

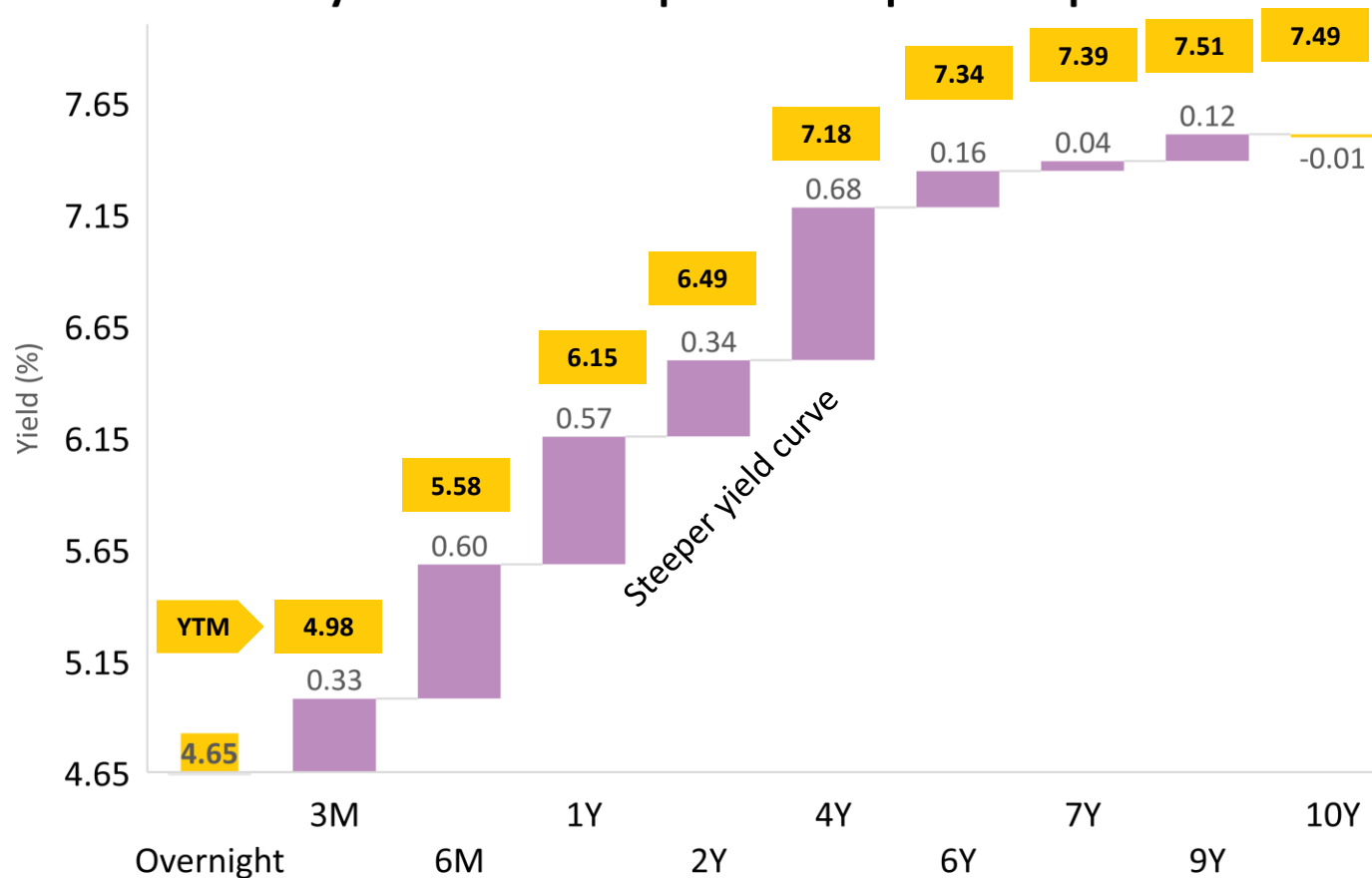
# BENEFITTING FROM THE STEEPNESS OF YIELD CURVE VIA IDFC GILT INDEX FUNDS



# Steep yield curve – An opportunity

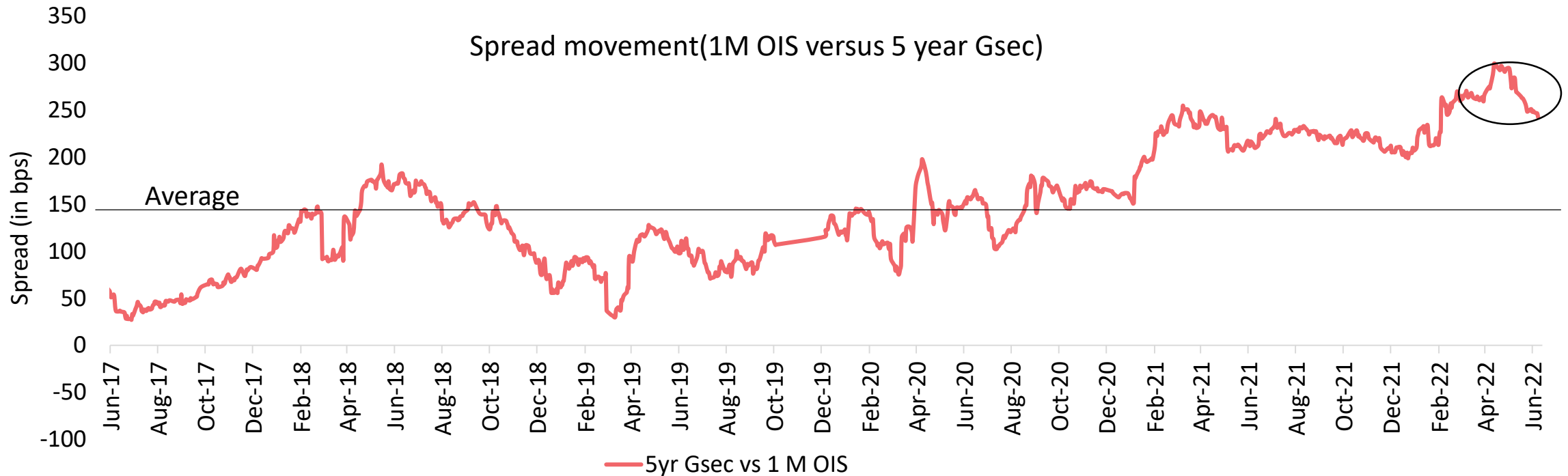
5-Year point offers sufficient carry buffer to interest rate hikes

### G Sec yield curve and spread over previous period



# Steepness of the yield curve offers relatively attractive opportunity at the 4–6-year point

The 4–6-year point remains relatively attractive. The relative **margin of safety in the intermediate duration** makes it opportune rather than waiting in cash.



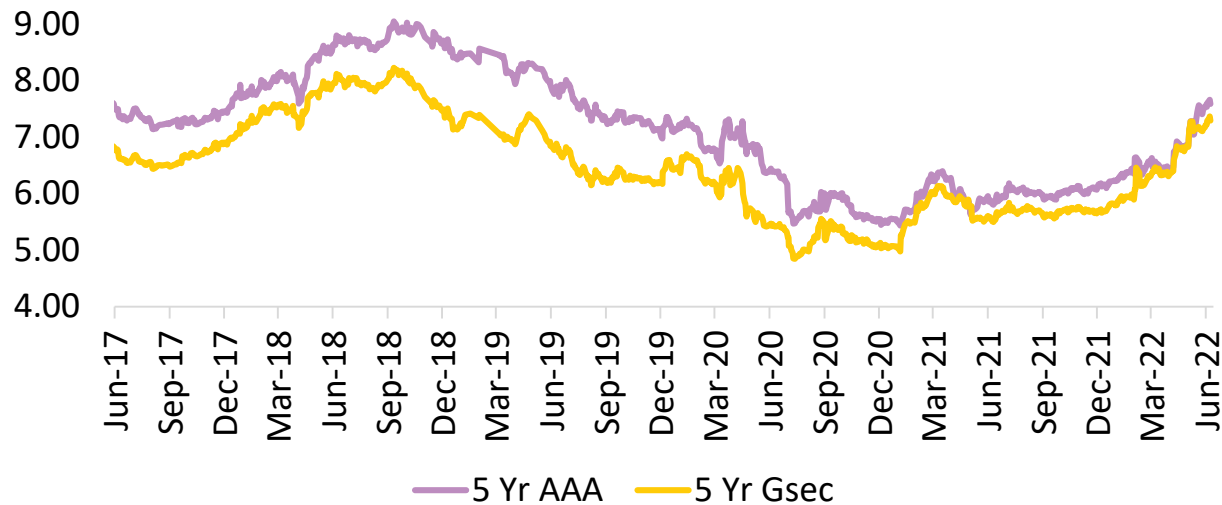
(in bps)	Current Spread	5year Average spread
5 year Gsec v/s 1M OIS	243	147

Data as on 8<sup>th</sup> June 2022  
 Source: Bloomberg  
 OIS – Overnight Index Swap

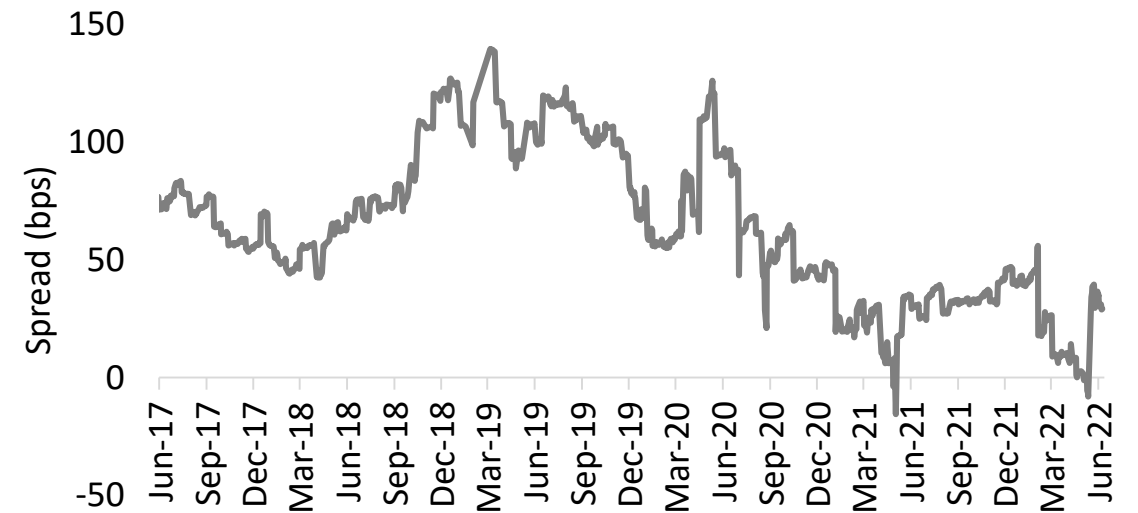
# Spread of average yield of 5-Year AAA and 5-Year GSec

- Currently, the difference between 5 year AAA yield and 5 year GSec yield is **29 bps**. Historically this **spread** was at an average **~62bps**.

5yr AAA versus 5yr GSec

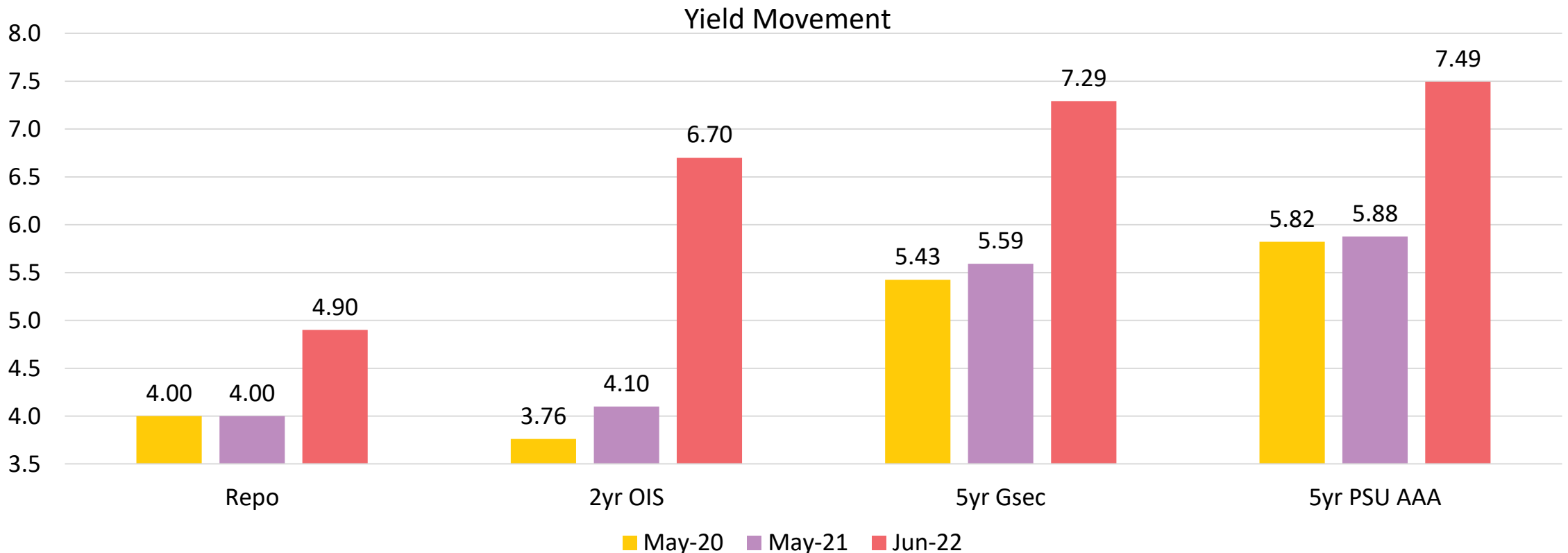


Spread 5yr AAA over 5yr GSec (in bps)



# Markets are already pricing in excessive rate hikes

- We believe markets are already discounting more rate hikes than RBI is likely to deliver (as seen below in the 2yr OIS segment) and so we could be in the last phase of the rate hike pricing.
- As seen from the below chart, yield across tenures has significantly moved up



# Be aware of the potential reinvestment risk when investing for shorter duration

Rs. 100 invested in 5-yr Gsec bond would yield Rs. 7.28 per year. Total earnings at the end of 5 years will be ~Rs. 36

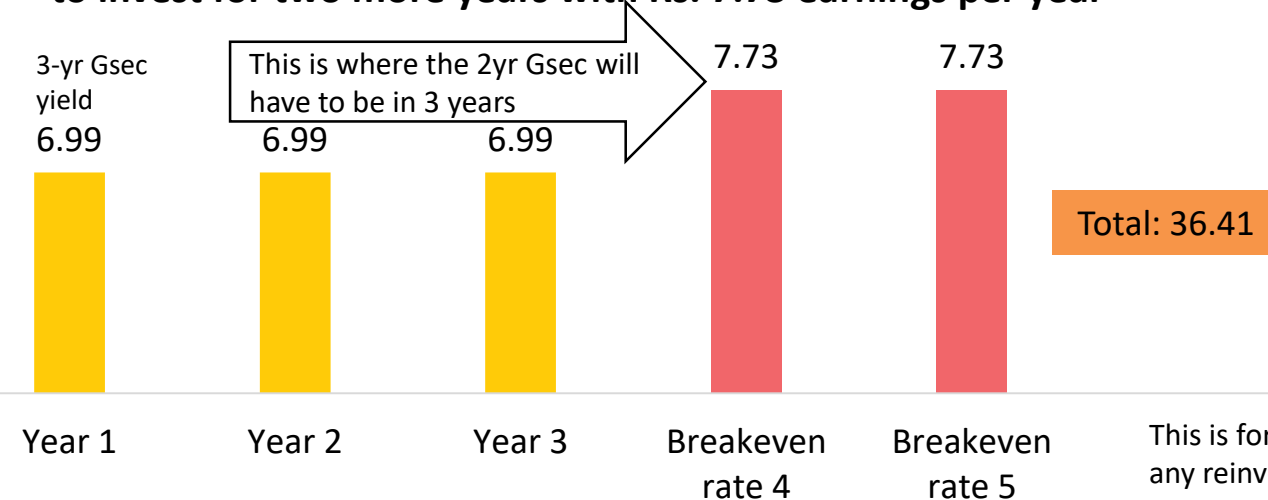


Comparing investing in a 5-yr strategy today to investing in a shorter strategy for 3yrs and then reinvest for 2 more years later

A 2-yr bond will have to move up by 123bps from today's level in 3 years (i.e. from 6.49% to 7.73%) to be equivalent to the earnings of 5-yr bond today

Therefore, it is important to be **aware of potential reinvestment risks** that may arise from being at the shorter end of the yield curve

If Rs. 100 is invested in 3-yr Gsec bond, it would yield Rs. 6.99 per year. To meet the above earnings of Rs. 36, one will have to invest for two more years with Rs. 7.73 earnings per year



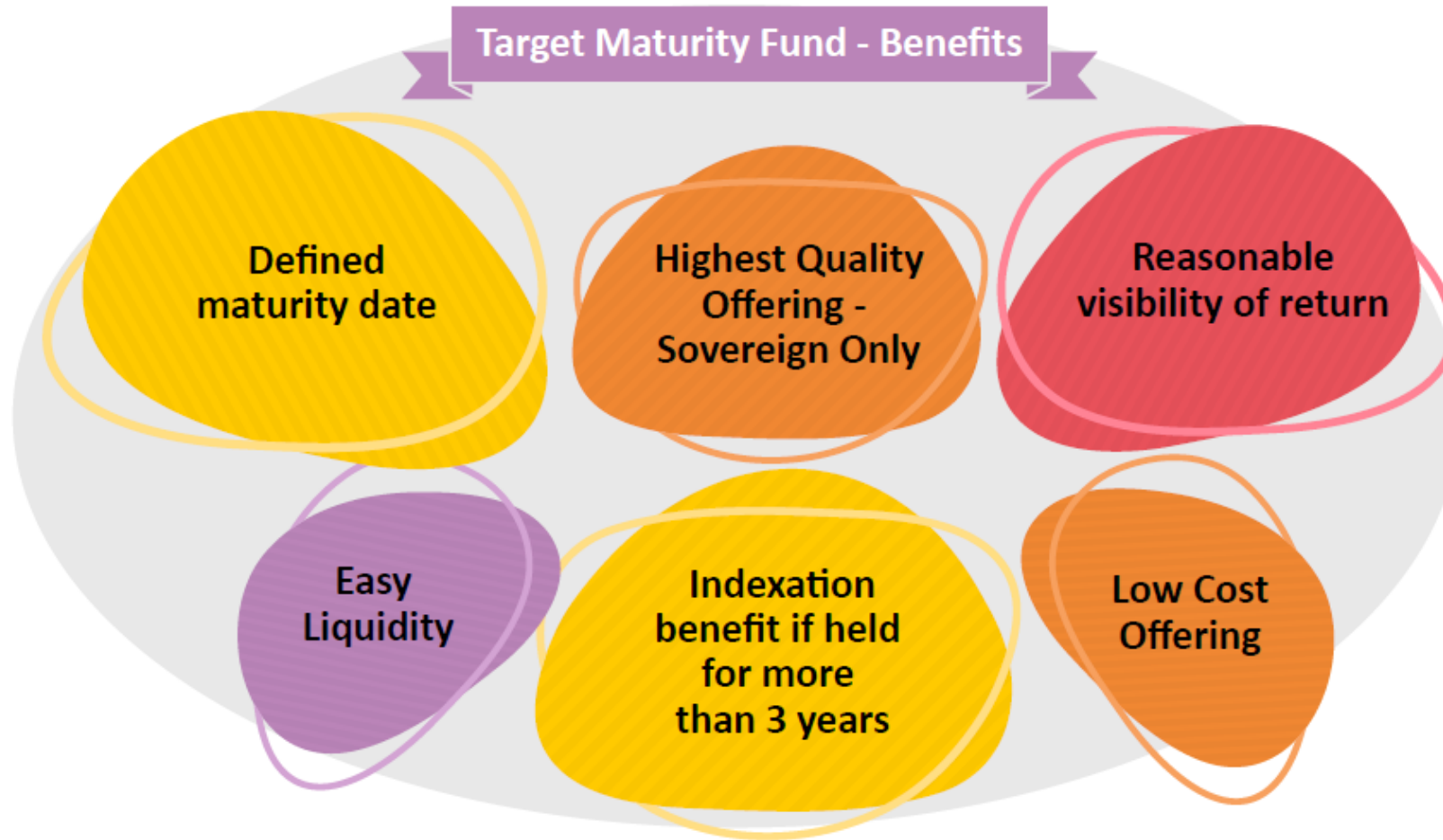
This is for illustration purpose only. The above does not consider any reinvestment risk impact. Data as on 8<sup>th</sup> June'22

# Summary

- Irrespective of near term volatility, one has to note that global monetary tightening (amplified by market yields already discounting steep future rate hikes) is progressing in what is a distinctly slowing global economy.
- While in some geographies the price of irresponsibly large stimulus over previous two years means a continued focus on tightening for now, this may not necessarily be true everywhere else. Our view remains that while RBI will get to a level of neutral relatively soon, the current cycle will still peak below 6% on the effective overnight rate.
- We reiterate preference for overweight 4 – 5 year government bonds.
- Further we see that the spread between 5yr AAA and 5yr GSec is lower than historical average currently, thereby **favouring investments in the 5-year Gsec segment**

Therefore, we believe our **IDFC Gilt Index Funds** are suitably placed to relatively benefit from the opportunity offered by the yield curve today

# Benefit of investing in Target Maturity Funds





# Target Maturity Fund – An alternative for traditional debt investment?

	<b>IDFC Gilt Index Funds</b>	<b>Fixed Deposit</b>
<b>Invests in</b>	Government securities and treasury bills	N. A
<b>Quality</b>	Highest Quality	Depends on credit rating of the bank
<b>Tenor</b>	Fixed tenor June 30,2027 <sup>1</sup> or April 05, 2028 <sup>2</sup>	Fixed tenor
<b>Withdrawal</b>	Any business day. One can even avail of SWP facility (systematic withdrawal plan)	On maturity, and may have a penalty on premature withdrawal*
<b>Market Risk</b>	Yes – daily NAV is published depending on market prices	No
<b>Duration Risk</b>	Initially high, then it keeps reducing as residual maturity decreases	N. A
<b>Guaranteed Returns</b>	No – but because these are target maturity schemes, one can have a reasonable visibility of performance	Yes
<b>Indexation Benefit</b>	Yes (IDFC Gilt 2027 Index Fund offers 5 years and IDFC Gilt 2028 Index Fund offers 6 years of indexation benefit)	No – Interest will be taxed as per individual's tax bracket

Fixed Deposits offer Fixed Rate of Return, while mutual funds are market linked. Bank Fixed Deposits are relatively safer as they are covered under DICGC to the extent of INR 5 lakh per account.

\*Generally, on premature withdrawal a certain amount may be charged as a penalty by the bank. ^ If invested till maturity of the scheme. Data as of 8<sup>th</sup> June'22

1: IDFC Gilt 2027 Index Fund    2: IDFC Gilt 2028 Index Fund

# Illustration of Rate hike/fall

	Current Yield	Rate movement	Revised Yield	Modified Duration	MTM gain/loss	Accrual	Total return	3 year Return	Accrual	Total return	5 year Return
<b>50bps up</b>	7.41%	0.50%	7.91%	4.25	-2.1%	25.7%	23.5%	7.30%	46.3%	44.2%	7.59%
<b>75bps up</b>	7.41%	0.75%	8.16%	4.25	-3.2%	26.5%	23.3%	7.24%	48.0%	44.8%	7.69%
<b>100bps up</b>	7.41%	1.00%	8.41%	4.25	-4.3%	27.4%	23.2%	7.19%	49.7%	45.5%	7.79%
<b>50bps down</b>	7.41%	-0.50%	6.91%	4.25	2.1%	22.2%	24.3%	7.53%	39.7%	41.8%	7.23%
<b>75bps down</b>	7.41%	-0.75%	6.66%	4.25	3.2%	21.3%	24.5%	7.59%	38.0%	41.2%	7.15%
<b>100bps down</b>	7.41%	-1.00%	6.41%	4.25	4.3%	20.5%	24.7%	7.65%	36.4%	40.7%	7.06%

*MTM gain/loss: Modified duration\*Rate movement*

*Accrual: Revised yield, compounded for 3 years*

*Total Return: MTM gain/loss + Accrual*

*3year Returns: Annualized returns based on total return*

In Contrast, today the FD and tax free rates are^:

3 year SBI FD rate: 5.45%

5year+ SBI FD rate: 5.50%

Tax Free Bonds:

NHAI 8.30% 2027: 5.00%

HUDCO 8.76% 2028: 5.43%

Source: SBI website and Bloomberg.

*This is strictly for illustration only and based on assumptions of rate hike at the beginning of the period. The illustration does not take into consideration the benefit of roll down, or cost of reinvestment or expenses. Returns are CAGR – Compounded Annualized Return. This is in no way a reflection of our expectation. Yield considered here are that of Crisil Gilt 2028 Index.*

*Data as on 8<sup>th</sup> June'22*

*^Data as on 31<sup>st</sup> May 2022*

# Illustration of Indexation benefit

Investors can avail indexation benefit if investment is held for more than 3 years

	Tax Free Bond <sup>1</sup>	Traditional Debt Investment	Crisil Gilt 2027 Index	Tax Free Bond <sup>2</sup>	Traditional Debt Investment	Crisil Gilt 2028 Index
Tenure (in years)	4.64	5.06	5.06	6.39	5.83	5.83
Indexations Availed	N.A	N.A	5	N.A	N.A	6
Return	5.00%	7.36%	7.36%	5.43%	7.41%	7.41%
Amount Invested	100,000	100,000	100,000	100,000	100,000	100,000
Redemption Value	125,379	143,270	143,270	140,204	151,703	151,703
Gains	25,379	43,270	43,270	40,204	51,703	51,703
Indexed Cost	N.A	N.A	121,665	N.A	N.A	126,532
Gains (post indexation as applicable)	N.A	N.A	21,605	N.A	N.A	25,171
Tax applicable	N.A	30%	20%	N.A	30%	20%
Tax Payable	N.A	12,981	4,321	N.A	15,511	5,034
Post Tax Gains	N.A	30,289	38,949	N.A	36,192	46,669
Post Tax Redemption Value	125,379	130,289	138,949	140,204	136,192	146,669
Return (post tax)	5.00%	5.36%	6.71%	5.43%	5.44%	6.79%

*This is for illustration purpose only*

Data as on 8<sup>th</sup> June 2022. Traditional investment is taxed at 30% and is assumed to be at the same rate as index (for illustration) and index fund is taxed at 20% post indexation. Cess and surcharge are excluded. Indexed cost arrived at assuming 4%p.a. growth rate in CII (Cost Inflation Index). Expenses, cost of reinvestment, impact of roll down have not been considered.

Tax Free Bond<sup>1</sup>: NHA1 8.30% 2027 Tax free bond

Tax Free Bond<sup>2</sup>: HUDCO 8.76% 2028 Tax free bond (Source: Bloomberg)

# About IDFC Gilt Index Funds

## IDFC Gilt 2027 Index Fund

(An open-ended Target Maturity Index fund investing in constituents of CRISIL Gilt 2027 Index. A Scheme with Relatively High Interest Rate Risk and Relatively Low Credit Risk.)

### Crisil 2027 Gilt Index

Average Maturity (years)	4.75
Modified Duration	3.89
YTM	7.36%
Date of Maturity	30-Jun-2027

Asset Class	Instrument Name	Maturity	Weights
Gilt	6.79% GS 2027	15-May-27	61.48%
	8.24% GS 2027	15-Feb-27	36.45%
Tbill	TB - 07/07/22 - 91D	07-Jul-22	0.69%
	TB - 13/07/22 - 91D	13-Jul-22	0.69%
	TB - 21/07/22 - 91D	21-Jul-22	0.69%

## IDFC Gilt 2028 Index Fund

(An open-ended Target Maturity Index fund investing in constituents of CRISIL Gilt 2028 Index. A Scheme with Relatively High Interest Rate Risk and Relatively Low Credit Risk.)

### Crisil 2028 Gilt Index

Average Maturity (years)	5.40
Modified Duration	4.25
YTM	7.41%
Date of Maturity	05-Apr-2028

Asset Class	Instrument Name	Maturity	Weights
Gilt	8.28% GS 2027	21-Sep-27	26.05%
	7.17% GS 2028	08-Jan-28	71.88%
Tbill	TB - 07/07/22 - 91D	07-Jul-22	0.69%
	TB - 13/07/22 - 91D	13-Jul-22	0.69%
	TB - 21/07/22 - 91D	21-Jul-22	0.69%

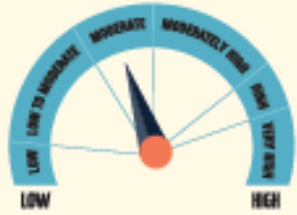
# Index Constituents

CRISIL Gilt 2027 Index			
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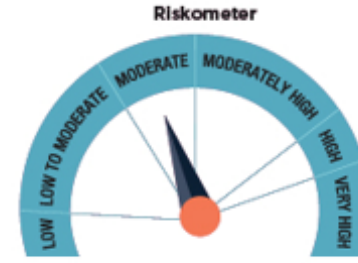
Investors understand that their principal will be at Moderate risk

**This product is suitable for investors who are seeking\*:**

- Income over the target maturity period.
- Investment in constituents similar to the composition of CRISIL Gilt 2027 Index.

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- Income over the target maturity period.
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*\*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.*

## Potential Risk Class of IDFC Gilt 2027 Index Fund

Interest Rate Risk	Credit Risk		
	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	<b>A-III</b>		

A-III [A scheme with relatively high interest rate risk and relatively low credit risk]

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A-III [A scheme with relatively high interest rate risk and relatively low credit risk]

# Disclaimer

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**MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.**

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