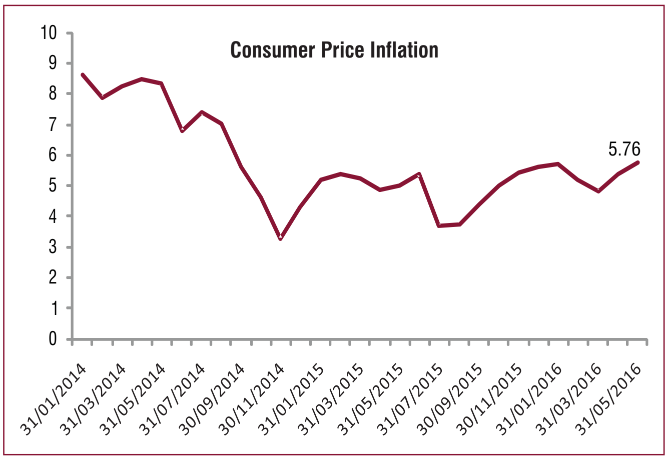
Monthly Fixed Income Update & Commentary on Focus Funds

July 2016

Birla Sun Life Mutual Fund

Key Rates & Market Yields	Jun-16	May-16
Repo Rate	6.50%	6.50%
Reverse Repo Rate	6%	6%
CRR	4%	4%
Overnight Rates		
CBLO	6.37	6.45
Short Term Debt		
3 months CP	7.73	8.07
6 Months CP	8.35	8.36
3 Months CD	6.69	7.17
6 months CD	7.09	7.29
91 days T-Bill	6.50	6.78
182 days T-Bill	6.81	6.91
364 days T-Bill	6.85	6.95
Long Term Debt		
3 yr G-Sec	7.13	7.22
5 Yr G-Sec	7.39	7.44
10 Yr G-Sec	7.45	7.47
Corporate Bond Yields (AAA)		
6 months	7.29	7.61
1 year	7.67	7.68
3 year	7.83	7.87

Macro Economic Parameters	Current Update	Last Update
CPI	5.47%	5.76%
WPI	0.34%	0.79%
IIP	0.1%	-0.80%
Trade Deficit	$5.1bn	$6.27bn
Current Account Deficit (CAD)	1.3% of GDP (Sep- Dec15)	0.1% of GDP (Jan- Mar16)
Fiscal Deficit	3.92%	3.50%
GDP Growth Rate	7.20%	7.90%
Exchange Rate Rs vs $	67.52	67.15



Data as on June 30, 2016. Source: Bloomberg, BSL AMC Internal Research

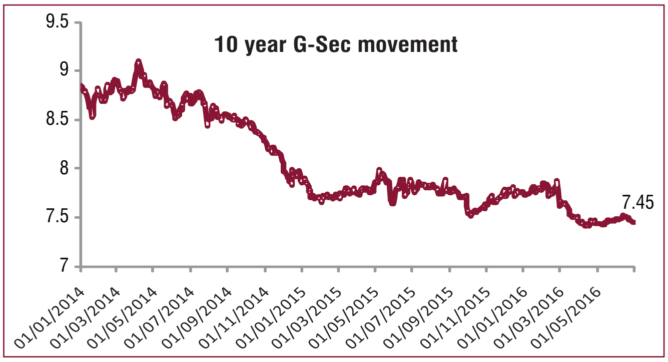
Fixed Income Market Update

- The fears of both BREXIT (Britain exiting European Union) and governor exiting the RBI materialised in the month gone by and kept the markets volatile.
- Following Brexit, the political fallout and ripple effect of it will play out over the next two years as Britain PM's successor will have to invoke Article 50 of the Lisbon treaty and then negotiation over exit will happen.
- From the market perspective, the event has left both the emerging markets as well as the developed markets volatile. We may expect monetary easing from G7 countries and some of the Emerging Markets (EM) and developed countries.
- India is likely to be impacted through its trade channels, however given its low exposure that would be contained. We can see however FII outflow in near term and low pace of inflows in medium term. This would imply more liquidity injection though Open Market Operations (OMOs) by the RBI.
- This suggests that the new Governor might be more dovish on rates than the incumbent means that we could be seeing both policy and markets rates lower from current levels.
- On the monsoon front, after the initial jitters of delay and higher deficit, rainfall has picked up steam in the past few days and become surplus now.
- The seventh pay commission payout has been approved by the cabinet. Over a lakh people will be given their pay hikes and pensions along with arrears. Both these developments are good for consumption demand.
- Global bond rally is on and India is also participating in that. We have seen yields coming down across the curve. For instance, the 10 year G-Sec has come down by 10 bps since the Brexit day.
- We remain positive on duration due to OMOs, net demand being favorable, inflation within reasonable limits. You may also look at the accrual funds whose yields are at attractive levels at this point in time. We are also actively watching the credit markets which seem to have gone into overdrive.
- There is a surge in the supply of credits in various spaces like promoter financing space, real estate space, infrastructure projects / cash flow based projects, securitisation space is expected to provide ample opportunity to build credit exposure going forward.

Portfolio Action & Strategy

BSL Dynamic Bond Fund

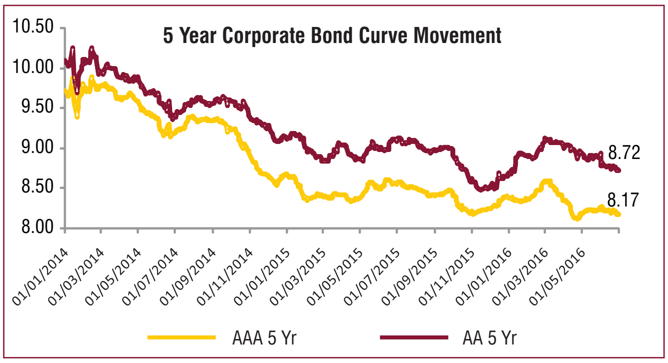
The fund has been running a duration strategy for over a year now with significant (~65%) exposure to long sovereign bonds (2045 & 2044 maturity bonds). Given the fiscal consolidation and reducing primary market supply as guided by RBI, the HTM (hold to maturity) demand for these bonds is expected to remain high for long term investors like Insurance companies, Pension funds, Provident Funds etc. The potential for capital gains from these bonds is quite high.



Going forward, after we have benefitted from our existing positions in sovereign bonds and corporate bond spreads (AAA-G-Sec) at close to their near average levels (~70-80 bps), the portfolio may steadily start increasing exposure to corporate bonds after unwinding some G-Sec position.

BSL Medium Term Plan

Over the past few months, the fund has invested in sovereign bonds to guard against the erstwhile credit concerns. Currently the G-Sec holding in the portfolio has been brought down significantly (~11%) by booking profits. The cash and CBLO holding in the portfolio is ~28%. The surge in the supply of credits in various spaces like promoter financing space, real estate space, infrastructure projects / cash flow based projects, securitisation space is expected to provide ample opportunity for the fund to deploy its cash holdings going forward. Currently, the YTM of the portfolio is 9.08% and the modified duration is 1.98 yrs.



BSL Short Term Opportunities Fund

The scheme had been running a reasonable exposure to sovereign bonds (~35%) in the last couple of months. Going forward, we intend to bring down the exposure to sovereign bonds and increase exposure to corporate bonds. After remaining at ultra low levels for several months, Corporate bond spreads have moved up to median levels (50- 55 bps for AAA- Gsec). The fund is currently positioned in such a way that ~50% - 65% of the portfolio is invested in AAA/sovereign bonds and ~35% -50% of the portfolio is invested in AA centric corporate bonds. For the last few months we were constructive on duration and were underweight on corporate bonds. With expansion in corporate bond spreads & softening interest rate environment, we intend to build higher exposure to corporate bonds in our portfolio going forward. The YTM of the portfolio is currently at 8.41%. The fund continues to focus on an accrual strategy with a high credit quality bias.

BSL Cash Manager Fund

In this fund we have been running a modified duration in the range of ~1 year for the last couple of months. In the 1-2 year bonds space the spreads and carry currently look attractive to us owing to the liquidity position of the economy now & as expected to be in future with RBI's efforts towards moving to a neutral liquidity position from a the current deficit one. We believe that the RBI's efforts on infusing liquidity into the system to move it from deficit liquidity to neutral liquidity is going to ease short term rates going forward. Hence, it is only justified to benefit by investing in 1-2 year segment now and benefit going forward when the yields come down.

Owing to this strategy, the fund is at the higher end of its duration band (0.5 – 1.25 yrs) and hence, the credit risk taken in the fund at this time is limited.

Data as on June 30, 2016. Source: Bloomberg, BSL AMC Internal Research