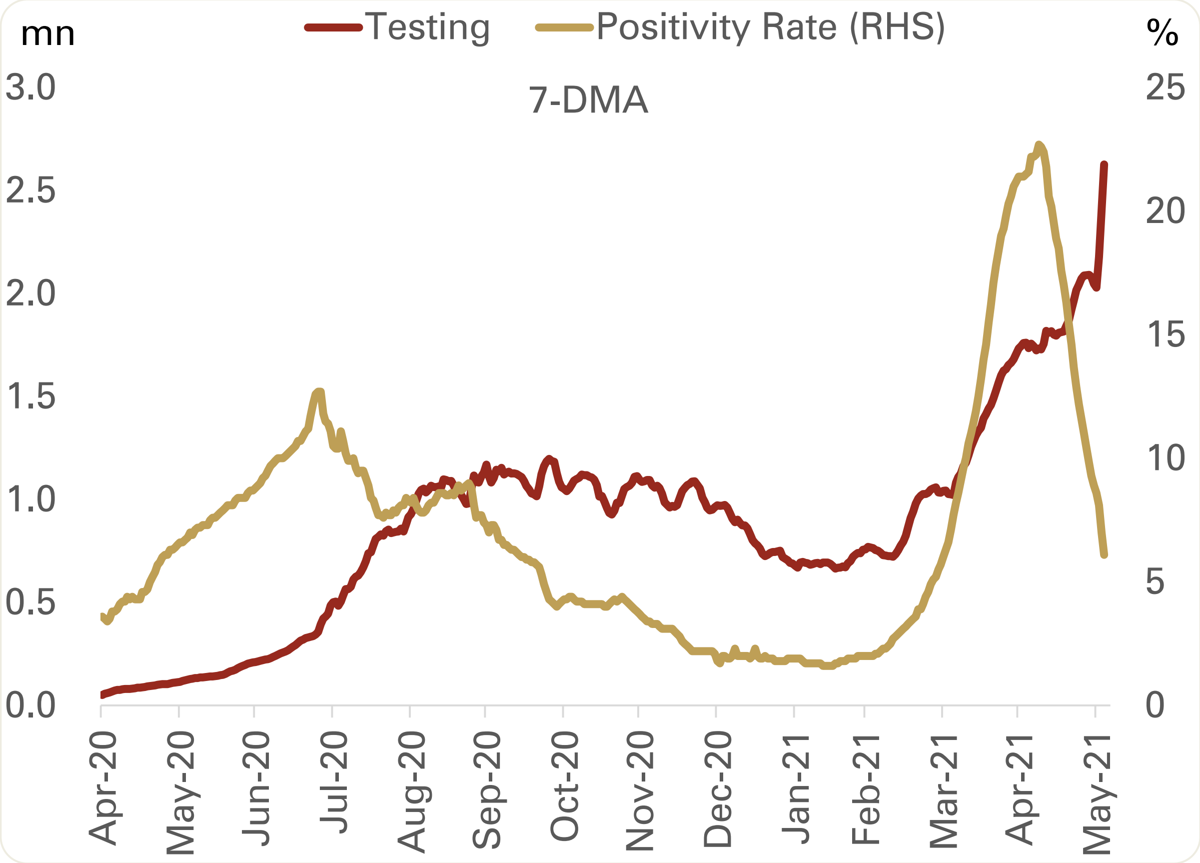
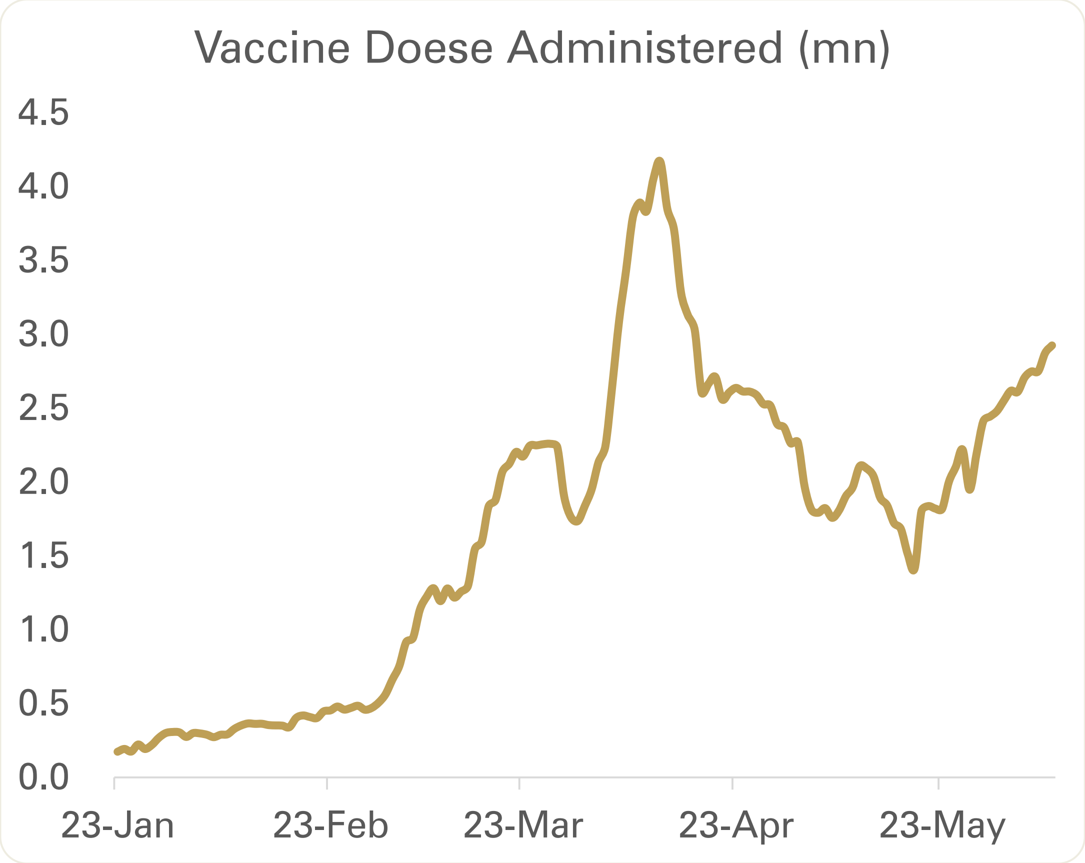
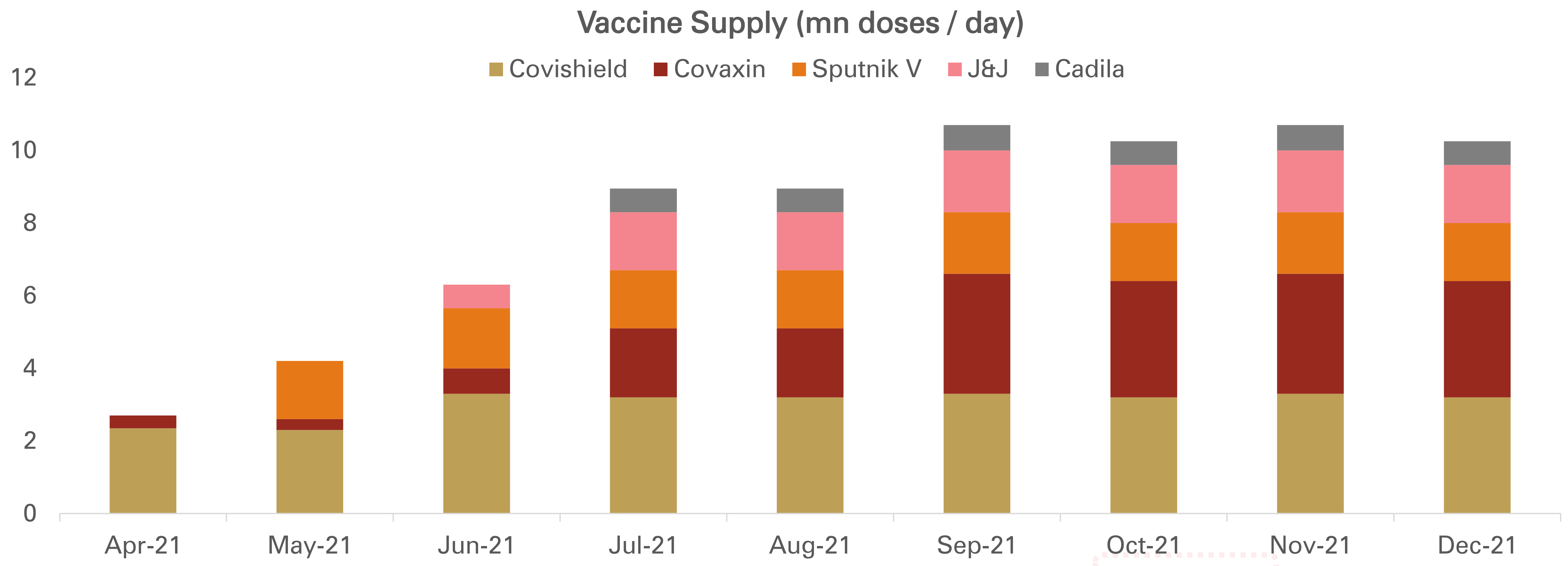
# India–Covid moderating Positivity Rate, higher testing & Vaccination




- In our last edition, we highlighted that a peak in Covid Positivity usually coincides with Peak Cases.
- After peak in May, Case Positivity rate & positive cases have dropped materially, giving comfort of likely opening up.
- Vaccine supply too has begun to pick up pace, as expected

# Expected Vaccine supply




70 Mn Covishield doses produced per month by Serum Institute in Apr-May, 10 Mn Covaxin produced per month in Apr-May, 50Mn/50Mn/20Mn doses of Sputnik V/J&J/Cadila produced from May/Jul/Jun 21.

Government aims to ramp up vaccine production, with a pledge to produce at least two billion doses between August and December this year.

# Entire target population expected to get vaccinated by end CY21

| Vaccination Progression (in Crs) | HCWs | FLWs | Age Group 45+ yrs | Age Group 18-44 yrs | Total |
|---|---|---|---|---|---|
| Estimated Population | 1 | 2 | 27 | 59 | 89 |
| Total Vaccine Dosage required for a 2-dose vaccine | 2 | 4 | 54 | 118 | 178 |
| Total Vaccine Doses Administered | | | | | 21.6* |

| Illustrative Vaccination Progression (in Crs) | Jun-21 | Jul-21 | Aug-21 | Sep-21 | Oct-21 | Nov-21 | Dec-21 |
|---|---|---|---|---|---|---|---|
| Expected Vaccine Capacity per day | 0.4 | 0.5 | 0.9 | 1.1 | 1.0 | 1.1 | 1.0 |
| Total Vaccination doses per month | 11 | 16 | 28 | 32 | 32 | 32 | 32 |
| Cumulative Vaccine doses administered | 32 | 48 | 75 | 108 | 140 | 172 | 204 |

Health Care Workers (**HCW**) & Frontline Workers (**FLW**); *Data till 31st May 2021

If current vaccine production plan is to fructify, there is a high probability that entire targeted population (18+ age) may get vaccinated by end of the current calendar.

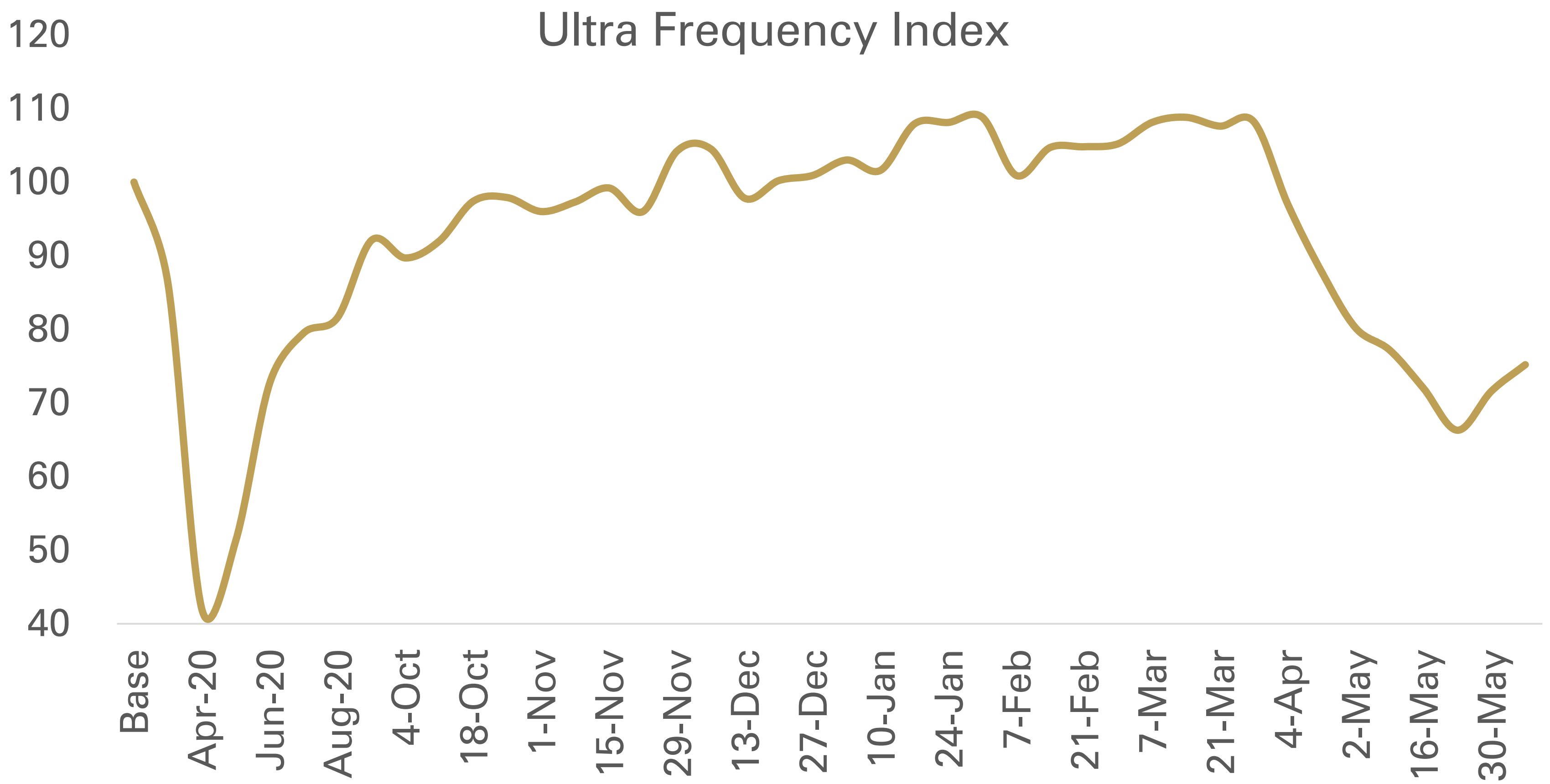
# Indian markets outperformed as Cases have declined

| Performance Since 08-May** | World | | S&P | | Nasdaq | | EM | | India | |
|---|---|---|---|---|---|---|---|---|---|---|
| Sector (%) | Avg. Wt. | Return | Avg. Wt. | Return | Avg. Wt. | Return | Avg. Wt. | Return | Avg. Wt. | Return |
| **Total** | **100** | **1** | **100** | **1** | **100** | **2** | **100** | **3** | **100** | **8** |
| Defensives | 64 | 2 | 71 | 1 | 98 | 2 | 61 | 2 | 47 | 7 |
| IT | 21 | 2 | 26 | 2 | 48 | 3 | 20 | 2 | 17 | 8 |
| Discretionary | 12 | 0 | 12 | (2) | 17 | (2) | 17 | 0 | 8 | 12 |
| Comm. Serv. | 9 | 1 | 11 | 1 | 20 | 2 | 11 | 2 | 3 | (1) |
| Health Care | 11 | 3 | 13 | 0 | 7 | 7 | 5 | 8 | 6 | 5 |
| Cons. Staples | 7 | 2 | 6 | 1 | 5 | 1 | 6 | 5 | 9 | 6 |
| Utilities | 3 | 1 | 3 | 0 | 1 | 0 | 2 | 7 | 4 | 16 |
| Cyclicals | 36 | 1 | 29 | (0) | 2 | (3) | 39 | 3 | 53 | 9 |
| Materials | 5 | (2) | 3 | (2) | | | 9 | (2) | 10 | 6 |
| Industrials | 10 | (0) | 9 | (2) | 2 | (3) | 5 | 5 | 4 | 14 |
| Real Estate | 3 | 6 | 3 | 7 | | | 2 | 1 | 0 | 21 |
| Financials | 15 | 1 | 12 | (1) | | | 18 | 4 | 26 | 7 |
| Energy | 3 | 5 | 3 | 3 | | | 5 | 10 | 12 | 15 |

Note: **India's Covid Test Peak Positivity Rate

Indian Equities underperformed Global Equities due to 2nd wave of COVID infections. However, as case positivity rate has dropped (with increased testing), domestic markets have bounced back and are now witnessing marginal outperformance on a YTD basis.

# UFI already beyond inflexion point



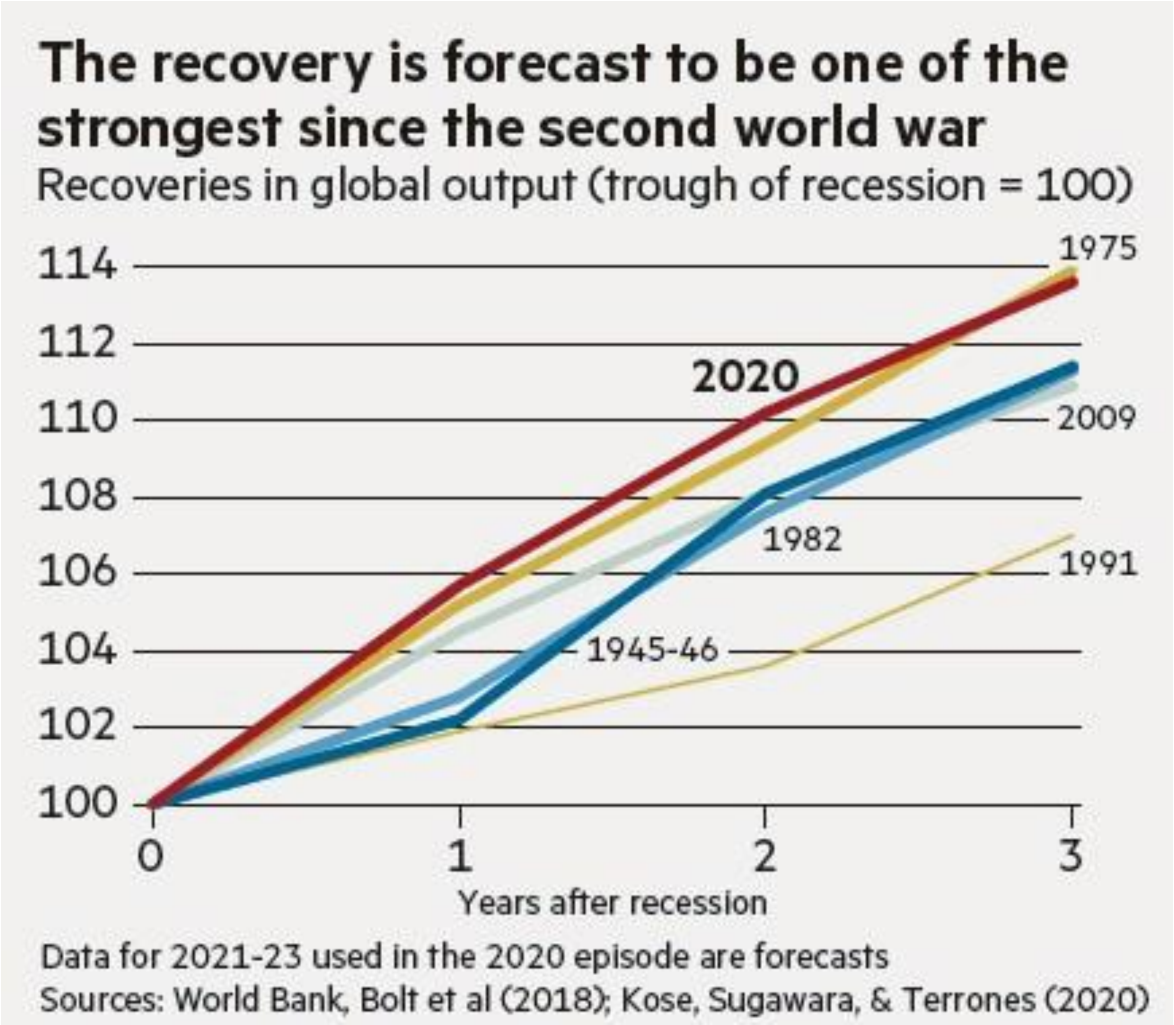

**ICICI Bank's weekly UFI** continued its upward trend for 2nd consecutive week, recording an index reading of 75.2 (vs. 71.6 in the previous week).

Rise in Vehicle registrations (indicating an improving consumer demand environment); Google & Apple mobility indicators and activity across categories such as retail, grocery, transit stations, parks & workplaces improved WoW, indicating increased people mobility upon easing of restrictions.

Bottoming out of UFI is now evident, & is expected to continue its uptrend as gradual opening up of localised lockdowns will support the broad-based recovery starting from June. Further unlocking of restrictions which is expected from the latter half of the month should enable economic activity to gather pace. With Centre's decision to procure vaccines in large supply, the pace of vaccination drive may also become expeditious, propelling recovery.

# Risk-on rally – Global Inflation remains a key risk

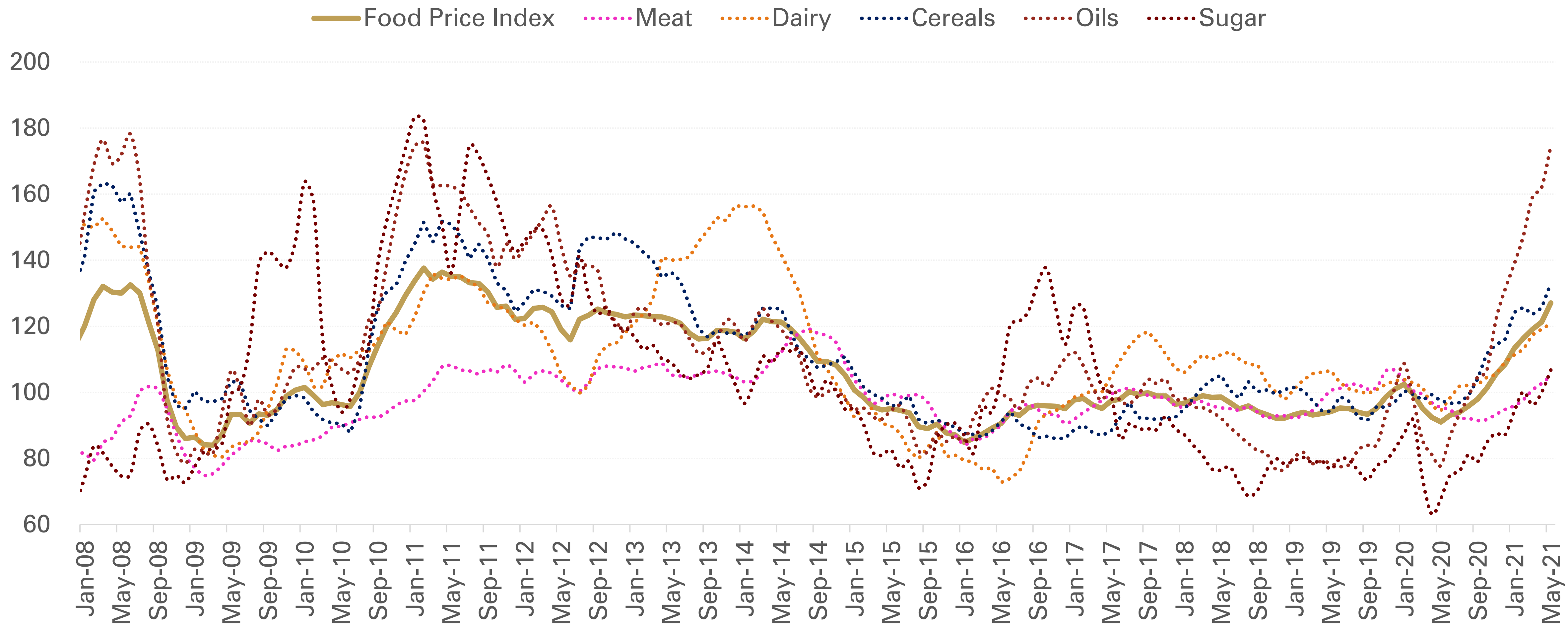
# A very strong recovery…




- As depicted in the chart (Source: FT), the recovery over current & next year is likely to be strongest since 1975
  - Economic output expected to be **above trend** in Developed Economies, esp. US
- 1970's saw a sharp rise in inflation. There is a growing risk of inflation sustaining at levels tolerable by Monetary Authorities
  - Federal Reserve, however, has articulated that the current inflation is transitory

Will higher inflation be sustained, requiring an earlier than expected monetary tightening move?

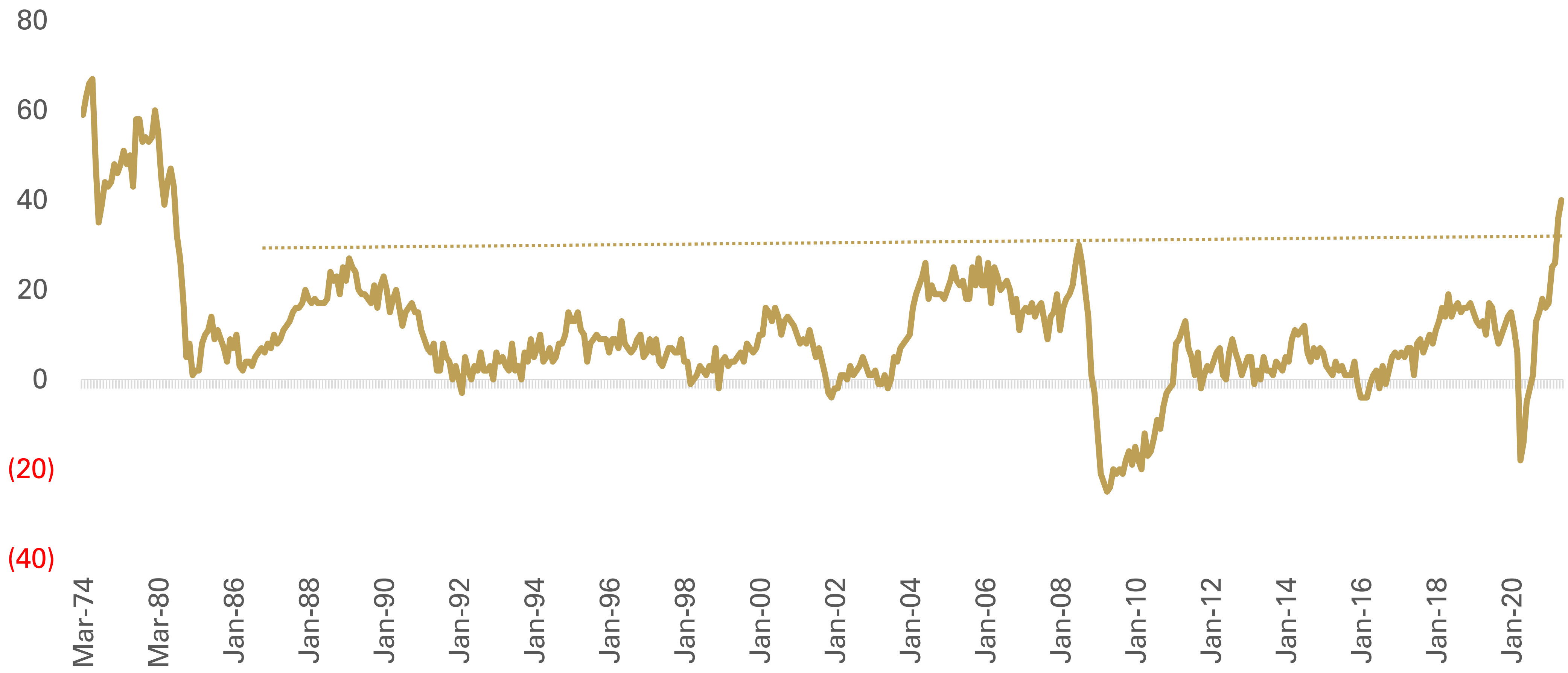
# May registered a sharp increase in value of the Food Price




FAO - Food and Agriculture Organisation of the United Nations; FFPI - FAO Food Price Index

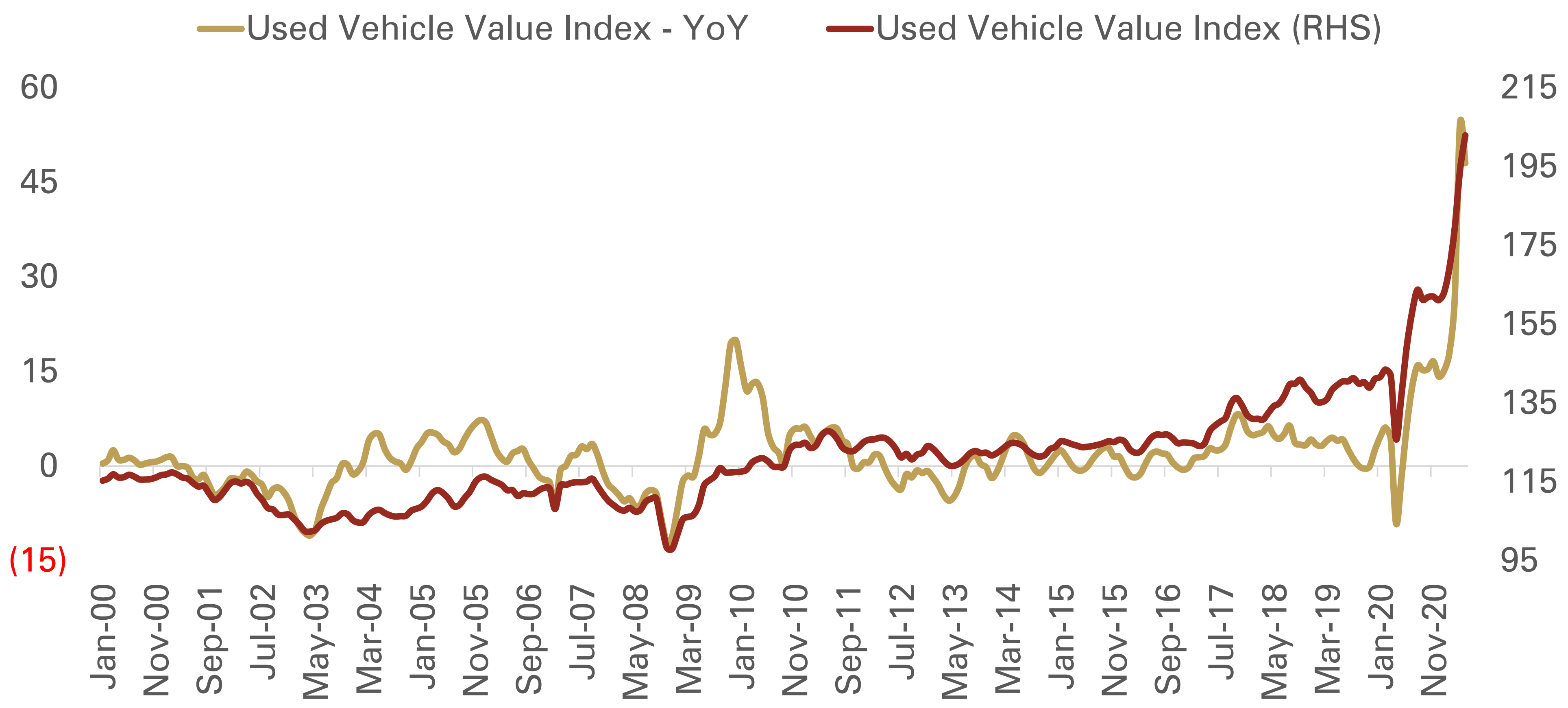
May-21 increase represented the biggest mom gain since October 2010. It also marked the 12th consecutive monthly rise in the value of the FFPI to its highest value since Sep-11, bringing the Index only 7.6% below its peak value of 137.6 points registered in Feb-11. **Sharp increase in May reflected a surge in prices for oils, sugar & cereals along with firmer meat & dairy prices.**

# NFIB Small Businesses Prices Paid (%)



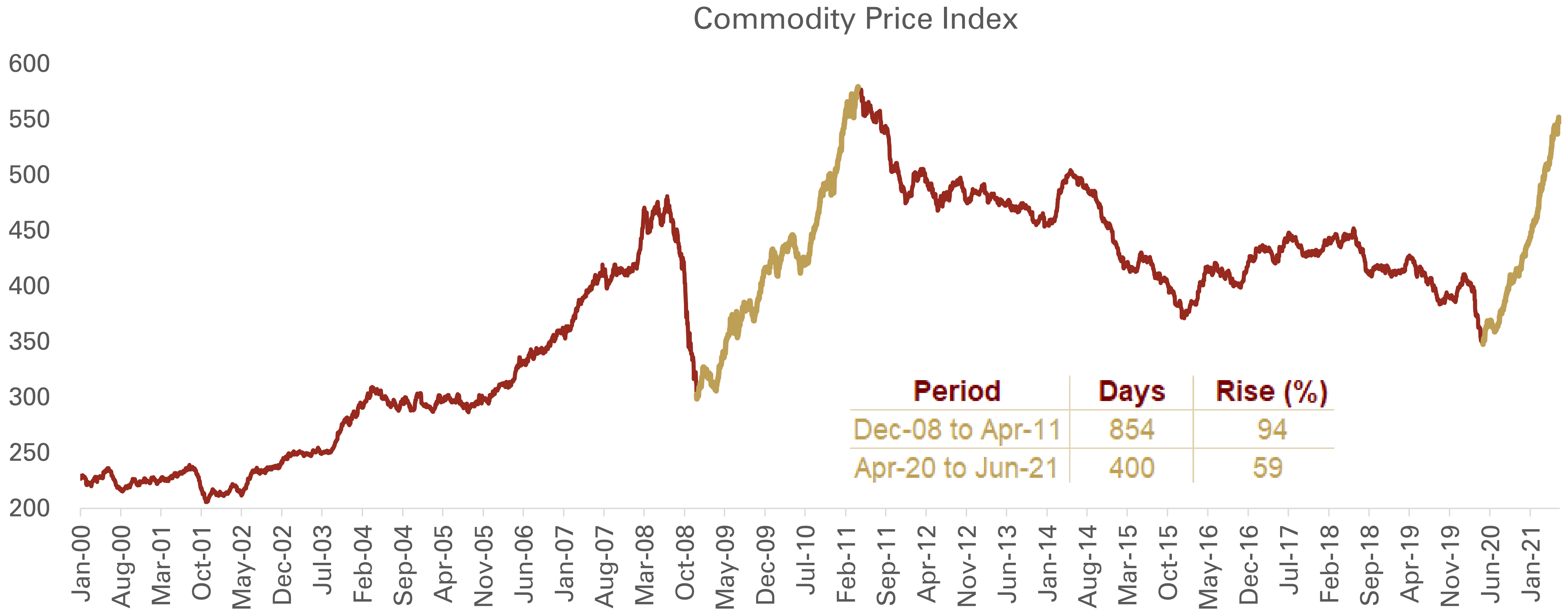

Net percent of owners raising average selling prices increased four points to a net 40%, the highest reading since April 1981

# Used Vehicle Prices witnessing an unprecedented rise




Used vehicle prices have risen by more than 50% on YoY basis. While it is also owing to supply shortages due to pandemic and chips supply issues, strong demand driving pricing higher is clearly evident

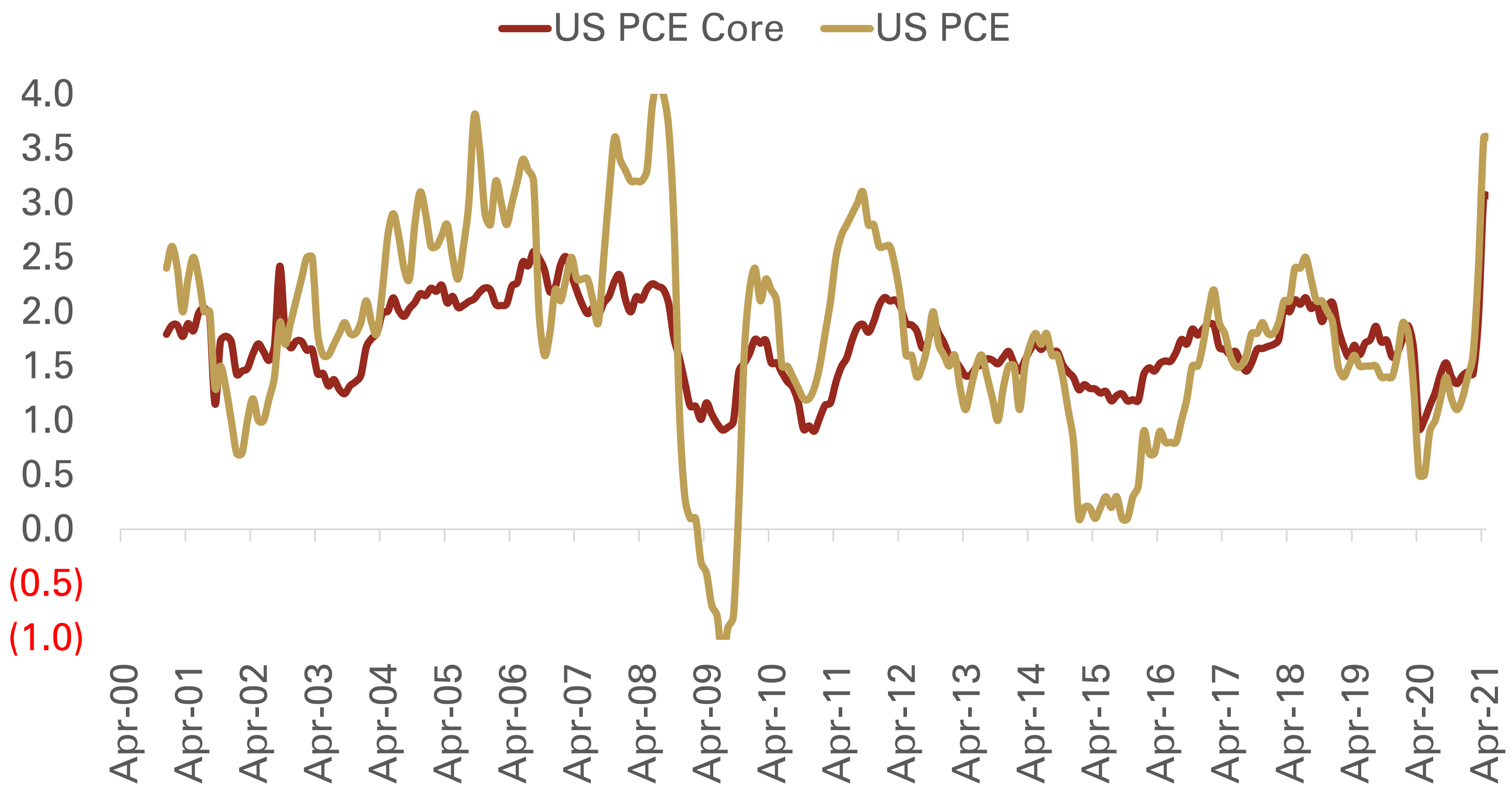
# Commodity Prices continue to influence Inflationary expectation




| Period | Days | Rise (%) |
|---|---|---|
| Dec-08 to Apr-11 | 854 | 94 |
| Apr-20 to Jun-21 | 400 | 59 |

Higher commodity prices are leading to input cost pressures in-turn leading to price to rise and inflationary risk, going forward.

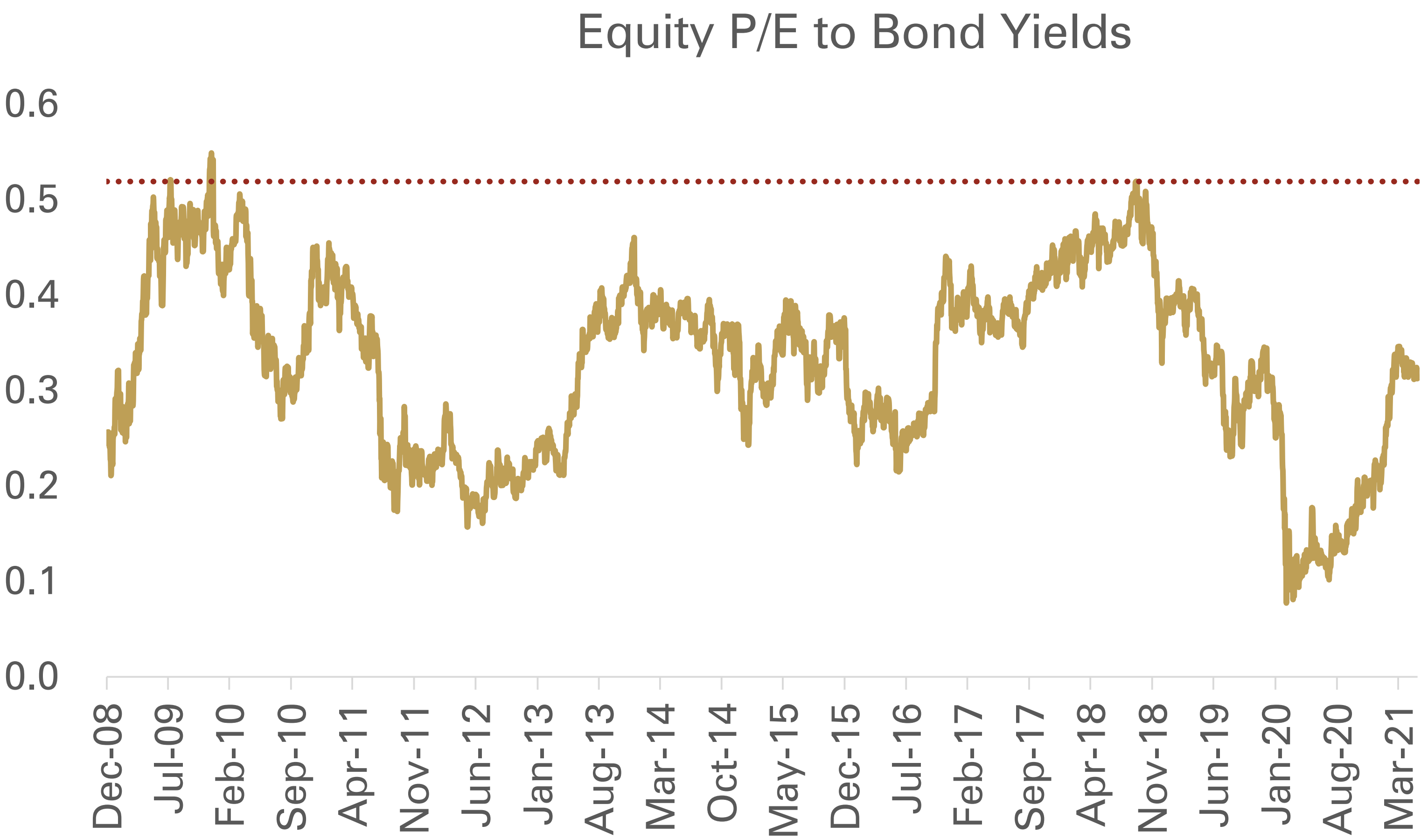
# Consumer Price Inflation showing upward surge




- PCE price index increased 3.6% in April from one year ago, reflecting increases in both goods and services.
- Energy prices increased 25% while food prices increased 0.9%. Excluding food and energy, the PCE price index increased 3.1% in April from one year ago.

**It is possible that Inflation, although higher now partly due to base effect and partly due to supply constraints, may not sustain. Nonetheless, risks are rising.**

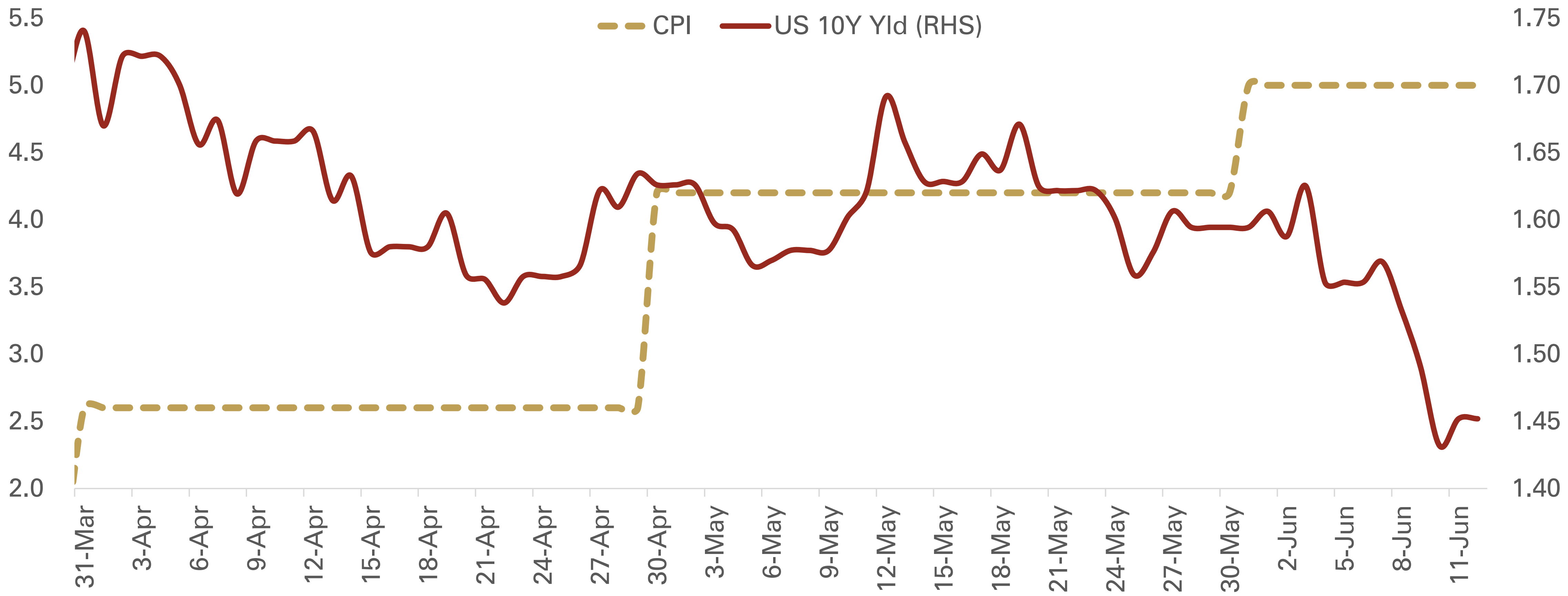
# Why is Inflation a risk to markets?




- US Bond Yields have stopped rising, despite rising inflationary expectations, given that Fed commentary has been guiding the market of being tolerant of 'transitory' inflation, and therefore no immediate risk of monetary tightening.
- If, however, inflation sustains at higher levels, there is a risk that market may begin to discount monetary tightening earlier than expected, causing bond yields to rise

Our favorite chart (above) which compares Equity Price to Earnings to Bond Yields shows that market has tended to peak out (& fall thereafter) when this ratio touches 0.5. All else being equal, if US 10 Year Bond yield were to rise to beyond 2% (& swiftly), a correction is natural to expect. If the rise is gradual / orderly, market volatility may not witness very high volatility as there is support from 'Economic Growth'

# But Bond Yields are showing divergence with inflationary data!



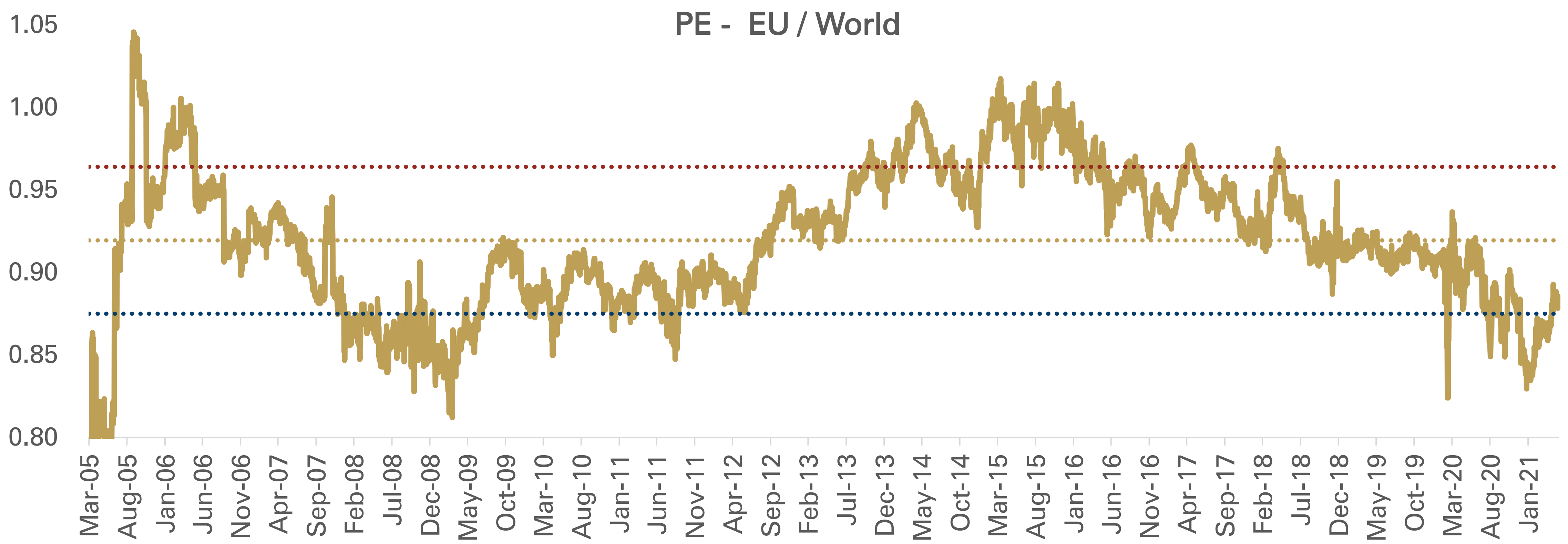

Usually one would expect US Bond Yields to move up in response to rising inflationary pressures. However, as economic data has come out, Bond Yields have actually receded off late. Hence, economic and market data are giving divergent signals, with latter seemingly being aligned with Fed's view of inflation being 'transitory' than likely to be sustained. If it does, risks discussed above materialize.

# To conclude: Inflation risks cannot be ignored

- US Growth is likely to surprise on the upside, also imparting support to earnings growth
- That, however, is also likely to be followed by rising inflationary expectations – although bond market isn't yet signaling the same convincingly
- Expectations high that Fed shall also indicate its plan to taper by Q4 CY 2021
- A sustained inflation, ahead of market expectation, can cause bond yields to rise sharply.
- **Risk**: High equity valuations, therefore, may correct in response to a sharper rise in yields

**Above induce risks of corrections in H2 CL 2021, although could provide an entry opportunity**

# European Equities are well placed relative to other markets

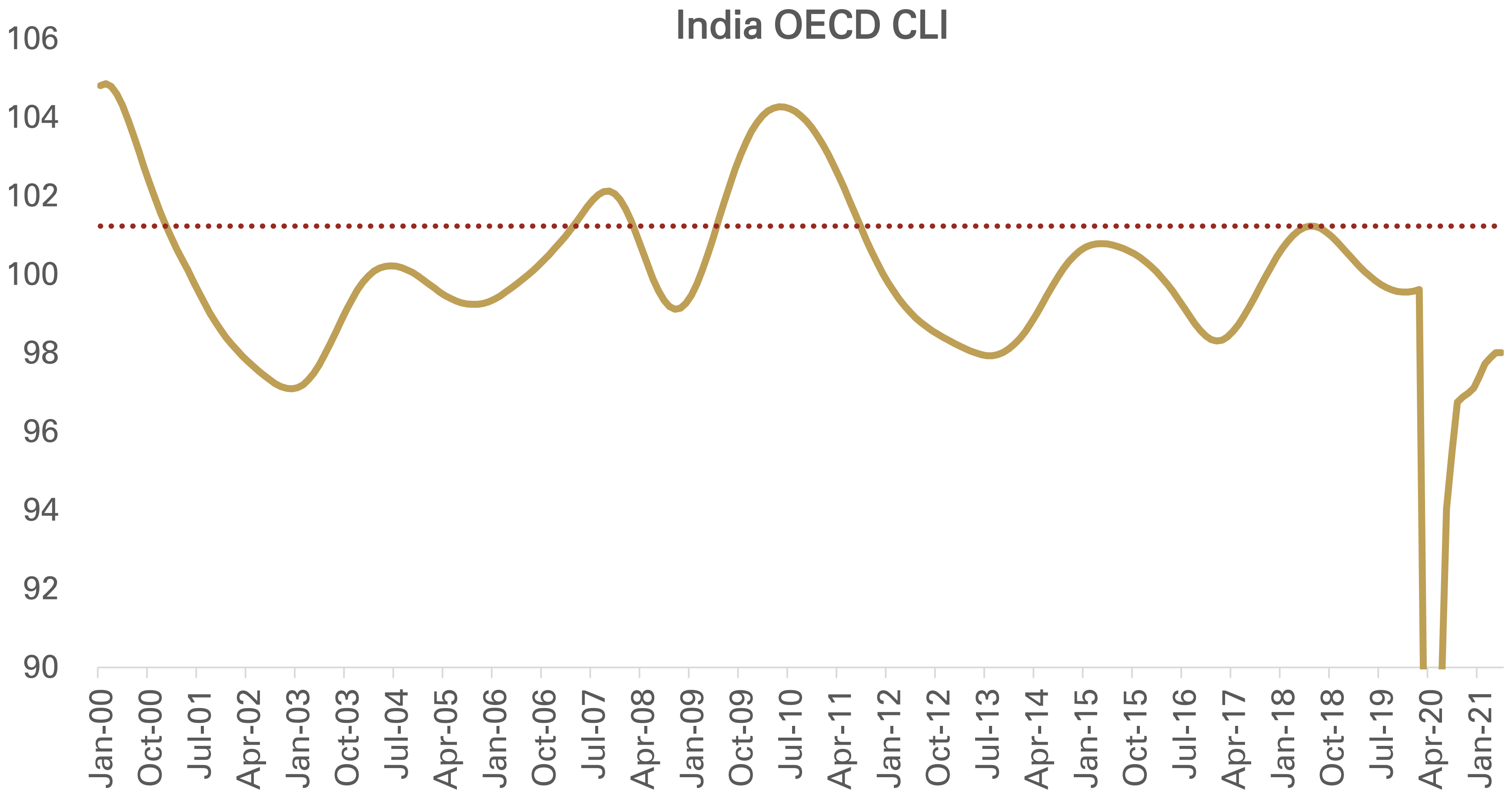



European equities look attractive basis relative valuations and improving growth prospects supported by accelerating vaccine rollouts and re-openings (as government restrictions on economic activity are loosened). Also, it remains a current account surplus economy providing cushion in times of external vulnerability.

# India

## Economic & Corporate cycle likely to support good earnings growth

# India OECD CLI expected to witness improvement

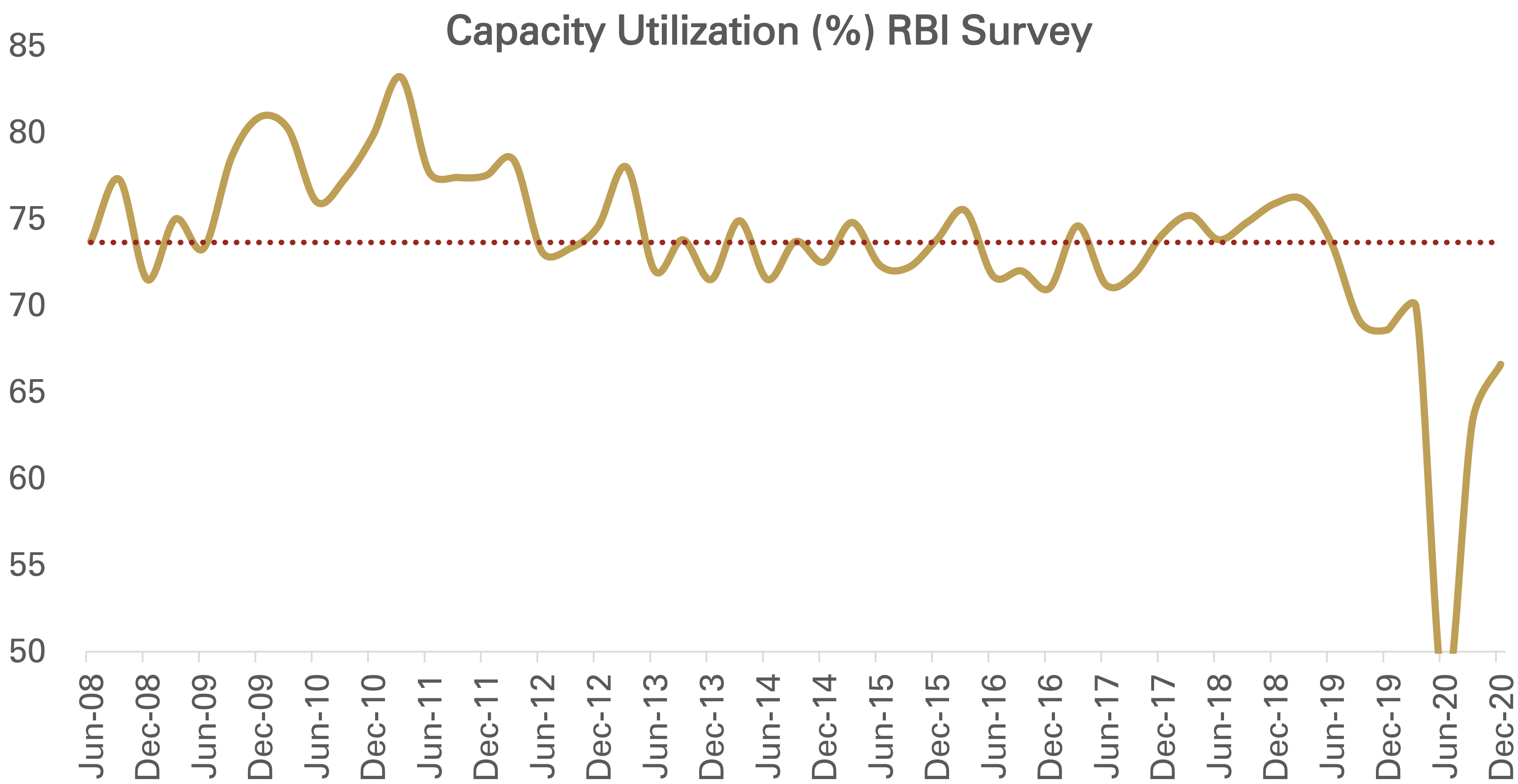



OECD Composite leading indicators (CLIs), designed to anticipate turning points in economic activity relative to trend, point to a steady expansion.

India's economic cycle is in an expansion mode, and far away from cyclical peak

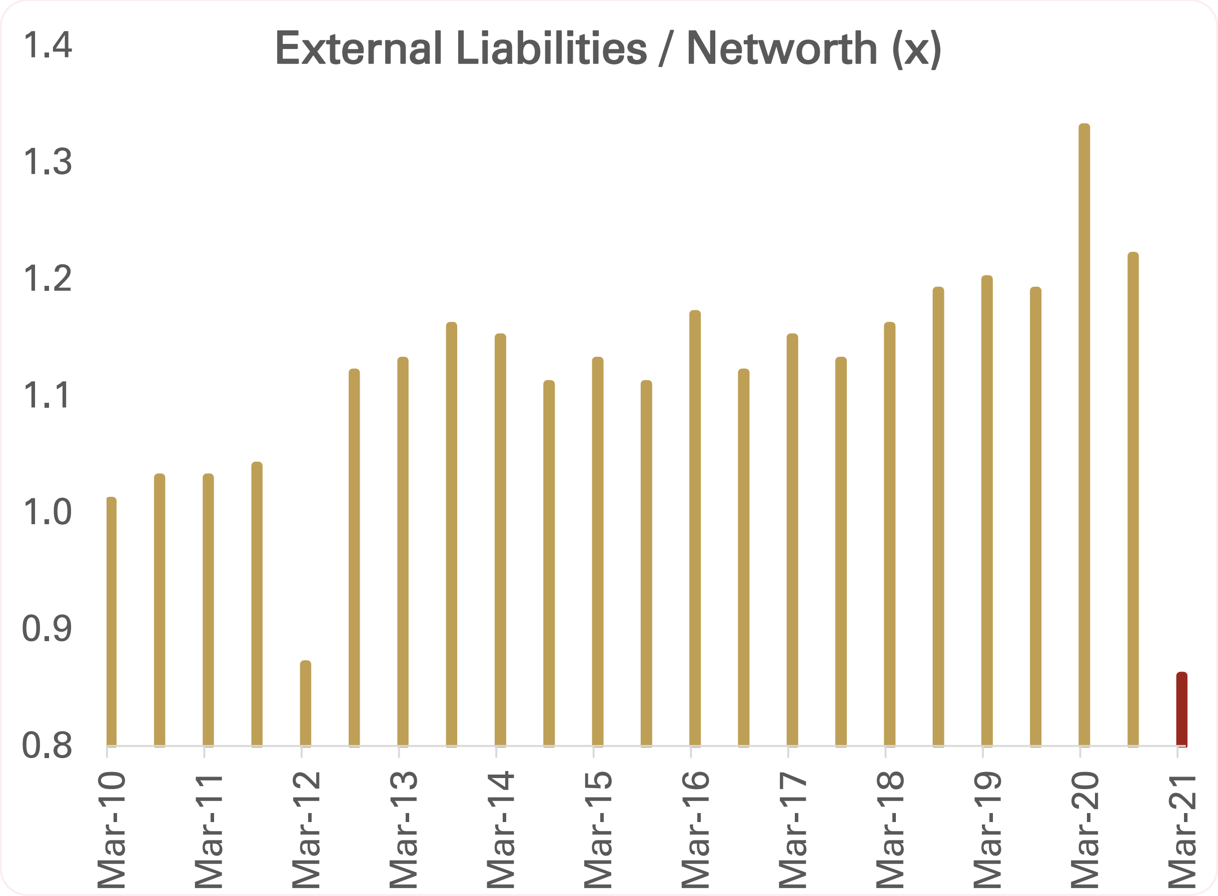
The expansion has historically lasted for between 1 to 4 years, depending on the global scenario & India's macro situation (which remains quite strong). Risk, however, is if domestic inflation also shoots up beyond RBI's tolerable level, which isn't our base case.

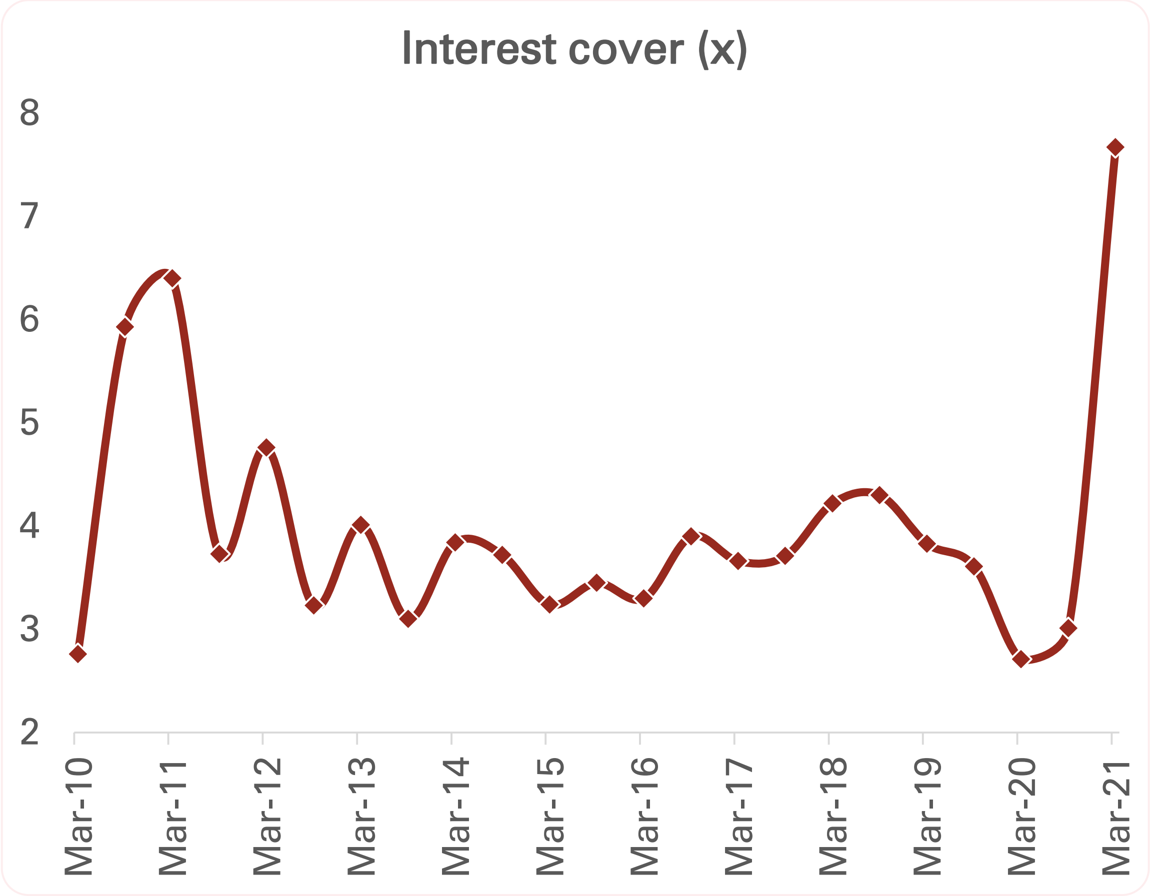
# Capacity Utilization levels are much below normal levels




Utilization levels would have risen somewhat since last survey in Q3 FY 21, however, unlikely to be meaningful. As utilization level rises higher basis improving economic activity, corporates are expected to benefit not only from higher turnovers but higher profitability on back of favorable operating leverage kicking in (assuming input cost pressures are being passed upon).

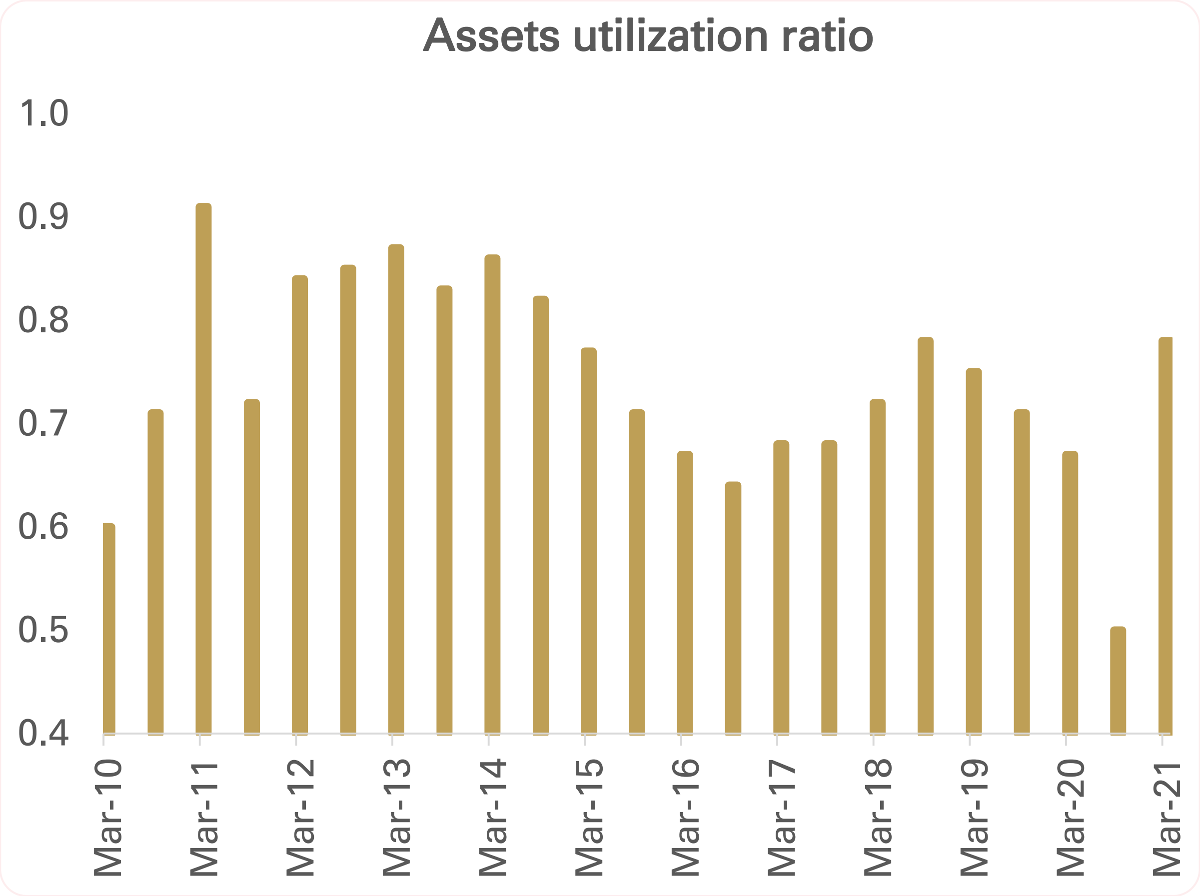
# Improving Balance Sheet Strength (Ex-Financial) Sector

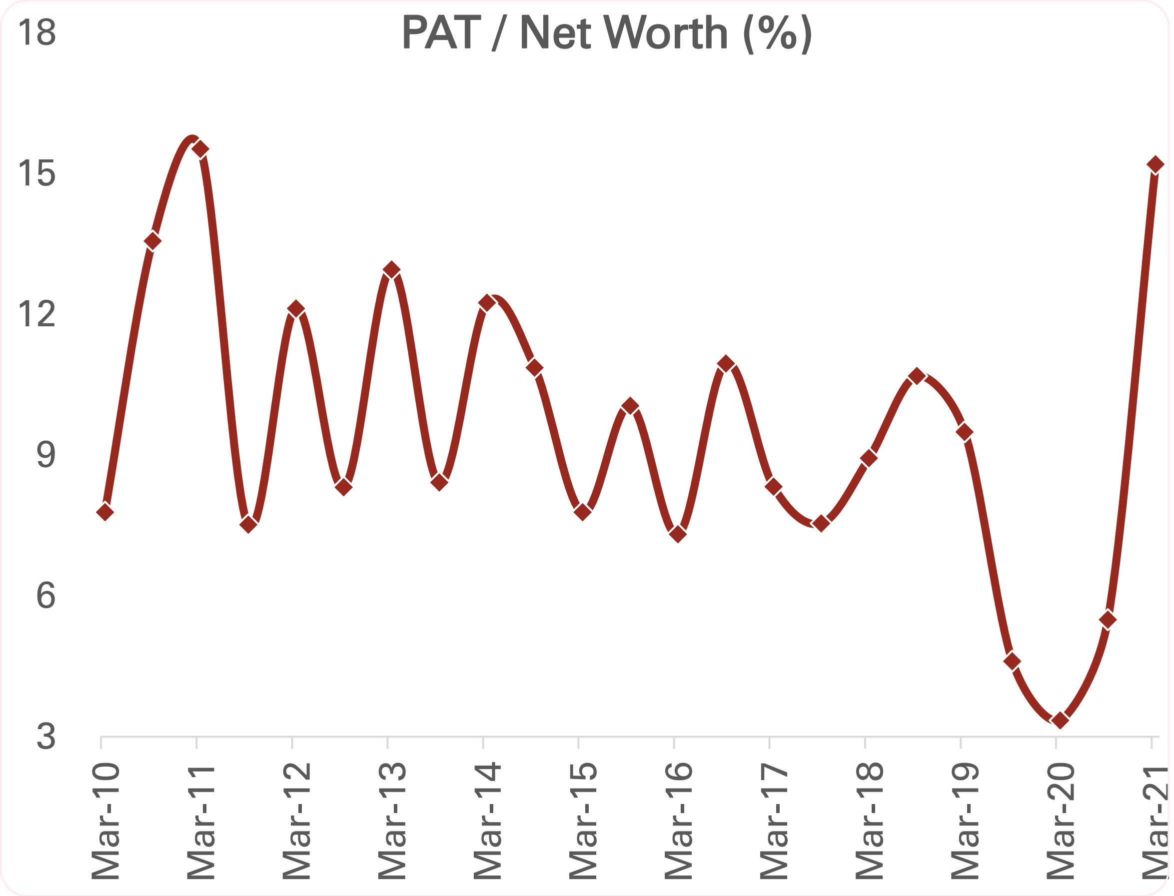



Lower external liabilities (proxy to Debt / Equity ratio & leverage), higher interest coverage ratio and other key ratios too augurs well for corporate India not only making them resilient against vagaries of economic cycles but providing potential growth opportunities too …..

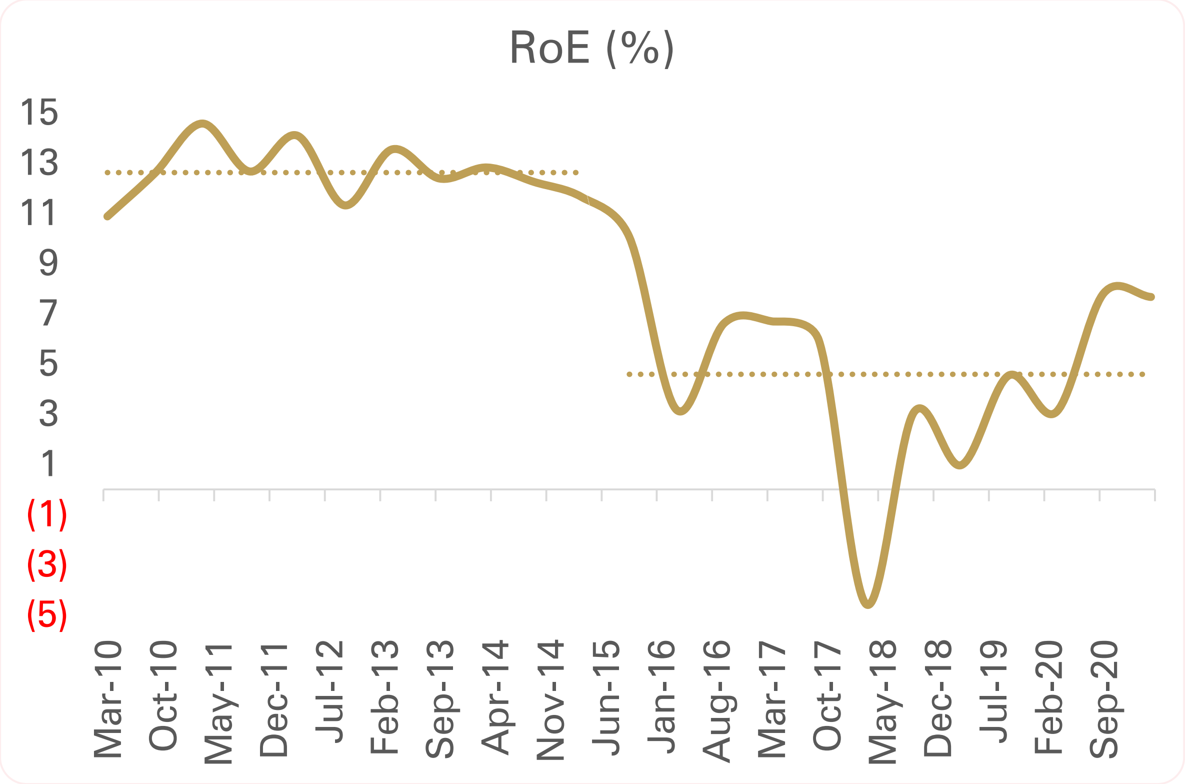
# Improving Balance Sheet Strength (Ex-Financial) Sector

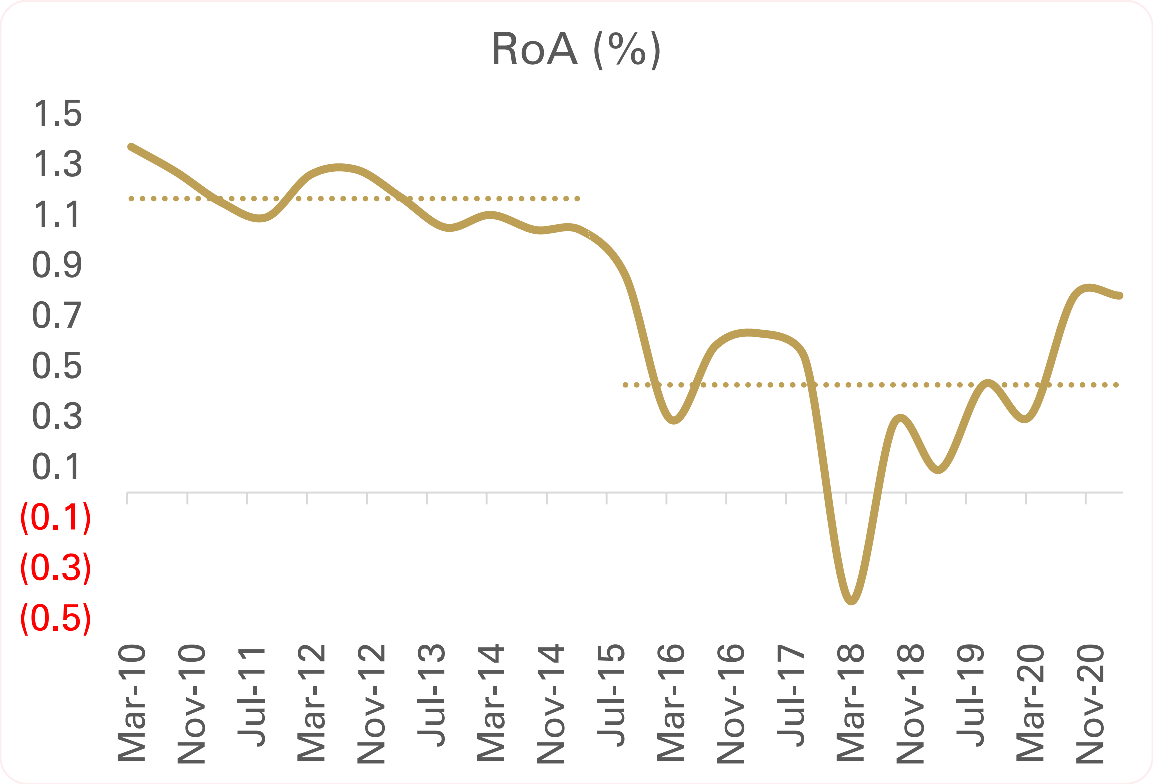



….. similarly with higher turnover ratios and return on equity (PAT / Net Worth).

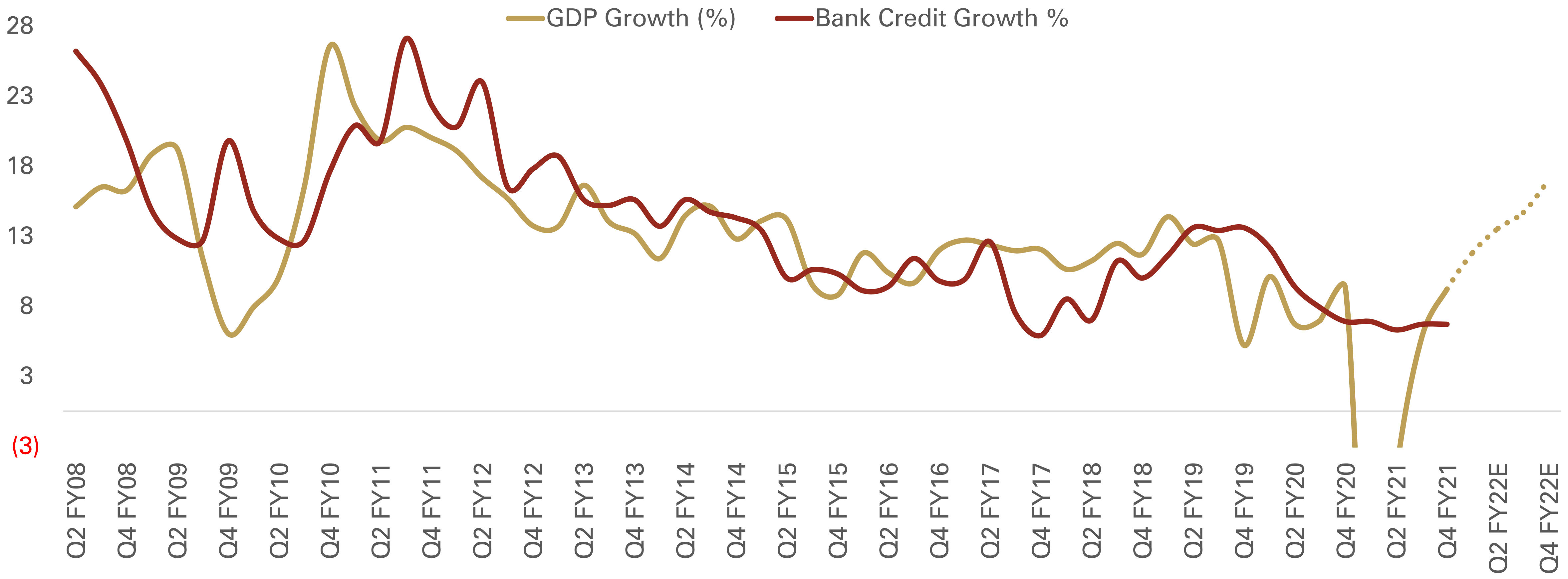
# Improving Balance Sheet Strength – Financial Sector




The overall Financial Sector, especially the lenders, remain below peak on profitability, giving confidence of normalization in earnings over next two years.

# India - Banks Gross Bank Credit Growth




As GDP picks up, the bank credit cycle is also likely to closely follow from near bottom currently

# To conclude: Conducive factors at play

**Local economic cycle far from peak, providing confidence of good future growth**

# Q4 FY21 – Earnings Review

# Q4 FY21 - Earnings Review

**Low base effect and Metals aid earnings growth**

- Q4FY21 net income for corporates witnessed sharp YoY increase primarily due to the Covid-led disruption in the base quarter and aided by continued economic recovery in reporting quarter.
- Also, strong earnings growth reported by companies in commodity sectors has led to robust growth in earnings on aggregate basis.
- For the 151 NSE 200 set of companies that have reported, revenue, EBITDA and net profit growth were 22%, 60% and 196% YoY, respectively. Ex- PSU Refineries, Metals, Bharti, M&M & Tata Motors, NSE 200 revenue and earnings growth were ahead at 20% and 54%.
- Margins have expanded by 434 bps points on an aggregate basis. Ex-Tata PSU Refineries & Metals, Nifty 200 set of companies has witnessed expansion of 183 bps.
- Across the board, input cost pressure has not dented earnings outlook indicating the ability to rationalize and pass on cost which is corroborated by elevated WPI at 7.6% over Feb-Apr’21 (indicator of pricing power for manufacturers). Going forward, cost pressures may arise as operations resume in full swing and raw material prices continue to see upward pressure. But, as growth normalizes, operating leverage benefits should kick in and support margins.

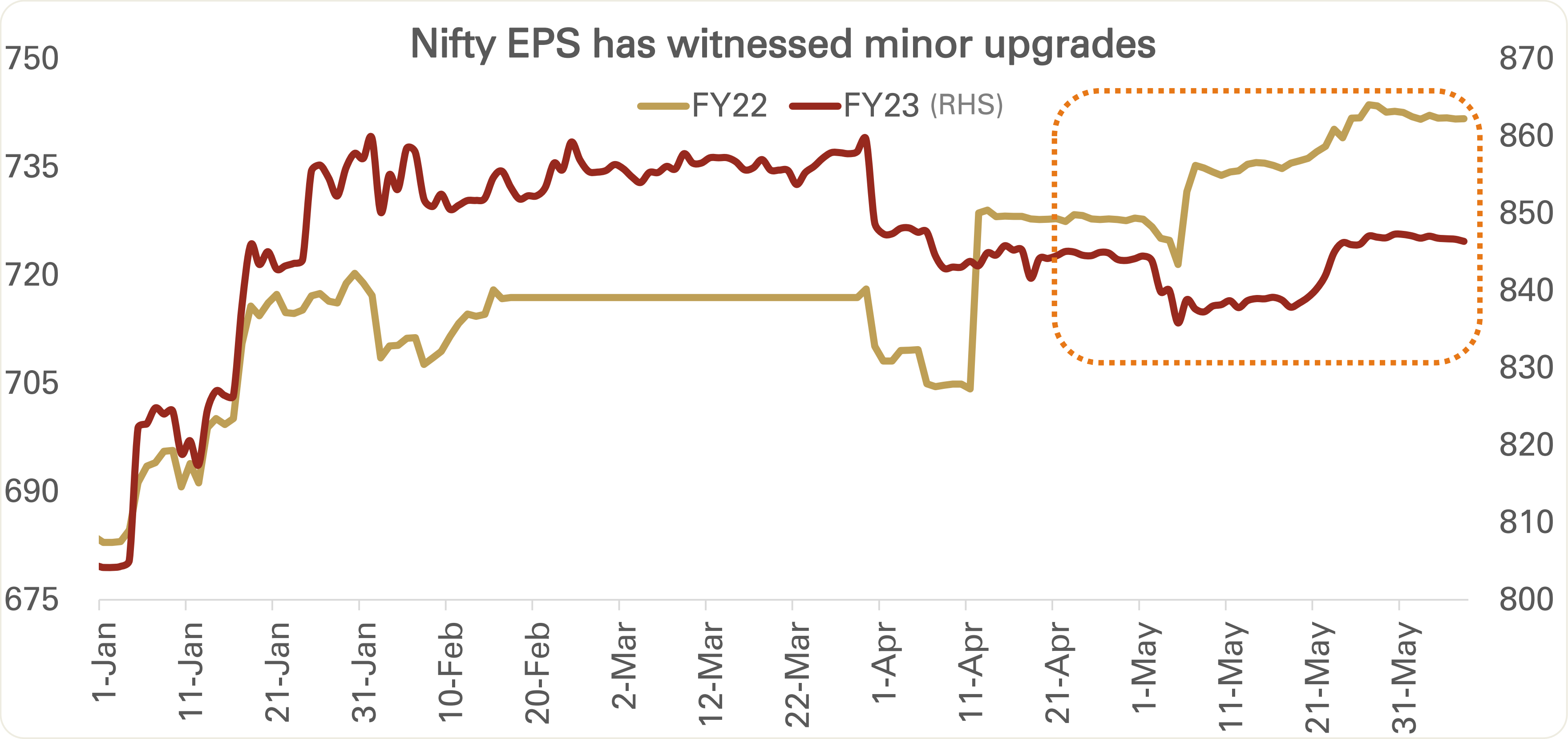
# Q4FY21 – Earnings review - Powered By Commodities

| Sector | No. | Sales | | | EBITDA | | | PAT | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Rs bn | Co's | Q4 FY21 | Q4 FY20 | Growth % | Q4 FY21 | Q4 FY20 | Growth % | Q4 FY21 | Q4 FY20 | Growth % |
| Cons. Staples | 14 | 608 | 492 | 24 | 129 | 106 | 22 | 91 | 76 | 19 |
| Cons. Discretionary | 26 | 2,352 | 1,733 | 36 | 333 | 138 | 142 | 38 | (58) | (L to P) |
| Telecom | 2 | 322 | 247 | 31 | 157 | 105 | 50 | 21 | (46) | (L to P) |
| Cement | 7 | 599 | 472 | 27 | 148 | 101 | 46 | 66 | 63 | 5 |
| **Domestic non-cyclicals** | **49** | **3,881** | **2,945** | **32** | **767** | **449** | **71** | **216** | **35** | **515** |
| Health Care | 19 | 514 | 491 | 5 | 124 | 85 | 46 | 56 | 31 | 80 |
| IT | 11 | 1,274 | 1,183 | 8 | 333 | 281 | 18 | 214 | 202 | 6 |
| **Exports** | **30** | **1,788** | **1,673** | **7** | **457** | **367** | **25** | **271** | **234** | **16** |
| PSU Bank | 4 | 1,016 | 773 | 31 | 393 | 285 | 38 | 89 | 41 | 120 |
| Pvt Bank | 11 | 946 | 857 | 10 | 456 | 398 | 15 | 210 | 106 | 99 |
| NBFC | 17 | 708 | 442 | 60 | 184 | 99 | 87 | 151 | 86 | 76 |
| Insurance | 4 | 429 | 352 | 22 | 16 | 16 | 2 | 13 | 13 | (3) |
| **Financials** | **36** | **3,099** | **2,423** | **28** | **1,050** | **797** | **32** | **463** | **245** | **89** |
| Sub-Total Non-Cyclicals | 115 | 8,768 | 7,041 | 25 | 2,274 | 1,612 | 41 | 950 | 514 | 85 |
| Industrials | 12 | 825 | 719 | 15 | 160 | 116 | 38 | 75 | 57 | 34 |
| Utilities | 4 | 223 | 190 | 18 | 51 | 40 | 30 | 10 | (11) | (L to P) |
| Materials | 5 | 1,362 | 944 | 44 | 374 | 153 | 145 | 172 | 12 | 1,379 |
| Energy | 8 | 5,312 | 4,560 | 16 | 507 | 173 | 193 | 366 | (47) | (L to P) |
| Others | 7 | 117 | 126 | (7) | 13 | 20 | (34) | 4 | 9 | (57) |
| Sub-Total Cyclicals | 36 | 7,840 | 6,539 | 20 | 1,106 | 502 | 120 | 628 | 20 | 3,114 |
| **Total** | **151** | **16,608** | **13,581** | **22** | **3,380** | **2,114** | **60** | **1,578** | **533** | **196** |
| **Total Adjusted*** | **139** | **10,173** | **8,493** | **20** | **2,453** | **1,886** | **30** | **1,237** | **802** | **54** |

Note: *Ex-PSU Refineries, Metals, Bharti, M&M & Tata Motors

Metals & Energy sectors lead earnings growth

# Earnings upgrade cycle continues although pace has moderated



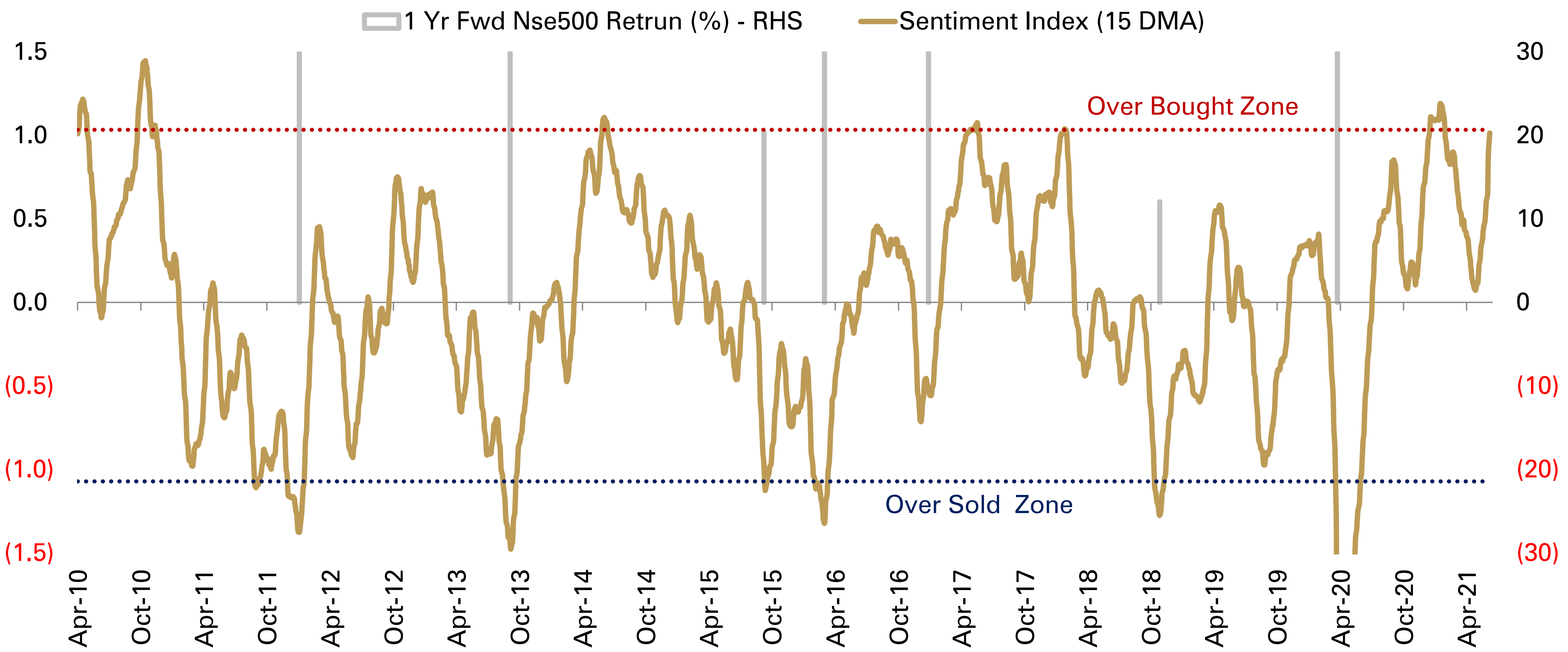

- Despite drop in several economic activity indicators (due to localized lockdowns), earnings have not witnessed downgrades.
- Nevertheless, EPS has witnessed minor upgrades.

**Key reasons for upgrade in recent times:**

- Energy & metals have witnessed big upgrades while multiple stocks in sectors like Consumer discretionary, Telecom, Construction, etc. have seen meaningful downgrades. So while, there are minor upgrades on an aggregate level, they are from the more volatile sectors.
- Larger companies & organized sector in the economy have been gaining market share and would likely have gained again in the 2nd wave.

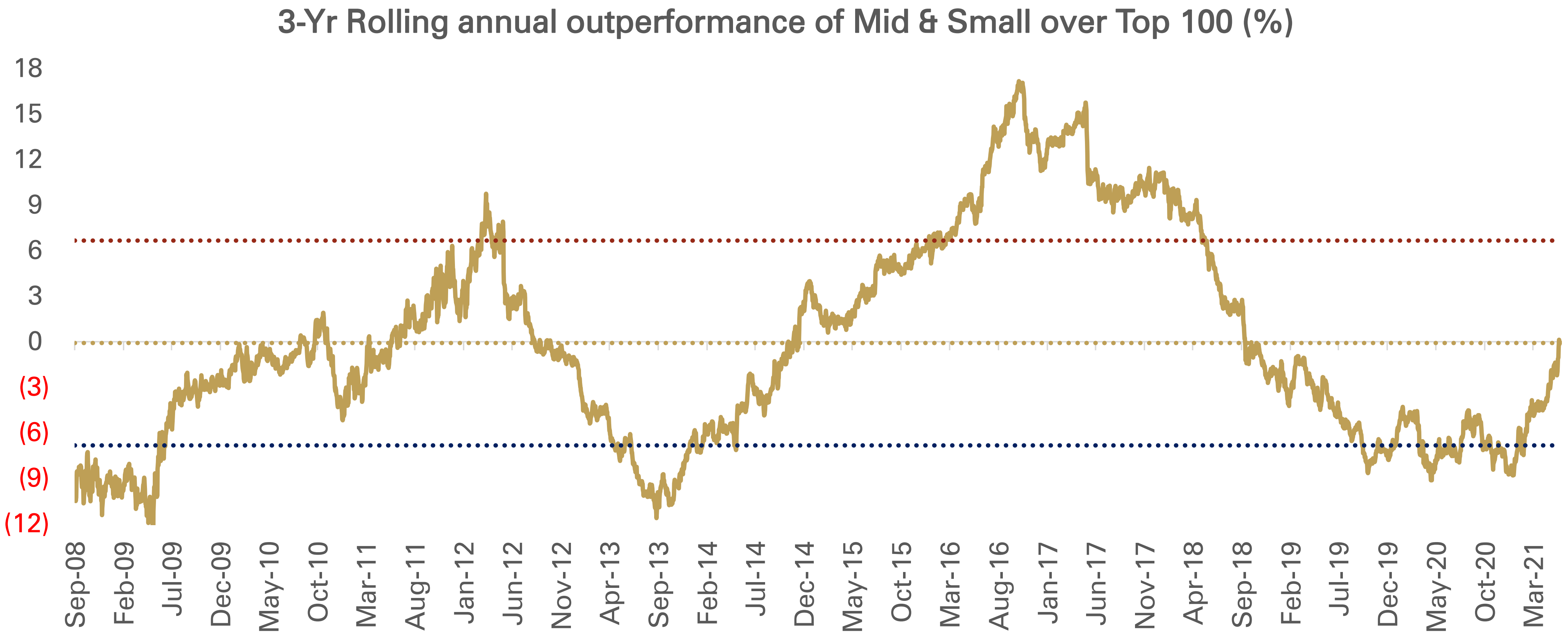
# Equity Strategy & Valuations

# Indian sentiment indicator at Over Bought Zone



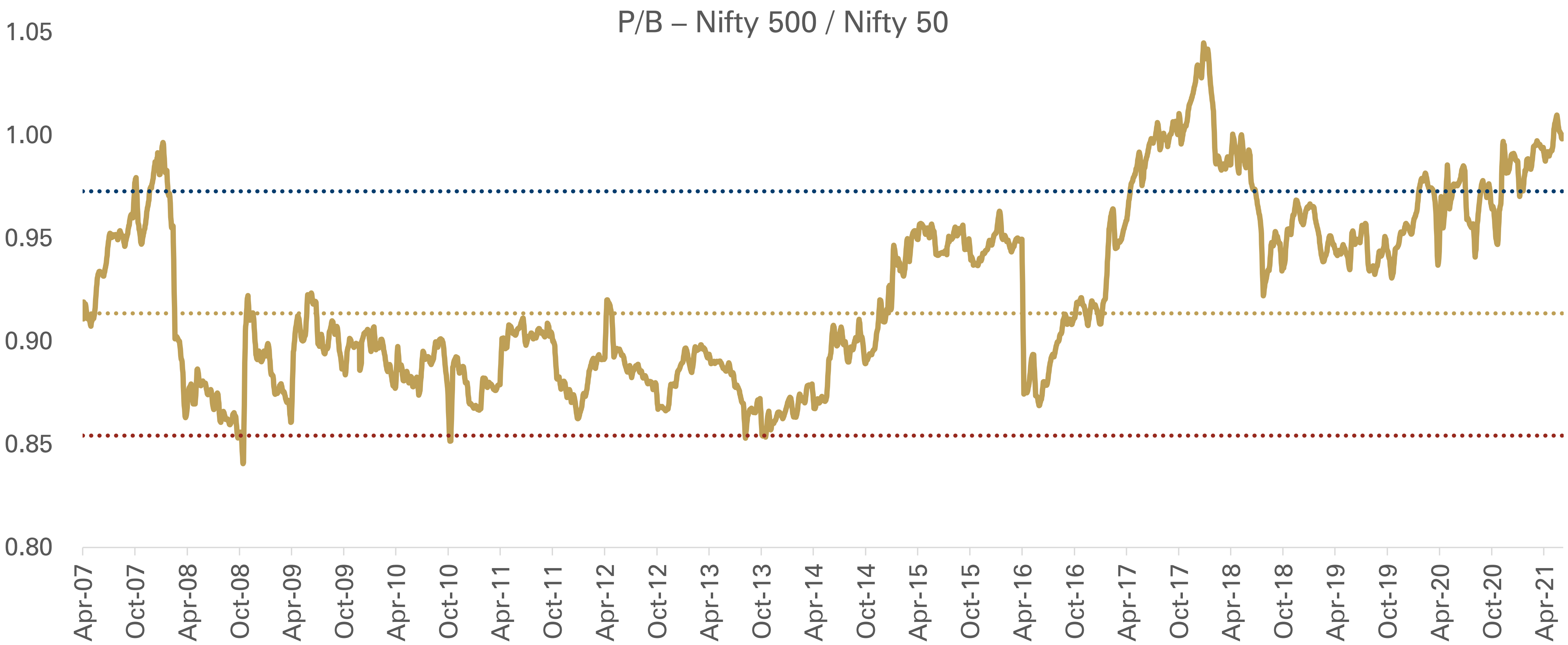

Lower Sentiment Index indicates a better buying opportunity given above avg 1 year forward return & vice versa. Sentiment Indicator has inched up and is now in over bought zone, indicating a likely near term consolidation

# Rolling Outperformance of Mid & Small w.r.t. Large caps



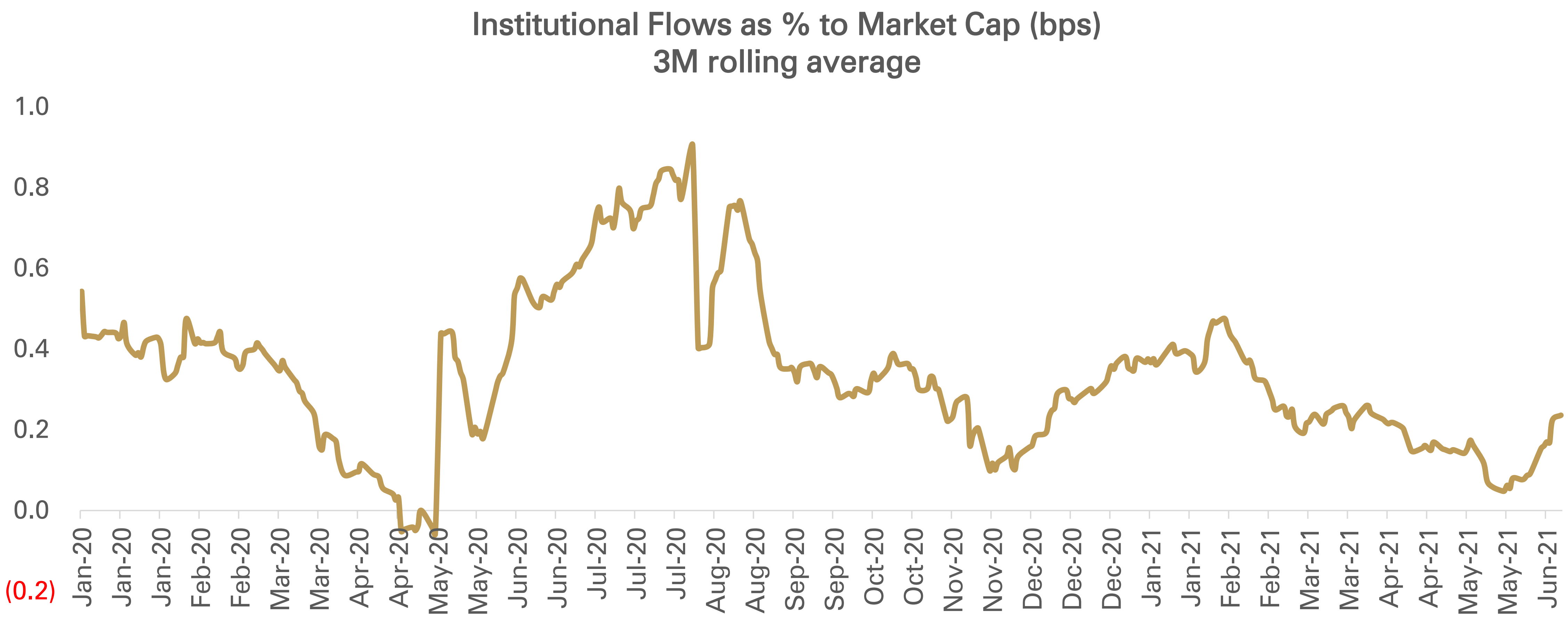

Since Mar-21, Mid & Small caps underperformance has progressively reduced & is now at average levels. Current technical indicator suggest Mid & Small cap outperformance is yet to peak.

# Valuations: Mid & Smallcaps w.r.t. Nifty are relatively expensive



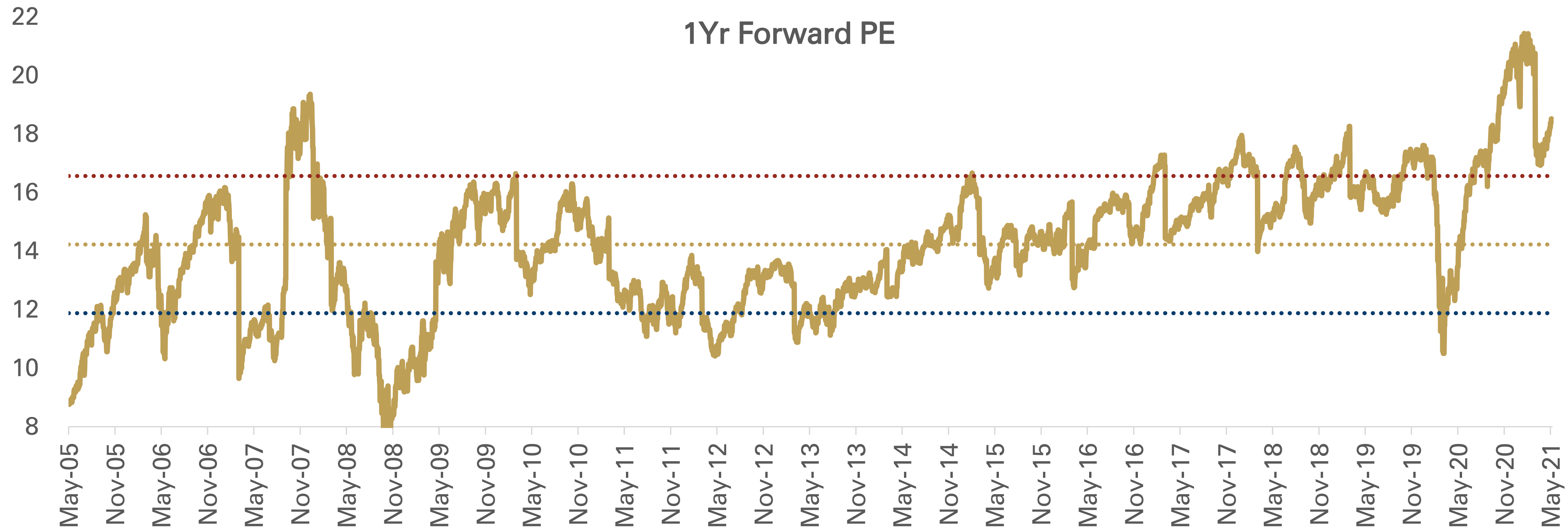

Relative valuations of Mid & Small caps (inferred from broader index Nifty 500) with respect to Nifty has edged at above +1 Std dev. and is now moving closer to peak levels witnessed in Jan 2018.

# Equity Flows have witnessed moderation




Recent market up-move has been supported by Institutional Flows, which doesn't indicate excess just as yet

# Valuations likely to de-rate as yields rise




While valuations are decisively on higher side but may not cause markets to materially correct as long as global markets and yields are stable. However, market performance is likely to be lower than earnings growth as valuations are likely to mean revert over medium term.

**Theme ahead is likely to be stronger economy but volatile markets with upward bias**

# India - Sectoral Valuation: Cyclicals are relatively well placed

| Sector | Percentile Rank | Frwd PE | 2Yr EPS Growth | PEG |
|---|---|---|---|---|
| Next50 | 0.9 | 22.7 | 13.3 | 1.7 |
| MNC | 0.9 | 33.7 | 20.3 | 1.7 |
| IT | 1.0 | 22.3 | 14.8 | 1.5 |
| FMCG | 0.7 | 29.4 | 20.1 | 1.5 |
| Infra | 0.5 | 15.7 | 13.8 | 1.1 |
| Pharma | 0.9 | 23.7 | 21.7 | 1.1 |
| PSE | 0.2 | 7.7 | 7.9 | 1.0 |
| Small250 | 0.9 | 15.9 | 16.4 | 1.0 |
| NSE500 | 1.0 | 18.9 | 20.3 | 0.9 |
| Mid | 0.8 | 16.2 | 19.1 | 0.8 |
| Financials | 0.6 | 15.5 | 18.4 | 0.8 |
| Nifty | 1.0 | 18.6 | 22.4 | 0.8 |
| Media | 0.1 | 13.7 | 23.0 | 0.6 |
| Energy | 0.4 | 9.8 | 17.2 | 0.6 |
| Bank | 0.7 | 15.1 | 28.1 | 0.5 |
| Auto | 0.9 | 18.2 | 39.1 | 0.5 |
| Real Estate | 1.0 | 29.7 | 73.8 | 0.4 |
| Metal | 0.7 | 9.5 | 28.7 | 0.3 |
| PSU Bank | 0.6 | 7.0 | 46.0 | 0.2 |
| P / B | | | | |
| Bank | 0.6 | 2.0 | | |
| Energy | 0.4 | 1.2 | | |
| Metal | 0.9 | 1.4 | | |
| Small250 | 1.0 | 2.4 | | |
| Nifty | 1.0 | 2.8 | | |

Several sectors and stocks appears to be fairly valued and offering limited scope for re rating, returns will likely follow roll forward (in earnings) or potential upgrades in earnings (as actual earnings follow expected trajectory). **Banking continues to offer opportunities on 'buy on dips'**

# Equity Strategy

We **maintain Equal Weight position in Equities** given that full year expectations haven't materially changed. Advent of the 2nd COVID wave has disrupted the recovery momentum. The challenges with respect to Q1 FY22 earnings and inflation in key raw material could act as a headwind in the near term. However, basis Q4 FY21 results, we are yet to witness earnings downgrade. Additionally, on the positive front,

- Economy has begun to gradually open up, providing positive fillip;
- Steady uptick in the daily vaccination rate from the lows and with fresh capacity expected to come soon

Hence, normalization is expected to be sooner than later.

- Stronger balance sheets for banks, healthier (listed) corporate balance sheets, leaner cost structures & reforms around formalization of economy, corporate taxes, PLIs, GST, real estate, etc augur well. This coupled with expected normal monsoons, focus on manufacturing exports is positive.

- **While some de-rating (in equity multiples) is likely, they may not fall materially below +1 Standard Deviation just as yet** given the overall global & cyclical tailwind.

- Medium term, cyclical & economy facing sectors like **Banking**, Industrials / Capex, Energy etc. are still not in outright expensive zone & offer reasonable growth prospects & can be added to in current phase of underperformance / on dips.
- Defensive sectors (like IT, Pharma, FMCG & select Discretionary) exhibit stretched valuations.
- Also prefer a “late recovery theme” as a portfolio from a medium term perspective

However, one needs to be prepared for a US led correction in H2 2021

# Risks

- **Global Inflation & US Tapering risks are rising**: Inflation risks induce uncertainty and Tapering is a certainty though timing is debatable. This has to be seen in context of high equity valuations and expectations that Dollar shall remain range bound
  - Further rise in real yields has the potential to de-rate equity valuation especially growth stocks, if the pace of increase is sharp. An orderly gradual increase may not be disruptive.
  - Trajectory of Dollar and consequent flows into EM including India remain critical support for market performance. Any reversal is expected to increase market volatility.
- Rising cases of Covid, despite the 2020 learnings & template, do not necessarily offer room for complacence, although our base case continues that the current spell shall be far less economically impactful vs H1FY21.
- Higher levels of crude prices has the potential to impact domestic macros adversely
- In the near term, some equity market corrections cannot be ruled out owing to over optimism in market sentiments (which works as contra indicator). However, we continue to see any tactical corrections as welcome opportunities to buy into pro economy assets and sectors.

# Fixed Income

# RBI announcements amid second wave of COVID-19

The RBI Governor made a series of unscheduled announcements on May 5, 2021 in light of the sharp upsurge in infections that is likely to upset the economic momentum. While the global economy is coming back supported by monetary and fiscal stimulus, activity is still uneven across sectors and countries and the outlook looks uncertain in near term.

In the assessment for India, the governor noted that aggregate supply conditions seem to be not much impacted. Aggregate demand conditions, on the other hand, may see a temporary dip depending upon how the virus situation unfolds. However, the impact is expected to be moderate in comparison to last year.

**Announcement of GSAP**: The governor highlighted the easy domestic financial conditions is likely to continue. After success of first round of GSAP of INR 25,000 crore, second such program has now been scheduled for 20$^{th}$ May for an higher aggregate amount of INR 35,000 crores.

The measures announced by the Governor largely included easy access of credit to various priority sectors, relaxation in overdraft facility for State Governments and other regulatory measures.

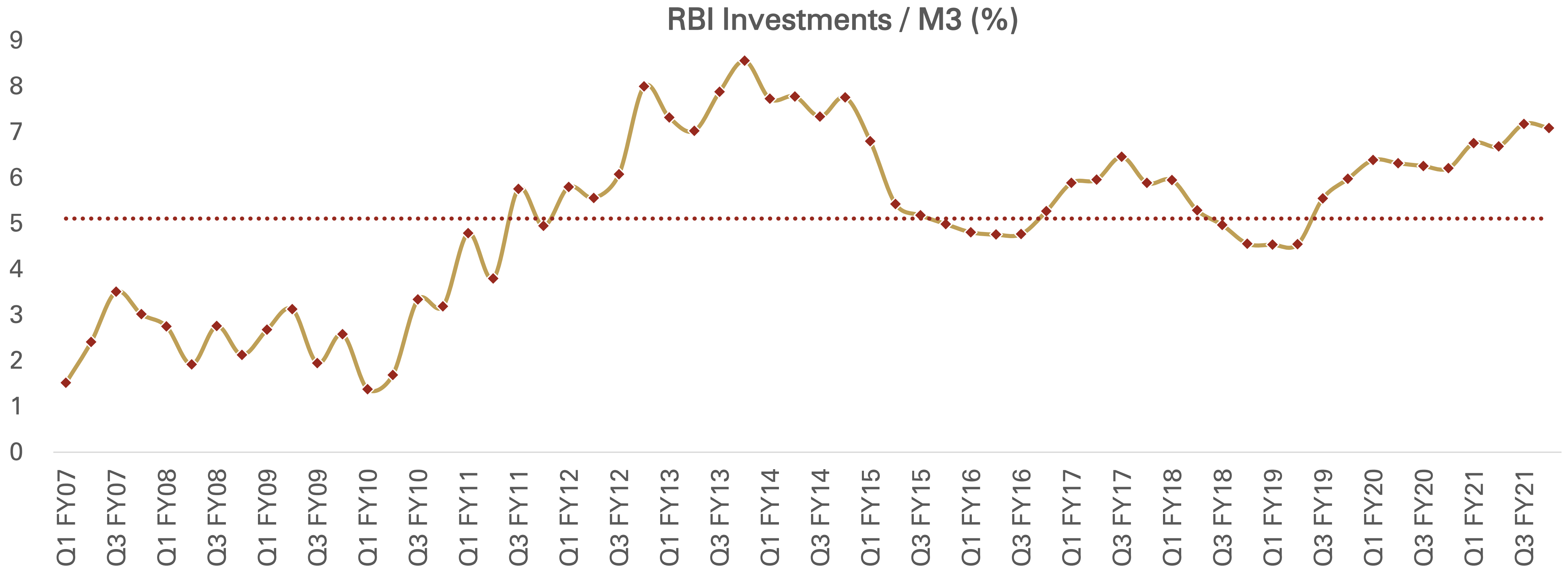
**These announcements had a positive impact on sentiment. These measures not only sounded pragmatic but also timely and had positive impact on bond yields.**

# Other Measures

Various further measures were announced aimed at incentivizing credit flow to high priority areas currently as well as to smaller & more susceptible balance sheets. Key ones are highlighted below:

| | |
|---|---|
| Term liquidity facility of Rs. 50,000cr | The RBI announced an on-tap liquidity window of ₹50,000 crore (tenor of up to three years at the repo rate) for the health care sector. Banks can use this window for a wide range of entities involved in healthcare services related to COVID; banks can lend directly or through other intermediary FIs |
| Special Long-Term Repo for SFB | To provide further support to small business units, RBI will conduct special 3y long-term repo operations of INR 10,000cr at repo rate for small finance banks (SFB), to be deployed for fresh lending up to INR 10 lakhs per borrower |
| Relaxation in over draft facility for state government | RBI has allowed maximum number of days of OD in a quarter increased from 36d to 50d; number of consecutive days of OD increased from 14d to 21d; facility available up to 30 Sep 21; WMA limits of states already enhanced on 23 Apr 21 |
| Resolution Framework 2.0 for individual, small businesses | Individuals and small businesses having aggregate exposure of up to INR 25 crore that have not availed of previous restructuring and whose borrowing was 'Standard' as on March 31, 2021 shall become eligible to restructure their loans up to September 30, 2021.<br><br>For small businesses and MSMEs that previously restructured, lending institutions are also being permitted to review the working capital sanctioned limits. |

# RBI has expanded its Balance Sheet to support economy




The data above reflects RBI's investments (pre-dominantly GoI Securities) relative to total money supply (M3). RBI has expanded its balance sheet by 80bps in FY2021, and is likely to do the same in foreseeable future, anchoring long bond yields at near current levels. A question although remains how will market react when this ends!

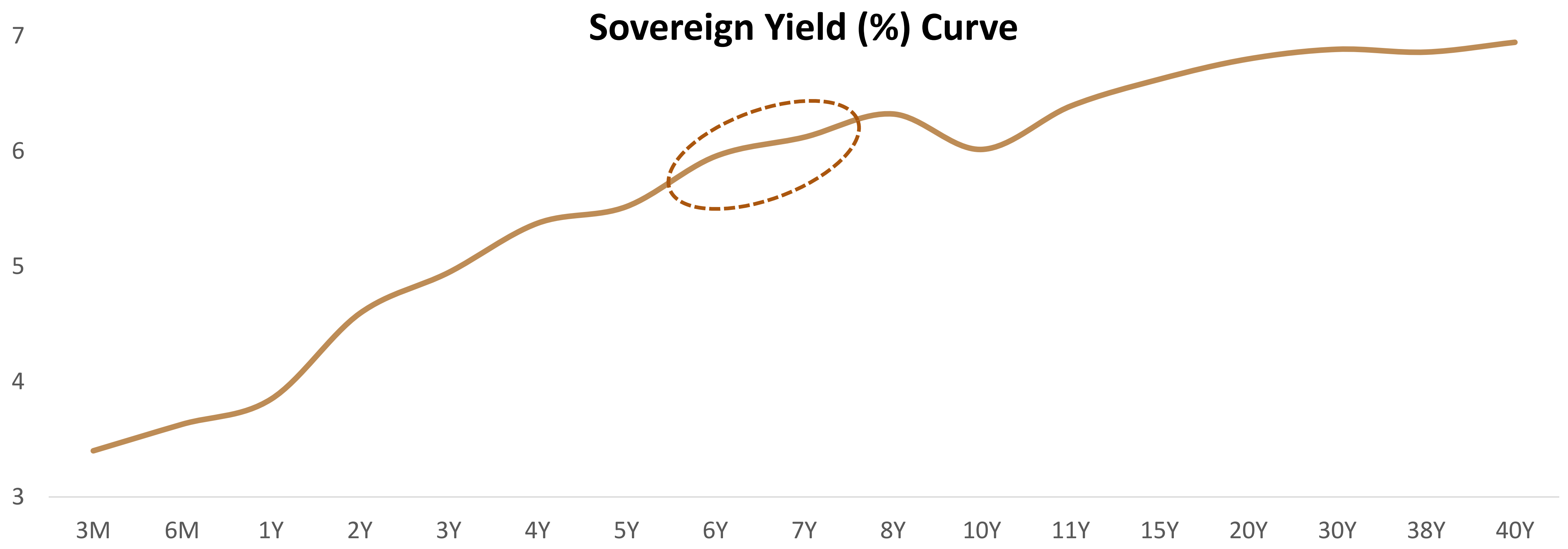
**There is a significant scope for further balance sheet expansion, relative to various DM Economies – For US Fed~40%, BOJ~47%, Euro Zone~ 51%.**

# Yields across the curve have gone up CYTD

| Particulars | 11 June 2021 | 9 April 2021 | 6-Apr 2021 | 1 Jan 2021 | Change from 1-Jan Inc/ (Dec) |
|---|---|---|---|---|---|
| **Call Rate** | 3.00 | 3.10 | 3.35 | 3.05 | (0.05) |
| **Repo** | 4.0 | 4.00 | 4.0 | 4.0 | - |
| **Short Duration** | | | | | |
| **3M T-Bill** | 3.40 | 3.34 | 3.24 | 3.01 | 0.39 |
| **6M CD** | 3.70 | 3.80 | 3.77 | 3.5 | 0.20 |
| **6M CP** | 4.0 | 4.35 | 4.30 | 3.8 | 0.20 |
| **G-Sec** | | | | | |
| **1 Year Gilt** | 3.90 | 4.00 | 3.87 | 3.50 | 0.40 |
| **2 Year Gilt** | 4.50 | 4.60 | 4.54 | 4.25 | 0.25 |
| **5 Year Gilt** | 5.50 | 5.85 | 5.84 | 4.99 | 0.51 |
| **10 Year Gilt** | 6.02 | 6.02 | 6.12 | 5.83 | 0.19 |
| **10 Year SDL** | 6.6 | 6.60 | 6.69 | 6.43 | 0.17 |
| **Corp Bonds** | | | | | |
| **1 Year AAA** | 4.20 | 4.35 | 4.30 | 3.90 | 0.30 |
| **3 Year AAA** | 5.20 | 5.10 | 5.10 | 4.68 | 0.52 |
| **5 Year AAA** | 5.90 | 5.90 | 5.95 | 5.50 | 0.40 |
| **1 Year AA** | 6.87 | 7.00 | 6.95 | 6.70 | 0.17 |
| **3 Year AA** | 7.80 | 7.90 | 7.86 | 7.44 | 0.36 |

Short term yields have come down after going up in first quarter of CY 2021, as it is likely that the RBI is likely to push back the calendar of prospective normalization owing to second wave.

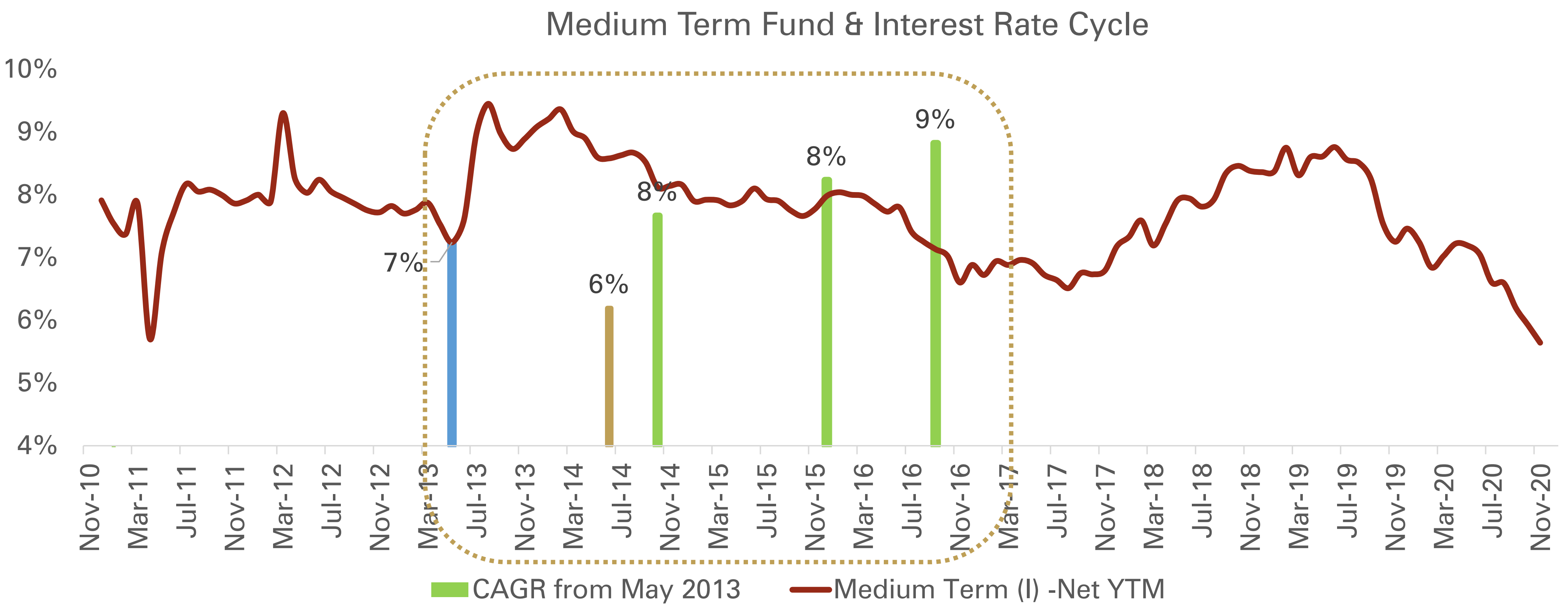
# Yield curve is steep




**As compared to 1 year yield of close to 4%, 6-8 year yields are close to 5.95-6.2%.**

Funds which are targeted towards portfolio maturity 2026-2028 are appropriate for lower risk investors seeking higher visibility of returns over holding period horizon. While there can be near term volatility, investors can consider the same with 4 year or above investment horizon. Returns are likely to be in line with current yield for holding period of 4 years and above.

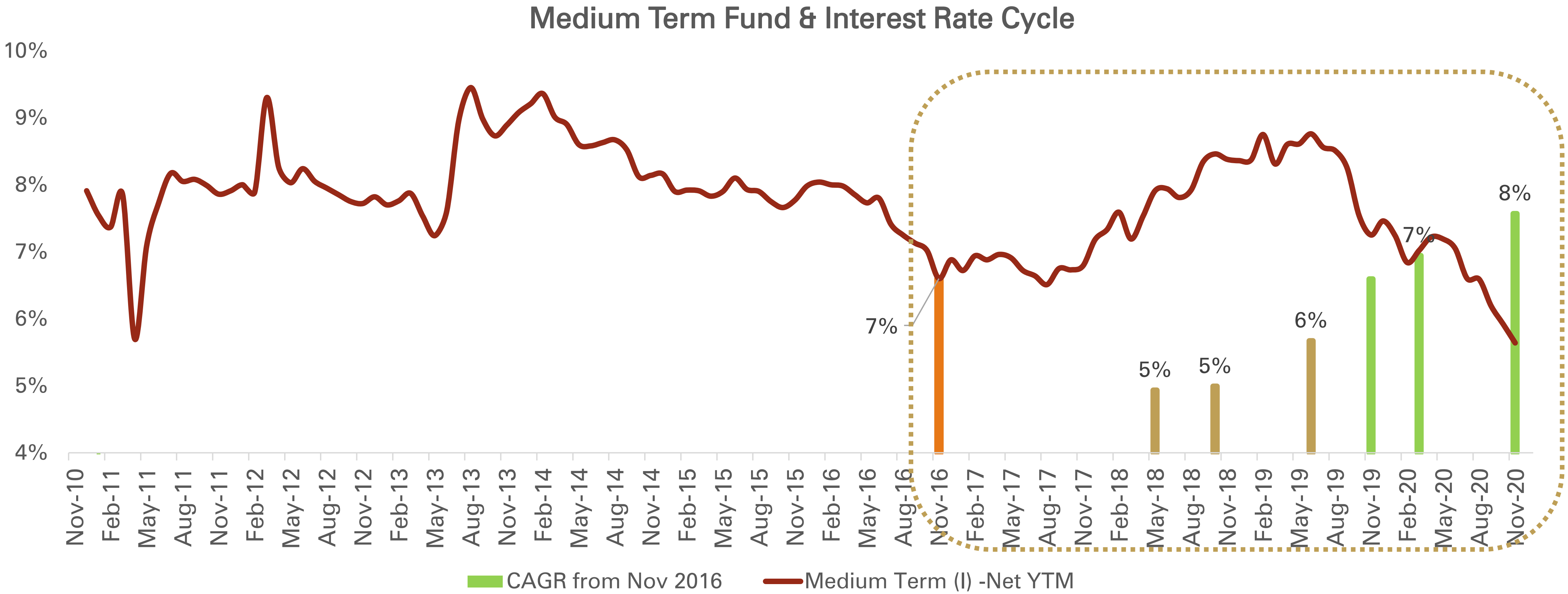
# Interest Rate Cycle and Portfolio Return (Chart-I)




Since 2012, interest rates were on gradual decline till May-13, however post that due to Fed taper tantrum, the rates inched up significantly and remained at those levels for almost a year and then started to decline gradually.

Investors who invested at lower yields with investment horizon of more than 3 years were able to significantly outperform Net YTM, as full interest rate cycle played out, despite lower return in short term

# Interest Rate Cycle and Portfolio Return (Chart-II)




Interest rates again bottomed close to demonetization in Nov-16, and started to move up since mid of 2017 and further impacted by downgrades/ defaults in few of the names. Interest rates stared to come down since mid-2019.

Investors who invested at lower yields in end 2016, with investment horizon of more than 3/4 years were able to significantly outperform Net YTM as the full interest cycle played out.

# Fixed Income Strategy

RBI announcements implies a change in RBI's economic outlook since last policy meeting in the aftermath of the second-wave. With RBI announcing various measures including GSAP programme, it will **restrict upside in long term yields from current levels in near term**. 10Y G-Sec is likely to trade in range of 5.80% to 6.25% and will be volatile.

Given low rates & expectation of gradual upward movement in short term yields over time, **investors should consider products with duration lower than investment horizon**. Following is preferred strategy:

**For investment horizon upto 3 months:** prefer liquid funds. Individual investors can consider bank savings upto 3 months as other categories can be volatile.

**For longer investment horizon (upto 1 year)**: investors can consider Ultra Short Term Funds, Arbitrage Funds & Deposits.

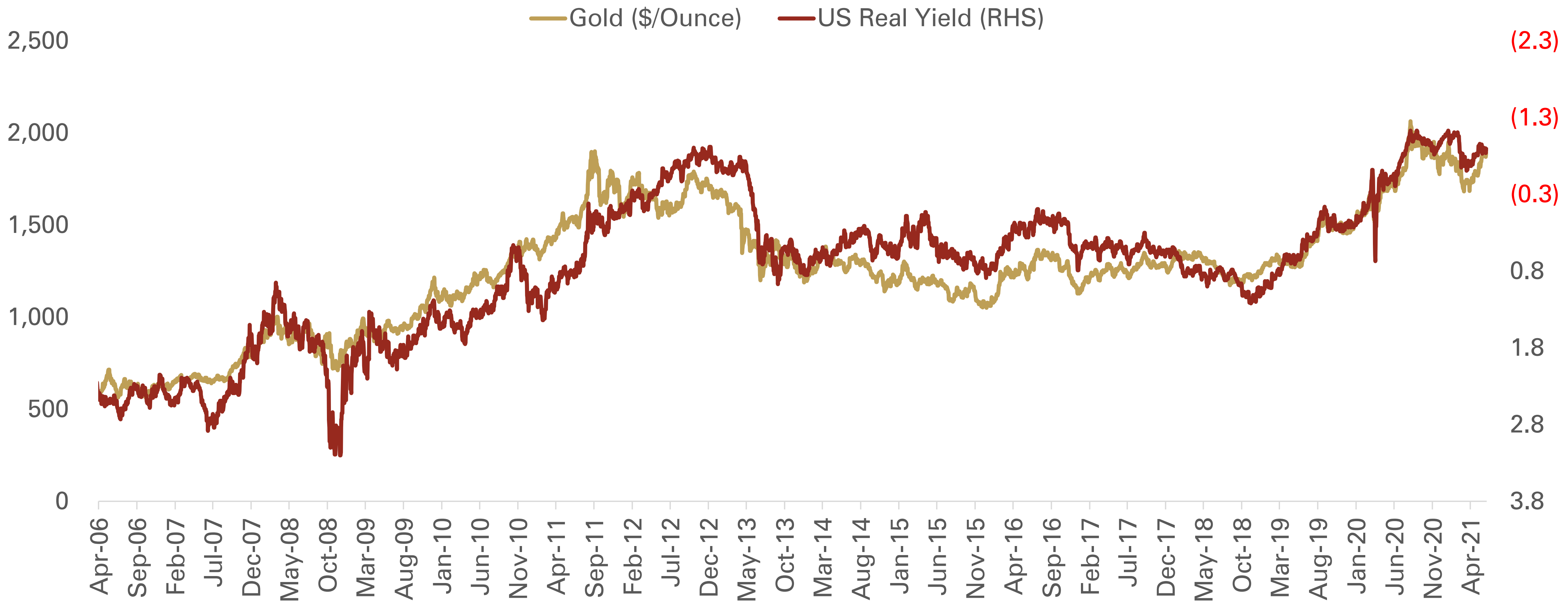
**Horizon of more than 3-4 years –**

- Prefer funds with reasonable mix of AAA and AA (**medium term portfolios**) which have net yields of more than 5.5%. As highlighted, strategy can outperform the current net yield over 3-4 years, and also 3 year roll down / AAA strategies.
- One can also consider 5-7 year roll down strategies, for investors with horizon of more than 4 years

We reiterate that the experience of last decade is instructive towards the interest rate cycle. After bottoming out, interest rates tend to rise, only to moderate – the overall cycle being 3 to 4 years. Hence, its critical to have a 4-year horizon for longer term investors.

# Gold

# As real yields fell, Gold has rebounded…




Decline in Real Yields has given some life to Gold – a proxy play on Real Yields, contrary to our expectation.

# Thank you

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