Indian sovereign bond was down by 23 bps on month on month basis to close at 6.37%. Oil prices witnessed sharp decline while the rupee plunged to nearly 6-month low on fears that Coronavirus can wreak havoc on the global economy. This outbreak has made a strong case for central banks, the Reserve Bank of India including, to pursue softer monetary policies.

**Market Performance**

The 10-year benchmark G-Sec yield closed at 6.37%, a decline of 23 bps from its previous close of 6.60% while that on the short-term 1-year bond ended 18 bps lower at 5.17%.

In the corporate bond segment, yields fell across the yield curve over the month. The 10-year AAA bond yield ended 34 bps lower at 7.20%, while the short-term 1-year AAA bond yield ended 5 bps down at 6.20%.

The spread between 1-year and 10-year AAA bond narrowed. Within the short term segment, yield on 3-month commercial paper (CP) was flat while 1-year CP yield was down by 10 bps at 6.10%.

**Macro-economic Developments**

India’s gross domestic product (GDP) growth for the third quarter (October-December) stood at 4.7% from the 5.1% in the July-September quarter.

Index of industrial production shrank 0.3% in December from the provisional growth of 1.8% a month ago while retail inflation rose to 7.59% in January vs 7.35% in December. WPI inflation accelerates to 10-mth high of 3.1% on costlier food items.

Purchasing Managers’ Index (PMI) for manufacturing surged to 55.3 in January while Services Purchasing Managers’ Index rose to 55.5.
Market Impact And Outlook

From a bond market perspective, February has turned out to be a very positive month, with all segments of the fixed income market rallying sharply.

Starting with the Budget, which led to a huge sigh of relief by the bond markets, followed by the RBI MPC, which despite the status quo on rates, kick started LTRO operations and finally the global bond rally driven by Coronavirus related fears – all contributed to a sharp lower in yields across segments.

**Union Budget FY21:** The Budget obviously had limitations in terms of the amount of resources that the government had in its kitty, to deal with. Given the constraints, it was a fairly decent budget from a bond market perspective with nil extra borrowings in this year, next year’s borrowings broadly in line with expectations at INR 7.8 lakh crore and potential for inclusion of IGBs in global bond indices.

**RBI MPC February 2020:** RBI Monetary Policy Committee (MPC) on February 6, 2020 maintained status quo with a 6-0 unanimous vote, both on policy rate and on its accommodative stance. The policy gives a fair amount of comfort to the market, that rather than just the headline CPI, the committee is focused on the underlying drivers of inflation and that demand side worries are still unfounded at a time when growth is so anaemic.

The real action was in the accompanying “statement on Development and Regulatory Policies”, with the move on Long Term Repo Operations (LTRO) for improving monetary transmission being a hugely significant one. Starting February 15, 2020 – the RBI started conducting term repos of one year and three year tenors up to total amount of INR 1,00,000 crore, at the policy repo rate of 5.15%. This essentially gives very cheap three year repo funding to banks, thereby bringing down short term rates very significantly over the coming months.

**COVID-19 Outbreak:** Finally, the Coronavirus driven risk-off sentiment in markets globally, led to an unprecedented rally in global bond yields, with 10-year US Treasuries rallying by almost 35 bps from 1.50% in January end to 1.15% by February end. A number of central banks announced pre-emptive rate cuts, with the US Fed also stunning the markets by announcing a 50 bps rate cut on March 3, which led to 10-year US Treasury piercing through the 1% mark for the first time ever.

In such a scenario, central banks around the globe have become entirely focussed on protecting downside risks to growth, and RBI is no different. The RBI Governor has already made statements indicating that the Central Bank is in readiness to take actions as warranted, leading to the markets virtually pricing in more than 50 bps of rate cuts over the coming few months.

The 10-year government security yield which had rallied by 23 bps from 6.60% to 6.37% through the month of February, witnessed a further rally of 14 bps to 6.23% by March 4, 2020. The shorter end of the G-Sec curve has rallied even more sharply, with 4 year G-Sec yield at 5.6%, down by more than 70 bps from January end levels. While corporate bond yields have moved lower as well, the pace has not been as sharp as the G-Sec rally. This has resulted in AAA spreads in the 3-year segment to widen to 60 bps over G-Sec, versus 25-30 bps seen a few weeks back. Similarly, AAA spread in the 7-10 year segment is at 75-85 bps over G-Sec.
**Investment Strategy & Fund Recommendations**

We are now entering a very volatile and uncertain phase of the bond markets. With Coronavirus fears driving the markets, we could see huge swings in either direction, depending on how things unfold, especially with regard to its spread in India. **We would start advocating some caution to investors, as yields move towards the lower end of the long term ranges.** While near term momentum is still favourable for being long duration, we could see sudden sharp upmoves as well, if and when the virus spread comes under control and growth expectations stabilise.

We believe investors should incrementally look for products which give some yield pick-up, by investing in less liquid AAA and AA rated securities, where the spreads over liquid AAAs are relatively attractive.

**Funds such as the L&T Low Duration Fund and the L&T Resurgent India Bond Fund are well positioned in this space, to offer meaningful yield pick-up, while still keeping risks moderate.**

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**This product is suitable for investors who are seeking**

**L&T Low Duration Fund**
(An open ended low duration debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 6 months to 12 months)
- Generation of reasonable returns over short to medium term
- Investment in fixed income securities and money market instruments

**L&T Resurgent India Bond Fund**
(An open ended medium term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 years to 4 years)
- Generation of income over medium term
- Investment primarily in debt and money market securities

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*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

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**Source:** MOSPI, Internal, Bloomberg

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