path of fiscal consolidation and widen sources of revenue generation. While some signals of relief to address recent stress of non-banking finance companies were announced, the Budget stopped short of providing concrete plans to resuscitate the recent growth slowdown.

From a portfolio management standpoint, we continue to largely confine ourselves to a bottom-up approach to stock selection and portfolio construction until stronger evidence of more broad-based growth emerges. We maintain a pro-cyclical stance and some portfolio shifts to capture a potential industrial/manufacturing recovery have been undertaken. Cyclicals with comfortable balance sheets and attractive valuations or companies with strong franchise value but presently facing growth headwinds do attract our attention.

Fixed Income Market

The drop in the bond yields continued over the previous month. The decline in yields was in the range of 15-20bps. The reasons for the drop in bond yields were mostly unchanged:

- Repo rate reduction of 25bps and change in monetary policy stance to accommodative from neutral
- OMO announcement by RBI
- Resounding political mandate for the existing government leading to an improvement of investor confidence
- Improved sentiment amongst foreign investors leading to continuation of foreign inflows
- Slowdown in domestic growth leading to expectations of higher doses of rate reduction and liquidity infusion from RBI in the coming months
- Slowdown in global growth particularly in US and drop in US treasury yields by about 65bps YTD

The weakening inflation pressures globally and domestically has opened up reasons to believe successive rounds of rate reductions and Quantitative Easing (QE) across the globe. It's a quick 360 degree change for advanced economies from the beginning of the year. This has led to markets reacting positively in favor of bonds across the globe including India. Additionally Indian policy makers also seems to be gearing up for a full-fledged easy monetary policy action to support the revival of growth whilst the NBFC and Housing Finance Companies (HFC) deal with problems of lack of investor appetite in the capital market and lack of liquidity at this time of trust deficit and widening Asset & Liability Management (ALM). Hence we expect the MPC members to push through higher doses of rate reduction and infuse liquidity in order to address the deficit liquidity within the Banking sector (addressed to some extent), NBFC and HFC as well.

This anticipated action of RBI is expected to work towards improving the surplus liquidity within the banking system and eventually help in the transmission of the lower rates for the borrowers. The drop in interest rates should also help in balancing the overall leverage across sectors and help in attracting equity capital as costs of savings and investments move lower.

Restraining of the fiscal target at 3.3% for FY20 and proposal to move overseas for part government borrowings has been cheered by the debt investors and has now shredded the fears of excessive government borrowing.

Outlook –

We reason that the slowing domestic growth is due to both slowing global growth and slowing domestic consumption. Headline CPI (presently at 3.05%) for CY20 is expected to be comfortably well within 4% due to benign oil prices, drop in core inflation and soft food prices. The drop in core inflation in India to sub 4.5% levels in the recent months after staying at over 5.5% for the last few years highlights the slowing domestic consumption. Thus with slowing growth and high real interest rates, RBI is likely to continue the rate reductions and attempt to push the lower rates into the economy. However, drop in repo rate do not always guarantee lower borrowing cost and hence we feel RBI may take additional actions to infuse liquidity so as to help lower the deposit rates of the banks and enabling them to price their loans cheaper.

As the market reposition to a strong political mandate at the Centre and chances of steep repo rate reduction, amidst widespread slowdown, whilst there will be challenges on the fiscal front due to slowing tax collections, we urge investors to start selecting funds in alignment with their investment horizon and marginally longer depending on their individual risk appetite. Some additional duration over the investment horizon should work favorably, as the risk return matrix is tilted towards lower rates. We expect the actions of RBI to create additional demand for gilts and bonds in this environment through rate reductions and additional liquidity.

The risks to this view emanate from higher government borrowing calendar of FY20. However, it may get neutralized through creation of higher demand for gilts and bonds by infusing liquidity into the system by RBI, OMO and or from higher demand for Indian bonds from foreign investors amidst low rates globally.