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Five-year bond rally fizzles as yields price in rate cuts, focus shifts

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Reuters | New Delhi

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A widely popular strategy of investing in India's five-year government bonds is losing its appeal as the security has now nearly priced in likely rate cuts, five fund managers said on Thursday.
Heavy buying in the 6.75 per cent 2029 bond has knocked down the yield by 80 basis points (bps) since March, among the steepest declines across dated securities and only behind two- and three-year bond yields.

The five-year bond is also trading 15 bps below the policy repo rate of 6 per cent, the deepest inversion in 11 years.
"The yield is trading sharply below the repo rate due to multiple factors, but this move is now overdone," said Murthy Nagarajan, head of fixed income at Tata Asset

Management.

The Reserve Bank of India (RBI) is expected to lower rates by at least another 50 bps in the coming months.

The five-year segment appears to have priced in most of the anticipated easing, said Laukik Bagwe, fund manager and head of fixed income at ITI Mutual Fund.

"While the shorter end of the curve has outperformed, further gains may be limited without clearer signals from the RBI."

Still, foreign investors, including Nomura, Standard Chartered Bank and BofA Securities, have suggested investing in the five-year part of the curve, noting that liquidity infusions from the central bank will bode well for shorter-duration bonds.

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Fund managers say that the focus may now shift to 10-year debt.

"We expect benchmark 10-year bond yield to grind towards 6 per cent level in the medium term," said Dhawal Dalal, president and CIO - fixed income at Edelweiss Asset Management.

Dalal expects the repo rate to settle between 5.25 per cent and 5.50 per cent.

Tata Asset Management's Nagarajan also expects the 10-year bond to outperform hereon, with the yield seen moving towards 6.10 per cent.

The 10-year yield has fallen by 39 bps since March, widening its spread over the five-year yield to 35 bps - the highest in three years.

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