Axis Floater Fund: Strategy Change – 4 Year Sovereign Strategy

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Key Highlights

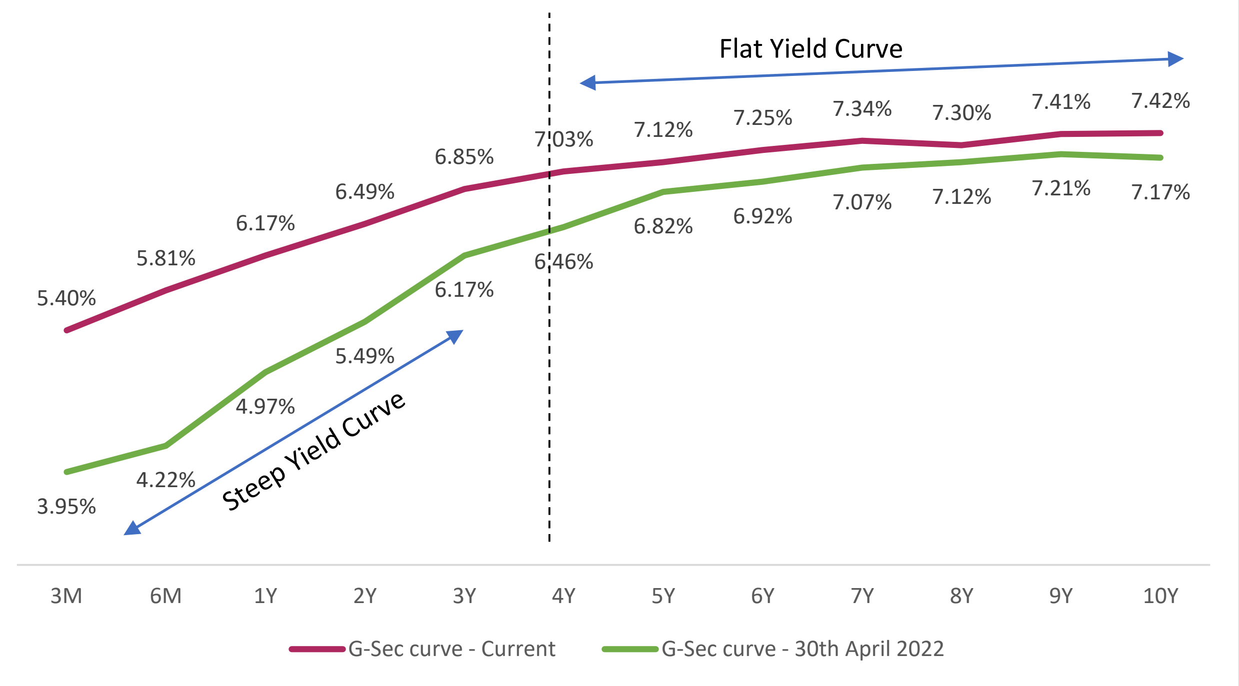
- Axis Floater fund was launched in July 2021 as a pure floater strategy
- Market forces have created a peculiar opportunity in the 4-year segment of the Sovereign markets
- Repositioning the portfolio into a 4-year Sovereign strategy aimed at providing investors with access to this opportunity

4 Reasons why we believe this strategy is ideal in current market scenario

#1 Curve flattening theme has played out

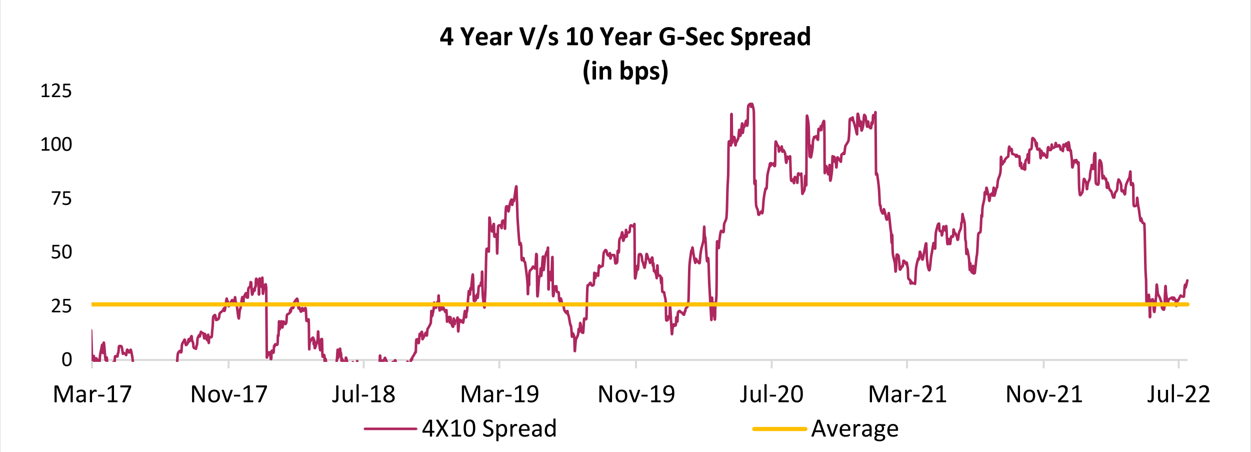
Since December 2021, RBI has been systematically withdrawing excess liquidity from the banking system as it looks to control runaway inflation. The 5 to 10yr part of the yield curve had already priced in the need for large simultaneous rate hikes resulting in a near flat yield curve.

The RBI was initially slow to react to changing economic pressures leading to steepness in 3m to 5yr part of the yield curve. This artificial steepness has begun correcting since March 2022. Typically, liquidity withdrawal affects the short end of the curve more than the long end. The resulting market movements have driven a surge in short bond yields. (Refer chart below).



Source: Bloomberg, Axis MF Research. Data as of 22^{nd} July 2022

This resulted in Spread Compression between 4X10 segment. The result offers attractive ‘carry’ opportunities for investors with 4-5-year investment horizon.



Source: Bloomberg, Axis MF Research. Data as of 22nd July 2022

Given the steepness at the short end the 4-year G-Sec offers a unique mix of 'Margin of safety' as well as competitive carry opportunities. With markets pricing in much of the rate hikes forecasted by the RBI, we anticipate limited market yield rises incrementally i.e. limited MTM impacts on such a strategy.

#2 Aggressive rate hikes priced in

The last 3 months have seen monetary policy responding to aggressive inflation pressures. As global central banks attempt to combat runaway inflation, global debt markets have priced in sharp rate hikes. Off cycle monetary meets and surprise rate hikes have kept markets volatile.

Global Central Banks	Implied Hikes	Implied Policy Rate
US Fed (June 2023)	+152	3.10%
ECB (June 2023)	+135	1.19%
BOE (June 2023)	+166	2.85%

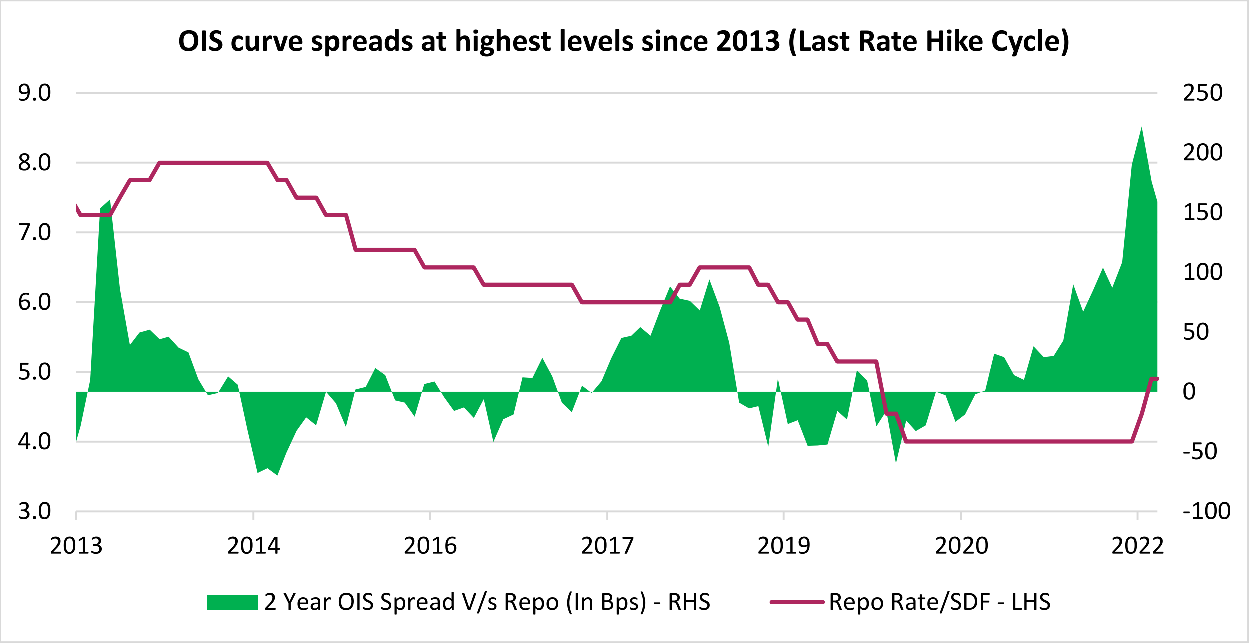
Source: Bloomberg, Respective central bank statements, Axis MF Research. Data as of 22nd July 2022

Domestic markets echo similar sentiments as bond markets in India have priced in terminal policy rates closer to 6.5%-7.00% from the current repo rate of 4.9%. Swap markets are pricing even higher aggressive rate hikes with implied policy rate expectations of 6.75% over next 12-18 months.

	Implied Hikes	Implied Policy Rate
RBI	+150-175	6.50%-6.75%*

Source: Bloomberg, Axis MF Research. Data as of 22nd July 2022

A key positive for central bankers has been the sharp fall in commodities. Commodities have corrected by 30-40% driven by weaker global demand outlook and fears of an inflation induced recession. Weaker commodities bode well for inflation, especially in a country which has a commodity heavy import bill. This offers conviction that we may be near anticipated peak interest rate levels.

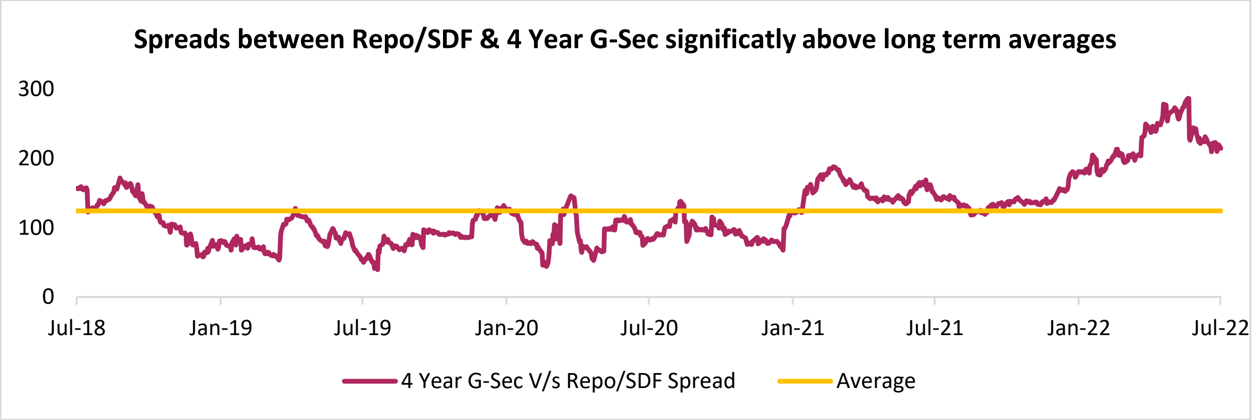


OIS curve spreads at highest levels since 2013 (Last Rate Hike Cycle)

Source: Bloomberg, Axis MF Research. Data as of 22nd July 2022

#3 Relative attractive Spreads

Spreads of G-Secs/SDLs and AAA's have compressed and are below long term averages. Hence from a risk reward perspective, the Sovereign curve provides an attractive investment opportunity. Also the spread between the Repo Rate / overnight rate vs the 4 year G - Secs rates is way above long term averages.



Spreads between Repo/SDF & 4 Year G-Sec signifícatly above long term averages

Source: Bloomberg, Axis MF Research. Data as of 22nd July 2022

#4 Mismatch in Bond Demand Supply Dynamics

Amidst a weaker global macro-economic environment, the government has resorted to higher public spending to offset weaker external demand. The government has budgeted its highest ever borrowing estimated at ~Rs 14.3 lakh Cr. In addition, the states have also identified stiff market borrowing (~Rs 8.25 lakh Cr) targets to meet their respective development agendas.

From a demand perspective,

a) market participants had widely anticipated suitable tax reforms to be undertaken to allow for Indian bond inclusion in global bond benchmarks. Inaction on this front has put the brakes on large foreign demand in India.

b) Limited RBI intervention especially at the long end could result in bond market volatility at the long end of the curve.

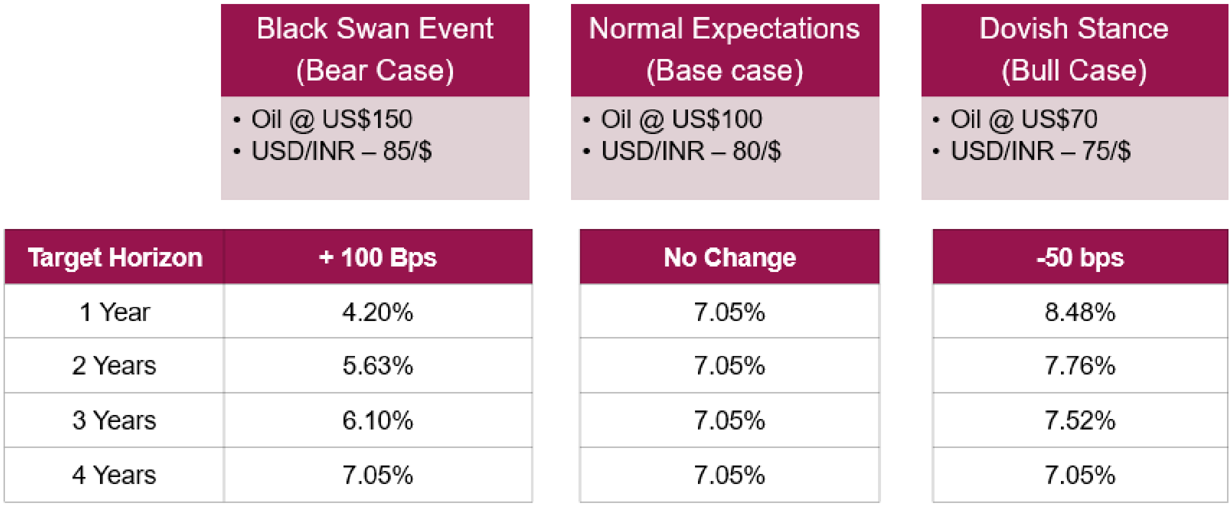
c) Corporate credit demand has also seen a significant improvement. Credit growth to the corporate sector hit a 7 year high according to the RBI. Incremental demand is likely to add to supply in the bond markets.

d) Global uncertainty along with elevated inflation are likely to keep long bonds volatile in the near term. We believe medium term India CPI inflation is unlikely to drop materially below 5% thus adding to uncertainties and volatility in the long bond space.

Product Positioning

The fund endeavors to build a portfolio of highly liquid Sovereign instruments with a residual maturity of 4 years. The portfolio of bonds will be held to maturity taking advantage of the relatively higher yields this segment currently offers. The fund will also create synthetic floating rate exposure via very short tenure interest rate swaps.

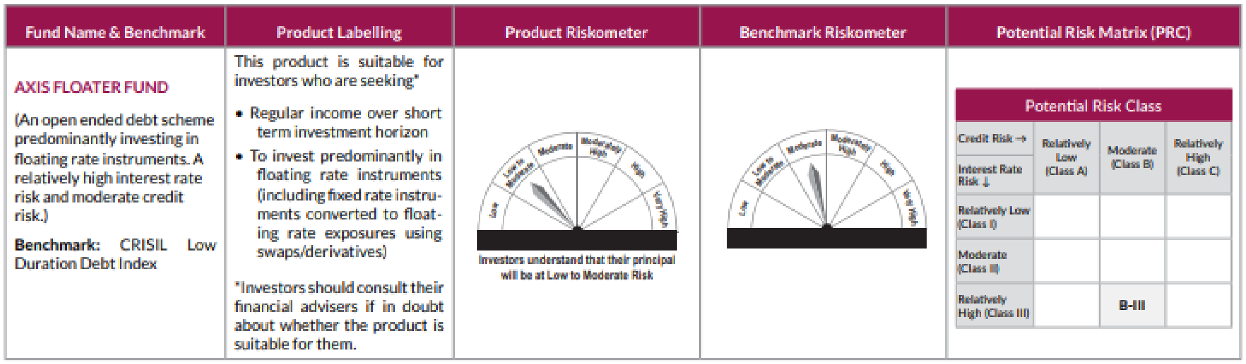
Scenario Analysis



	Black Swan Event (Bear Case)	Normal Expectations (Base case)	Dovish Stance (Bull Case)
	• Oil @ US$150 • USD/INR – 85/$	• Oil @ US$100 • USD/INR – 80/$	• Oil @ US$70 • USD/INR – 75/$
Target Horizon	**+ 100 Bps**	**No Change**	**-50 bps**
1 Year	4.20%	7.05%	8.48%
2 Years	5.63%	7.05%	7.76%
3 Years	6.10%	7.05%	7.52%
4 Years	7.05%	7.05%	7.05%

The above scenario analysis is based on the prevailing market rates on the G-Sec curve as of 22nd July 2022. The analysis is conducted using a modified duration of a bond at 2.85 years. The illustration is not an indication of returns. The analysis is to be used only for illustrative purposes only. The strategy assumes instruments are held to maturity over the 4-year investment horizon. **Past performance may or may not be sustained in the future.**

Product Labelling & Disclaimers



Fund Name & Benchmark	Product Labelling	Product Riskometer	Benchmark Riskometer	Potential Risk Matrix (PRC)
AXIS FLOATER FUND (An open ended debt scheme predominantly investing in floating rate instruments. A relatively high interest rate risk and moderate credit risk.) **Benchmark:** CRISIL Low Duration Debt Index	This product is suitable for investors who are seeking* • Regular income over short term investment horizon • To invest predominantly in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps/derivatives) *Investors should consult their financial advisers if in doubt about whether the product is suitable for them.	Investors understand that their principal will be at Low to Moderate Risk		

Potential Risk Class			
Credit Risk → Interest Rate Risk ↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Disclaimer

Past performance may or may not be sustained in the future. Data updated as on July 22nd, 2022. Statutory Details: Axis Mutual Fund has been established as a Trust under the Indian Trusts Act, 1882, sponsored by Axis Bank Ltd. (liability restricted to Rs. 1 Lakh). Trustee: Axis Mutual Fund Trustee Ltd. Investment Manager: Axis Asset Management Co. Ltd. (the AMC) Risk Factors: Axis Bank Limited is not liable or responsible for any loss or shortfall resulting from the operation of the scheme. This document represents the views of Axis Asset Management Co. Ltd. and must not be taken as the basis for an investment decision. Neither Axis Mutual Fund, Axis Mutual Fund Trustee Limited nor Axis Asset Management Company Limited, its Directors or associates shall be liable for any damages including lost revenue or lost profits that may arise from the use of the information contained herein. No representation or warranty is made as to the accuracy, completeness or fairness of the information and opinions contained herein. The AMC reserves the right to make modifications and alterations to this statement as may be required from time to time.

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