



First Capital
First Capital Research

*“MAINTAIN **BULLISHNESS**; INCREASE EXPOSURE”*

First Capital Fixed Income Recommendation - 12th OCT 18

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1.0 New Recommendation

MAINTAIN BULLISHNESS; INCREASE EXPOSURE

Weak Reserve Position spike yields

Following our previous report on 20th Sep 2018, yields have spiked 95-110bps in the overall yield curve due to the delay in the planned debt driven foreign inflows and drop in foreign reserve position by USD 1.4Bn to USD 7.2Bn as at end Sep 2018 [from USD 8.6Bn in Aug 2018] resulting from debt repayment, interventions and matured currency swaps. The currency continued to take a beating, peaking at LKR171.42: 1USD before registering an appreciation during the latter session on Friday 12th Oct 2018.

Yield at 18-Month high breaks upper bands

The rise in yields have broken the upper bands recommended by First Capital Research by about 100bps, with the 5-year maturity touching 12%, an 18-month high. Yields peaked during the early half of Friday (12th), primarily driven by the delay in the planned USD 1.0Bn syndicated loan from China Development Bank and the risks associated with it. However, reconfirming the fact that the rise in yields are temporary, yield curve beyond the 5Yr flattened amidst buying interest stemming from the long-term players led by the insurance companies.

Further Increase Exposure; We maintain our Bullishness

On the back of the current attractive yield positioning, we recommend investors to significantly increase exposure to 60% from 50% in medium to long tenor maturities. Despite the dip in yields over the latter half of Friday 12th, investors should also bear in mind that any further delays in the debt driven inflows may force yields back upwards specially in the short-mid tenor maturities.

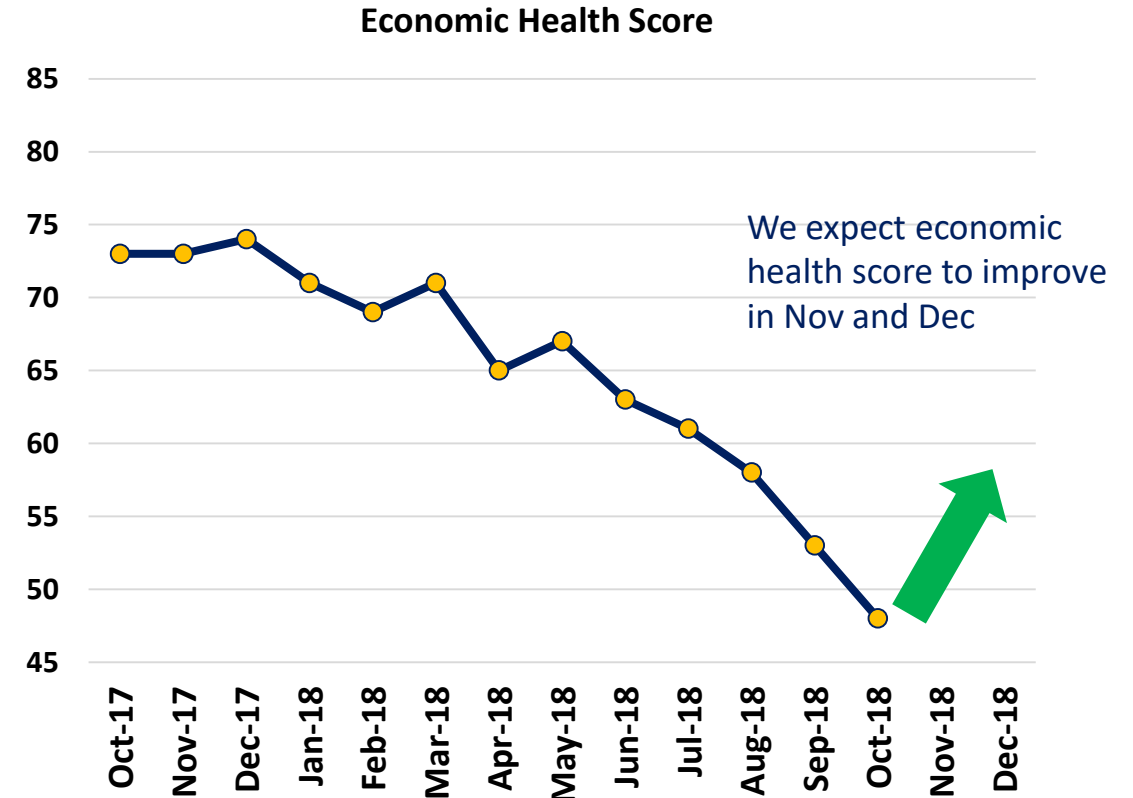
Portfolio Recommendation

Fixed Income Portfolio Recommendation

– Portfolio Recommendation: **Increase portfolio to 60% from 50%**

- Increase Carrying Portfolio to 35% from 30% and Trading Portfolio to 25% from 20%.

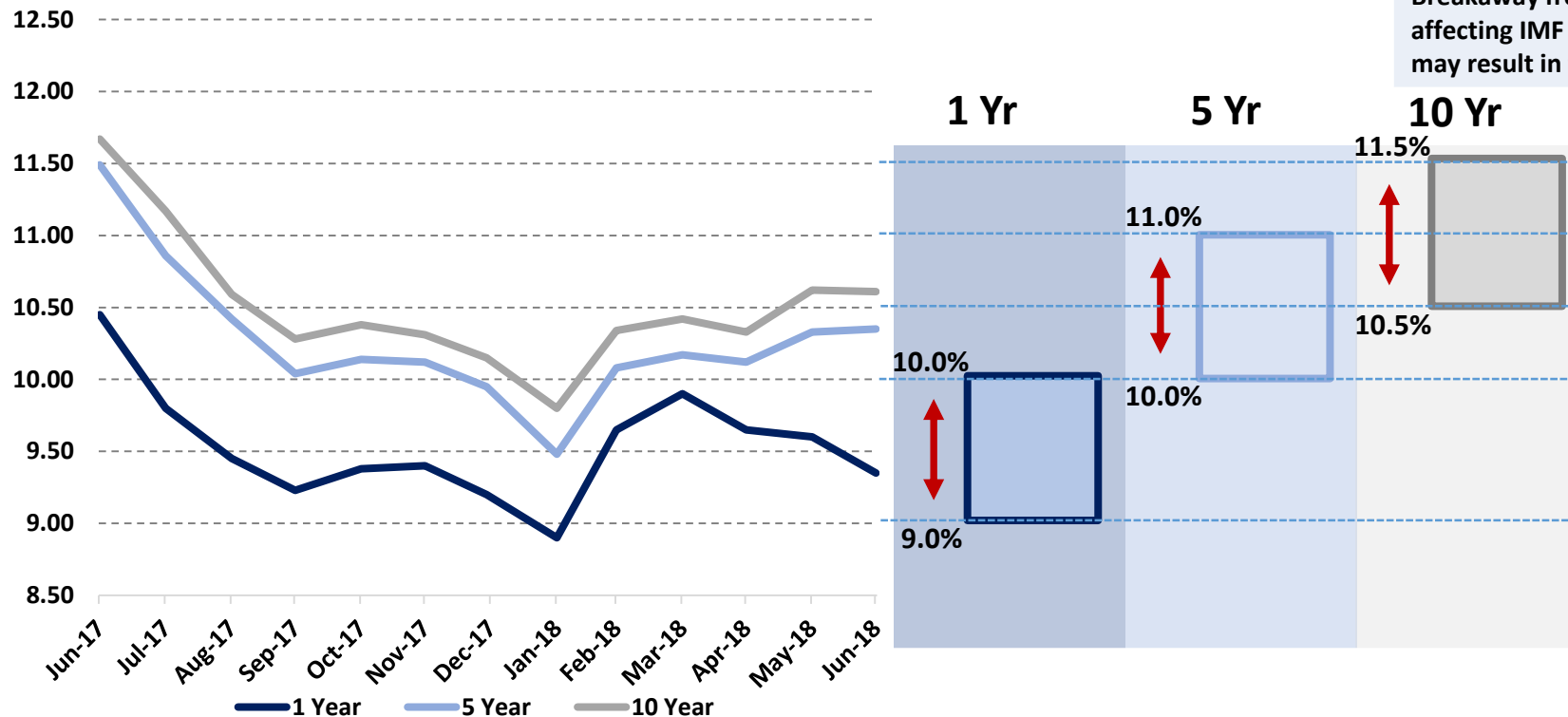
Yields of mid to long tenors 4Y, 5Y, 6Y and 7Y attractive price level to accumulate



Jul 2018 Re cap: Bond Rates to peak in 3Q2018 and gradually ease (12 months)

Expectations: **Moderately Bullish** beyond 3Q2018

Jul 2018 – Jun 2019	Probability	Impact
Bond Rates to peak in 3Q2018 and gradually ease	65%	Moderately Bullish / Stable
Breakaway from reform program (Deviations affecting IMF program) or political deadlock may result in the breaking the upper bands	35%	Bearish



Base Case (65% Probability) – Explanation

With higher borrowing requirement resulting in tight monetary conditions and increase in inflation could push the yield curve towards the upper bands. It could result in an increase in CBSL Holdings as well to manage interest rates.

Pressure could ease somewhat in 4Q2018, but will be short lived as debt payments continue to be high in 1Q & 2Q in 2019 with the maturity of the Sovereign Bonds

Policy Rate Expectations

On a base case First Capital Research expects a policy rates to remain stable throughout 2018. However, if GDP growth fails to pickup we expect policy rates to be cut by 25 basis points towards end of 3Q2018

Sequence of Events

16th Apr 2018 - **Reduce** overall portfolio to 50% from previous 60% mainly on mid-long tenors (5Y to 10Y). Cut Trading portfolio to 10% from 20%. (Primarily into 5Y to 10Y). Carry portfolio to be maintain to 40%.

23rd May 2018 – Maintain overall portfolio to 50%. Carry portfolio to be maintain to 40%. Trading portfolio to be maintained to 10%.

19th June 2018 - Maintain overall portfolio to 50%. Carry portfolio to be maintain to 40%. Trading portfolio to be maintained to 10%.

26th Jul 2018 - **Reduce** overall portfolio to 40% from previous 50%. Cut Trading portfolio to 0% from 10%. Carry portfolio to be maintained at 40%.

23rd Aug 2018 - **Reduce** overall portfolio to 30% from previous 40%. Cut Carrying portfolio to 30% from 40%. Trading portfolio to be maintained at 0%.

19th Sep 2018 - **Increase portfolio to 50% from 30%**. Increase Trading Portfolio to 20% from 0%. Carrying Portfolio to be maintained at 30%.

12th Oct 2018 - **Increase portfolio to 60% from 50%**. Increase Carrying Portfolio to 35% from 30% and Trading Portfolio to 25% from 20%.

2.0 Previous Recommendation

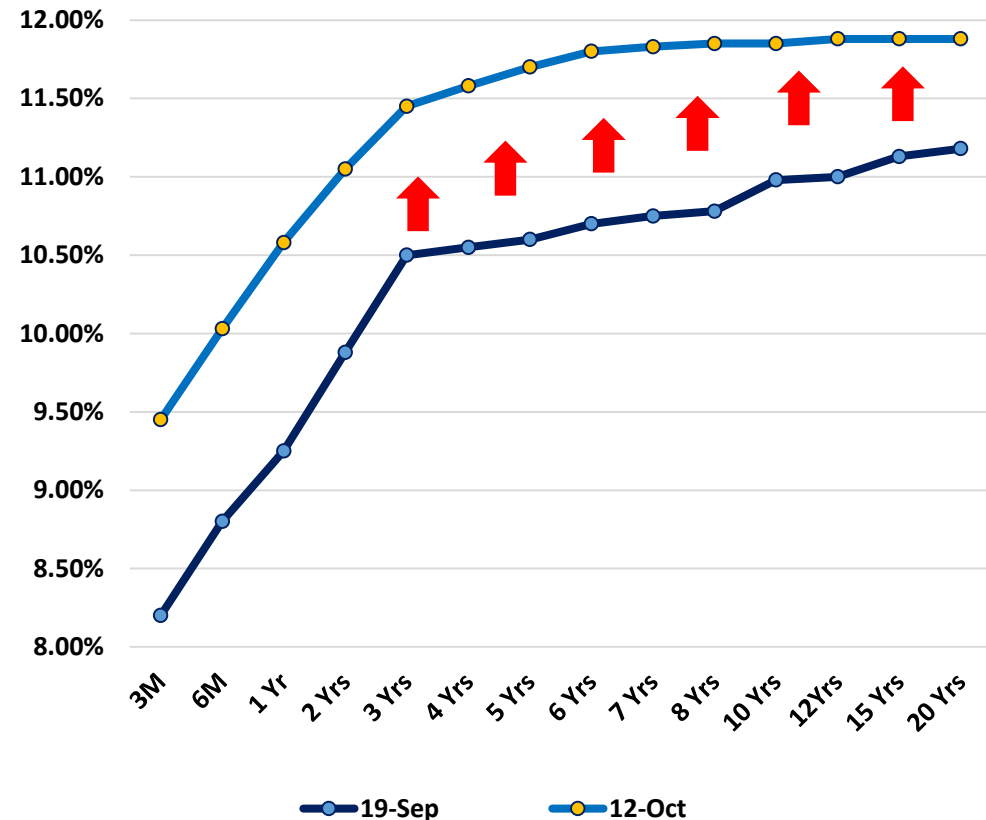
Previous Month 20th Sep Recommendations and Yield curve movement afterwards

Fixed Income Portfolio Recommendation

– Portfolio Recommendation: **Increase portfolio to 50% from 30%**

- Increase Trading Portfolio to 20% from 0%.
- Carrying Portfolio to be maintained at 30%.

Yields of short-mid tenors 3Y, 4Y and 5Y have fallen into a buy range while 7Y and 8Y have also registered attractive price levels to initiate accumulation



Rate Movement Review (Last 22 days)

Interest Rate Change (bps)			
Tenure	19-Sep	12-Oct	Change (bps)
3M	8.20%	9.45%	125
6M	8.80%	10.03%	123
1 Yr	9.25%	10.58%	133
2 Yrs	9.88%	11.05%	117
3 Yrs	10.50%	11.45%	95
4 Yrs	10.55%	11.58%	103
5 Yrs	10.60%	11.70%	110
6 Yrs	10.70%	11.80%	110
7 Yrs	10.75%	11.83%	108
8 Yrs	10.78%	11.85%	107
10 Yrs	10.98%	11.85%	87
12Yrs	11.00%	11.88%	88
15 Yrs	11.13%	11.88%	75
20 Yrs	11.18%	11.88%	70

- ❑ Following our previous report on 20th Sep 2018, yields registered 95-110bps upward movement in 3Yr to 15Yr well above our initial estimates on the back of the continuous delay in foreign currency debt inflows.
- ❑ Overall yield curve shifted upwards amidst some foreign selling pressure in the mid to long tenors.
- ❑ Heavy foreign outflow of LKR 28.0Bn was observed over the last 3 weeks.

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