



First Capital
First Capital Research

“LESSONS OF HISTORY; TIME TO UNLOAD”

First Capital Fixed Income Report – 06th Jan 20

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1.0 Previous Recommendation

Oct 2019 Re Cap

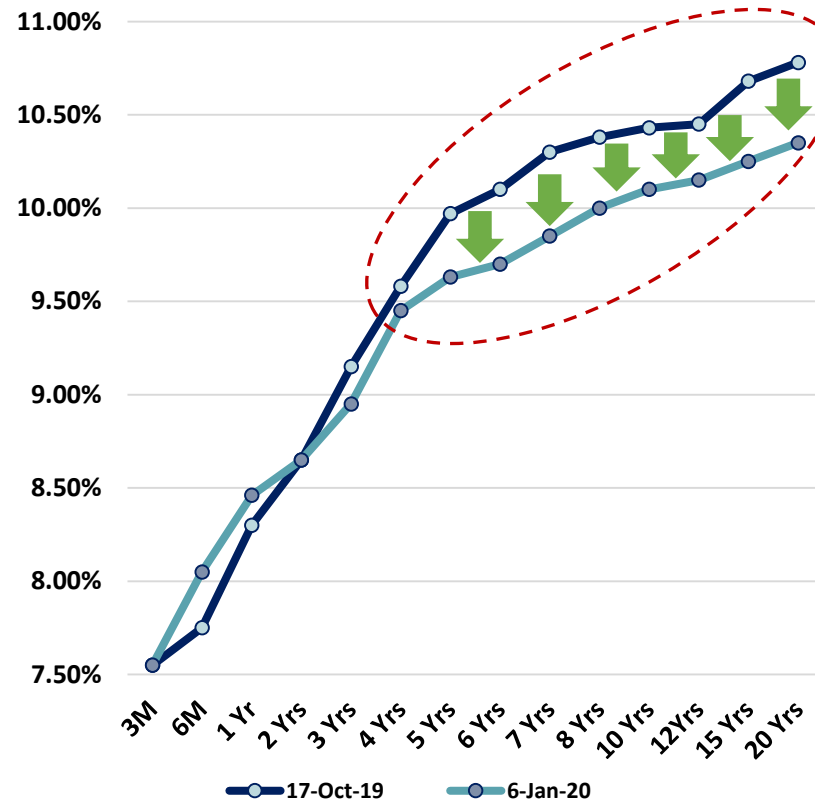
18th Oct Recommendations and Yield curve movement

Recommendation for 18th Oct 2019

– Portfolio Recommendation: **Increase overall portfolio to 50% from 45%.**

- Cut Carrying Portfolio to 15% from 30%.
- Increase Trading Portfolio to 35% from 15%.

With present macro economic environment, we recommend to reduce exposure in the carrying portfolio while increasing trading portfolio. Yields of mid to long tenors 5Y, 7Y, 8Y and 9Y are trading at attractive price levels to accumulate.



Tenure			Current Yield	Recommendation
< 91 Days	< 3M	Short	7.55%	Sell
< 182 Days	< 6M	Short	7.75%	Sell
< 364 Days	< 1Y	Short	8.30%	Sell
15-Dec-21	< 2Y	Short	8.65%	Sell
01-Oct-22	< 3Y	Short	9.15%	Sell
15-Dec-23	< 4Y	Mid	9.58%	Hold
15-Sep-24	< 5Y	Mid	9.97%	Buy
01-Aug-26	< 7Y	Mid	10.10%	Buy
15-Oct-27	< 8Y	Mid	10.30%	Buy
01-Sep-28	< 9Y	Mid	10.38%	Buy
01-May-29	< 10Y	Long	10.43%	Buy
15-Mar-31	< 12Y	Long	10.45%	Buy
15-Sep-34	< 15Y	Long	10.68%	Buy
15-Aug-39	< 20Y	Long	10.78%	Buy

2.0 New Recommendation

Sign of things to come

Previous Fixed Income Report – Increase exposure in mid-long tenor bonds

- In line with our expectations with the easing of political uncertainty post presidential election, coupled with favourable macro environment, bond yields eased off towards our targeted bottom bands of the yield curve. The hot favourites that we recommended 2023 and 2024 maturities saw a sharp dip in yields creating heavy capital gains. (Refer slide 3 for recommendation).

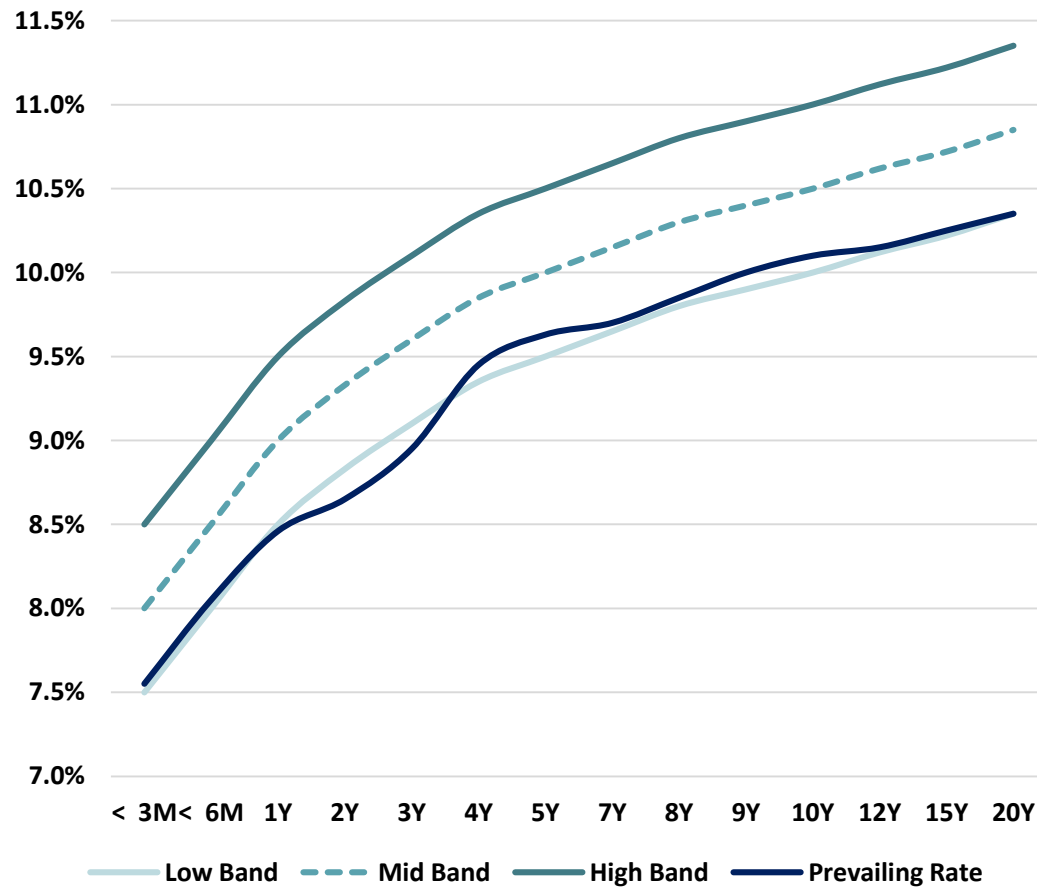
Recently provided hefty tax cuts may lead to fiscal slippage

Recently announced hefty stimulus package may cause fiscal slippage in light of the estimated loss to the government revenue. Reduction in tax revenue and uncertainty in all other indicators (Foreign Reserves, Inflation and exchange rate) may significantly deteriorate macro economic conditions and increase volatility of interest rates. Accordingly we lower our First Capital Economic Health Score for the bond market for the next couple of quarters.

Reduce exposure in Trading Portfolio: SELL

The Bond market yield curve is currently trading at the lower bands of the First Capital Research yield curve expectations (Refer slide 6). In our Bond Portfolio our current investment is assumed to have 50% exposure with 35% into trading portfolio and 15% in carrying portfolio. With the present macro economic environment, **we recommend to completely exit the trading portfolio** considering the volatile environment while maintaining exposure in the carrying portfolio. We recommend to avoid accumulation in the secondary market in order to bid for the auctions.

Yield Curve Recommendation



Tenure			Current Yield	Recommendation
< 91 Days	< 3M	Short	7.55%	Sell
< 182 Days	< 6M	Short	8.05%	Sell
< 364 Days	< 1Y	Short	8.46%	Sell
15-Dec-21	< 2Y	Short	8.65%	Sell
01-Oct-22	< 3Y	Short	8.95%	Sell
15-Dec-23	< 4Y	Mid	9.45%	Sell
15-Sep-24	< 5Y	Mid	9.63%	Sell
01-Aug-26	< 7Y	Mid	9.70%	Sell
15-Oct-27	< 8Y	Mid	9.85%	Sell
01-Sep-28	< 9Y	Mid	10.00%	Sell
01-May-29	< 10Y	Long	10.10%	Sell
15-Mar-31	< 12Y	Long	10.15%	Sell
15-Sep-34	< 15Y	Long	10.25%	Sell
15-Aug-39	< 20Y	Long	10.35%	Sell

Portfolio Recommendation

With present macro economic environment, we recommend to completely **exit the trading portfolio** considering the volatile environment while maintaining exposure in the carrying portfolio. We recommend to **avoid accumulation in the secondary market** in order to bid for the auctions.

Fixed Income Portfolio Recommendation

Portfolio Recommendation: - **Reduce overall portfolio to 15% from 50%.**

- Maintain Carrying Portfolio at 15%.
- Cut Trading Portfolio to 0% from 35%.



3.0 Economic Health Score

Jan 2020 FI Economic Health Score

Health score to further deteriorate towards 2Q2020

Primary Criteria - 49 - 02 - 47

Secondary Criteria - 11 + 02 - 01 - 12

Economic Health Score (Jan 2020) - 59

[As against 60 in Dec 2019 & 43 in Jan 2019 (1 Year ago)]

Changes to Health Score – Priority Criteria

Criteria	Update	Current Score	Add / Deduct Score	New Score
Foreign Reserves	Foreign reserves dipped by USD 0.3Bn during the month of Nov 2019 to USD 7.5Bn from USD 7.8Bn.	12/15		12/15
Liquidity	CBSL continuously conducting term reverse repo auctions to maintain liquidity.	09/15		09/15
Inflation	CCPI rose by 4.8% in Dec 2019 as the price of food items rose notably.	11/15	-01	10/15
Foreign Activity	Net outflow of LKR 16.0Bn in government securities over the last 4 weeks; Foreign holding around 1.9%.	04/10	-01	03/10
Credit	Private credit increased by LKR 47.1.0Bn in Nov 2019 recording four consecutive credit growths.	08/10		08/10
CBSL Holdings	CBSL sold LKR 10.0Bn in the last 2 months.	05/10		05/10

Primary Criteria - 49 - 02 = 47

Changes to Health Score – Secondary Criteria


Criteria	Update	Current Score	Add / Deduct Score	New Score
Rating Outlook	Fitch downgraded sovereign rating outlook to 'negative' over tax cuts.	02/05	-01	01/05
External Environment	Rupee broadly steady over the last 2 months.	01/05		01/05
BoT & BoP	Trade deficit increased to USD 838.0Mn in Oct 2019, from USD 758.0Mn in Sep 2019.	03/05		03/05
Political Risk	Political stability reinstated after Presidential election 2019.	03/05		03/05
Investor Confidence	BCI hits a 51-month high at 186 in Dec 2019 post presidential election.	02/05	+02	04/05

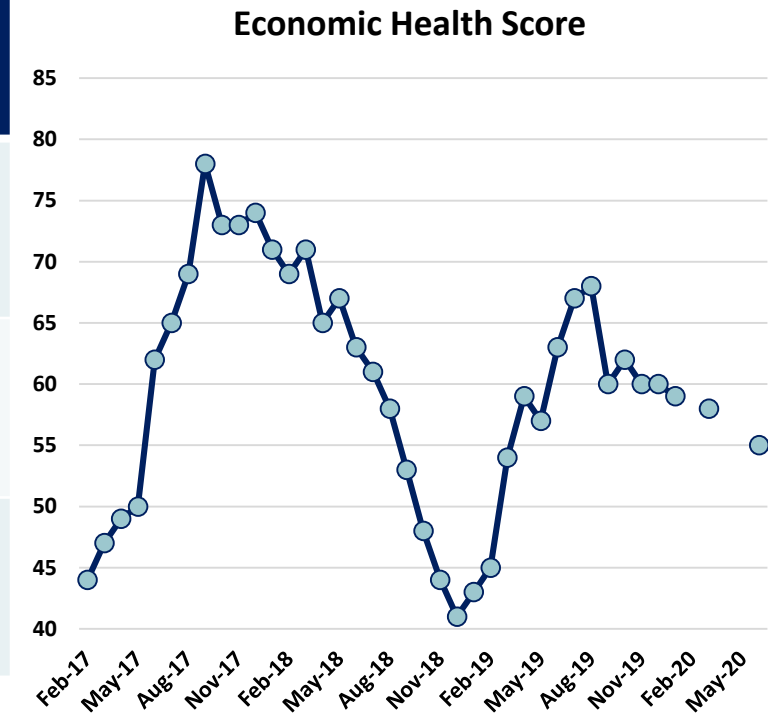
Secondary Criteria - 11 + 02 - 01 = 12

Sep 2019 Re Cap

Economic Health Expectations

	3 Months Outlook Jul-Sep 2019	3-6 Months Outlook Oct-Dec 2019	6-9 Months Outlook Jan-Mar 2020	9-12 Months Outlook Apr-Jun 2020
Health Score Estimate	50-60	55-60	60-65	55-60
Risk Level – Aug 2019	Medium 	Medium 	Medium-Low	Medium
Previous Expectations – Jun 2019	Medium-Low	Medium-Low		


Current Period



Risk Levels:- High: 40-50, Medium High: 50-55, Medium: 55-65, Medium Low: 65-75, Low: 75 above

Sequence of Events

19th Dec 2018 - **Increase portfolio to 50% from 40%.** Increase Trading Portfolio to 15% from 5%. Carrying Portfolio to be maintained at 35%.

11th Mar 2019 - **Increase overall portfolio to 55% from 50%.** Increase Carrying Portfolio to 45% from 35%. Reduce Trading Portfolio to 10% from 15%.

28th Mar 2019 - **Increase overall portfolio to 70% from 55%.** Increase Carrying Portfolio to 50% from 45%. Increase Trading Portfolio to 20% from 10%.

16th May 2019 - **Reduce overall portfolio to 40% from 70%.** Cut Carrying Portfolio to 40% from 50% and Trading Portfolio to 0% from 20%.

24th June 2019 - **Increase overall portfolio to 60% from 40%.** Increase Carrying Portfolio to 50% from 40%. Increase Trading Portfolio to 10% from 0%.

24th Jul 2019 - **Reduce overall portfolio to 45% from 60%.** Decrease Carrying Portfolio to 30% from 50%. Increase Trading Portfolio to 15% from 10%.

29th Aug 2019 - **Reduce overall portfolio to 30% from 45%.** Maintain Carrying Portfolio at 30%. Decrease Trading Portfolio to 0% from 15%.

18th Oct 2019 - **Increase overall portfolio to 50% from 45%.** Cut Carrying Portfolio to 15% from 30%. Increase Trading Portfolio to 35% from 15%.

06th Jan 2020 - **Reduce overall portfolio to 15% from 50%.** Maintain Carrying Portfolio to be maintained at 15%. Cut Trading Portfolio to 0% from 35%.

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