Market Insights from Santosh Kamath – CIO, Fixed Income

April 2020

1. Economic Impact of Lockdown

- Lost almost 2 months but may not lose proportionately 17% on GDP
- Economy is split as 15% agriculture, 30% industry and 55% Services
- Manufacturing which is 16% of GDP (within industry) is worst impacted.
- Impact on agriculture is seasonal and carries potential of not being severe
- Many services are operating albeit at a lower scale, thus impact will be lower
- Government will strike an optimum balance on the benefits to be offered to the wide spectrum and diverse needs of economy and society.

2. LTRO (Long Term Repo Operation) and its Impact

- Banks offered 3-year money @ repo rate under LTRO.
  - Total of Rs.1 lakh crore to be auctioned by RBI. 3 of 4 auctions done.
  - LTRO funds to be compulsorily used by banks for bond purchases – 50% each in primary issuances and secondary market purchases.
  - Banks need to hold these securities in held to maturity (HTM) category.
- Despite 3 auctions, spreads are still not down
  - Only a fraction of the money has got deployed so far.
  - Being HTM and not a trading call, banks need to procure board approvals for limits to be set up for selected issuers. This typically takes 1-2 weeks
  - Work from home and curtailed market timings causing some delay
  - This creates huge impending demand for corporate bonds
- Once banks start deploying the funds, spreads are likely to drop sharply for AAA companies first, then AA companies and over a period of time for A rated companies also

3. Elevated Short-term Yields and Outlook

- ~Rs.7 lakh cr in RBI's reverse repo window with average overnight rate @3.2%.
- Currently mutual funds largely responsible for rise in yields. Redemptions leading to selling pressure with few buyers in the market. Once banks start deploying LTRO funds, yields are likely to drop sharply and quickly.

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4. View on NBFCs

- Among 20-25 NBFCs we hold, 50% of this universe has a debt equity ratio of 2:1
- Over the last 12 months, few NBFCs we hold have raised Rs.10,000 crore of equity. Hence most NBFCs are in a better position. NBFC fear is blown out of proportion.

5. Liquidity Management in Portfolios

- We have approx. Rs.12,000-15,000 crore holdings maturing each year.
- We receive approx. Rs.6,000 crore of interest p.a.
- Generated approx. Rs.10,000 crore of liquidity from March 1 till date
- Prepayments have also been a significant portion of our cash flows.
- Prepayments, repayments, accruals, borrowings, normal liquidity put together help liquidity management.
- Dedicated borrowing lines from banks is an additional form of liquidity

6. Why borrowing in Portfolios is high

- Introduced by SEBI in 1996, fund can borrow upto 20% of AUM for maximum 6 months.
- Post 2008 we have dedicated bank lines to borrow should the need arise
- Borrowing provides fund liquidity instead of selling at distressed levels, particularly in cases where maturities may be in the very immediate future.

7. Concentration Management

- Internal limits stringent than regulatory requirements. Same is evident in our portfolios till end 2019.
- Higher concentration is passive and on account heightened redemptions alone. Thus a temporary phase.
- Optimum balance to be maintained between higher concentration and selling at distressed levels of yield, just to bring concentration down on immediate basis.
- Pre-payment by issuers has served us better than selling securities at high levels.
- Greenco (predominant shareholder is GIC or Singapore government) prepaid entire amount on 3 April much before December 2021 deadline
- Approx. 10 other companies have pre-paid since January 2020

8. Update on Holdings

- **AT1 Bonds : L**iquidity on AT1 bonds has come down and spreads have gone up
    - Industry not holding any AT1 bonds where one needs to worry over credit
    - Cannot comment on Yes bank as the matter is sub-judice
- **Vodafone:** Part repayment of the outstanding amount is due in July 2020.

- **Essel/ ADAG :** Sharp markdowns on securities of both groups. Done to ensure investors that exit do not do so at cost of investors that remain invested.
- **NBFC Holdings**
  - We don't see any big stress in our portfolio from the NBFC sector
  - **Shriram** is AA+ by all rating agencies, rating got reaffirmed despite market conditions.
  - **Edelweiss :** Rating got reaffirmed
  - **JM** : Rating got reaffirmed
  - **Small Business Fincredit** : Prepaid in April 2020, 6 months ahead of the scheduled time period.
  - Even if some of them have stress on the asset side, currently they have good liquidity on the liability side like bank lines, cash, offshore bonds
- **Diverse Groups – Vedanta, Piramal, Adani, Future Group**
  - **Adani**: No pending dues; prepaid us Rs.1000 crore in December 2019
  - **Future Group:** impacted by lockdown. Rs.1500 cr invested by Amazon for 3% stake, Rs.42,000 cr valuation, $500 mn 5-year offshore bonds closed
  - March maturities paid; Franklin India Ultra Short Bond Fund has no exposure as on March 31, 2020
  - SEBI guidelines will help as ratings will not get impacted during lockdown.
- **State Government Entities - UP Power / Andhra Pradesh Capital Region**
  - Government companies are countercyclical and are not impacted by how economy is functioning; have government guaranteed structures.

9. Opportunities Ahead

- As of now, Risk off is only in fixed income and not on equity in 2020.
- Opportunities in Corporate Bond Funds, AAA Bonds
- Even at shorter end products like Franklin India Ultra Short Bond Fund provide great investment opportunity.

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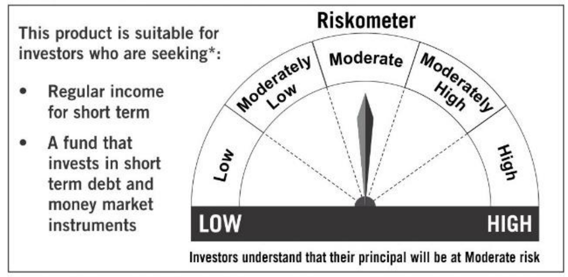
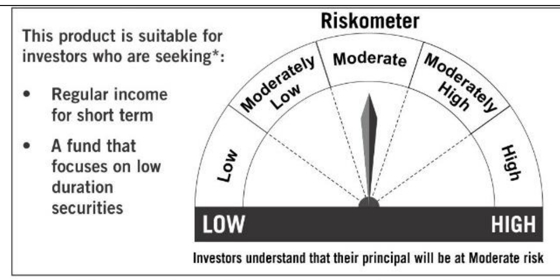
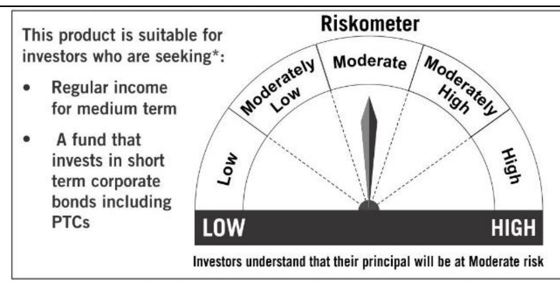
Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

Fund Name	Product Labelling
Franklin India Ultra Short Bond Fund (Number of Segregated Portfolios - 1)	 *Investors should consult their financial advisers if in doubt about whether the product is suitable for them.
Franklin India Low Duration Fund (Number of Segregated Portfolios - 2)	 *Investors should consult their financial advisers if in doubt about whether the product is suitable for them.
Franklin India Short Term Income Plan (Number of Segregated Portfolios - 3)	 *Investors should consult their financial advisers if in doubt about whether the product is suitable for them.