



First Capital
First Capital Research

First Capital Fixed Income Recommendation

2ND MARCH 2018

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ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 17

Previous Month 16th Feb Recommendations and Yield curve movement afterwards

Recommendation for 16th Feb 2018 (Last month)

Fixed Income Portfolio Recommendation

— Portfolio Recommendation: **BUY** primarily into the short tenors (2Y, 3Y, 4Y) and mid tenors of 5Y, 6Y

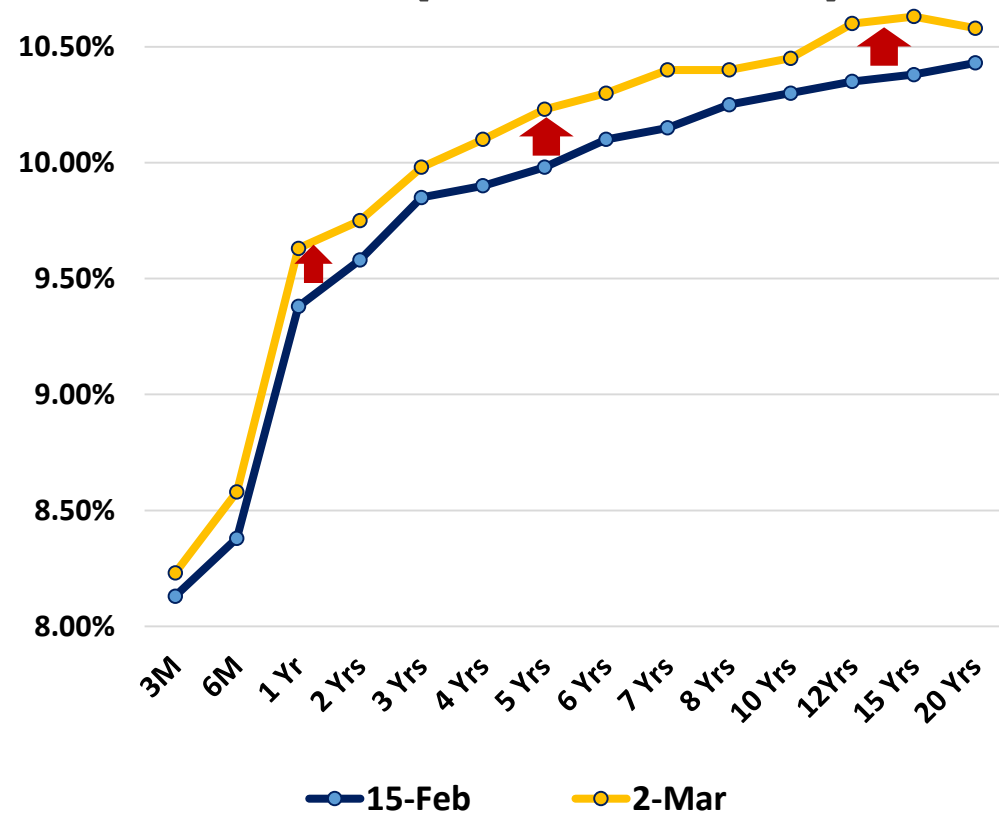
– Portfolio exposure: Overall portfolio to be increased to 40%.

- **Increase Trading portfolio to 10% from 0%.**
- Carry portfolio to be maintained to 30%.

– Yields of short tenors of 2Y, 3Y and 4Y have fallen into a buy range while 5Y and 6Y have also registered attractive price levels to initiate accumulation

We continue expect the overall yield curve to move upwards amidst the pressure in rates towards the 2Q and 3Q of 2018.

Yield Movement [17th Jan – 15th Feb]



Rate Movement Review

Interest Rate Change (bps)			
Tenure	15-Feb	2-Mar	Change (bps)
3M	8.13%	8.23%	10
6M	8.38%	8.58%	20
1 Yr	9.38%	9.63%	25
2 Yrs	9.58%	9.75%	17
3 Yrs	9.85%	9.98%	13
4 Yrs	9.90%	10.10%	20
5 Yrs	9.98%	10.23%	25
6 Yrs	10.10%	10.30%	20
7 Yrs	10.15%	10.40%	25
8 Yrs	10.25%	10.40%	15
10 Yrs	10.30%	10.45%	15
12Yrs	10.35%	10.60%	25
15 Yrs	10.38%	10.63%	25
20 Yrs	10.43%	10.58%	15

- ❑ Following our previous report on 16th Feb 2018, yields registered a significant upward movement after LG polls result
- ❑ Net Foreign outflow of LKR 872.0 Mn was observed last two weeks with some profit taking amidst very low level activities.
- ❑ Overall yield curve shifted upwards and heavy selling pressure was observed in the mid tenors.

Fixed Income Portfolio: New Recommendation – 2nd Mar 2018

Fixed Income Portfolio Recommendation

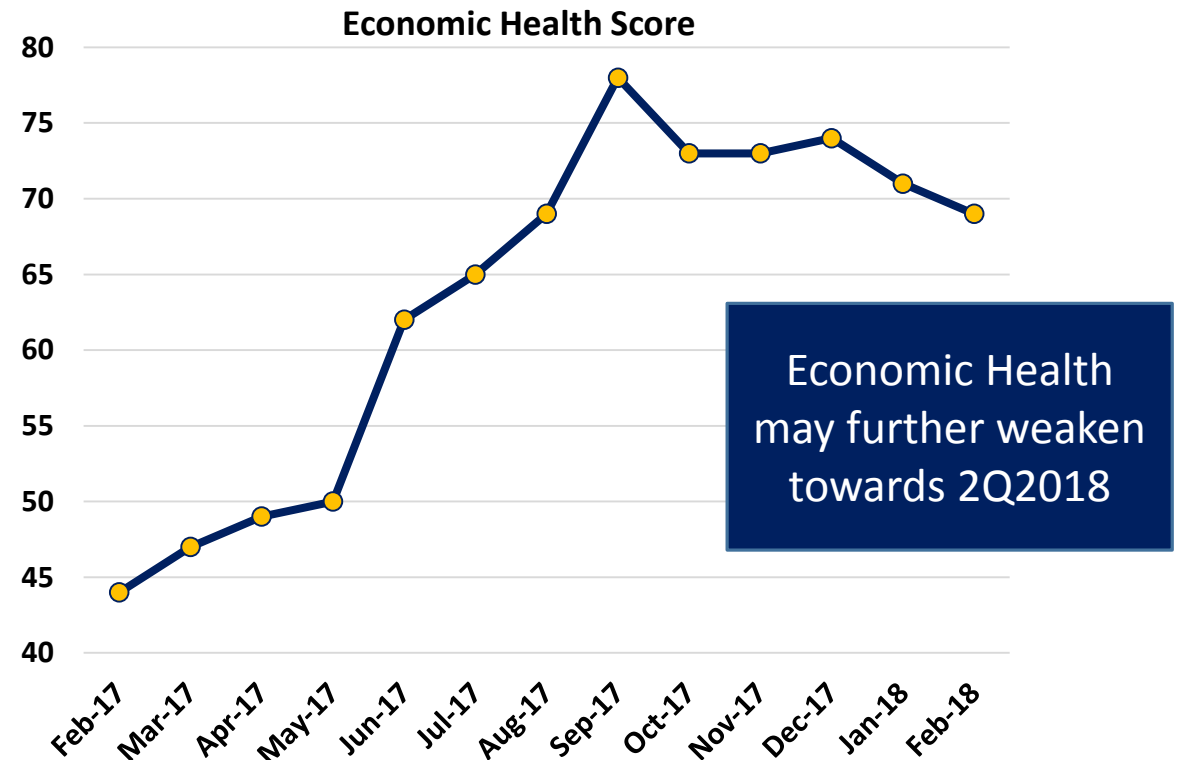
— Portfolio Recommendation: **BUY** primarily into the short tenors (2Y, 3Y, 4Y) and mid tenors of 5Y, 6Y

– Portfolio exposure: Overall portfolio to be increased to 50%.

- **Increase carry portfolio to 40% from 30%.**
- Trading portfolio to be maintained to 10%.

– Economic Risk level are same yields of short tenors of 2Y, 3Y and 4Y have fallen into a buy range while 5Y and 6Y have also registered attractive price levels.

We continue expect the overall yield curve to move upwards amidst the pressure in rates towards the 2Q and 3Q of 2018.



Re-cap [Jan 2018]: Time Period vs Health Score

	3 Months Outlook Jan-Mar 2018	3-6 Months Outlook Apr-Jun 2018	6-9 Months Outlook Jul-Sep 2018	9-12 Months Outlook Oct-Dec 2018
Health Score Estimate	65-75	65-75	60-65	65-75
Risk Level – Jan 2018	Medium-Low	Medium-Low	Medium	Medium-Low

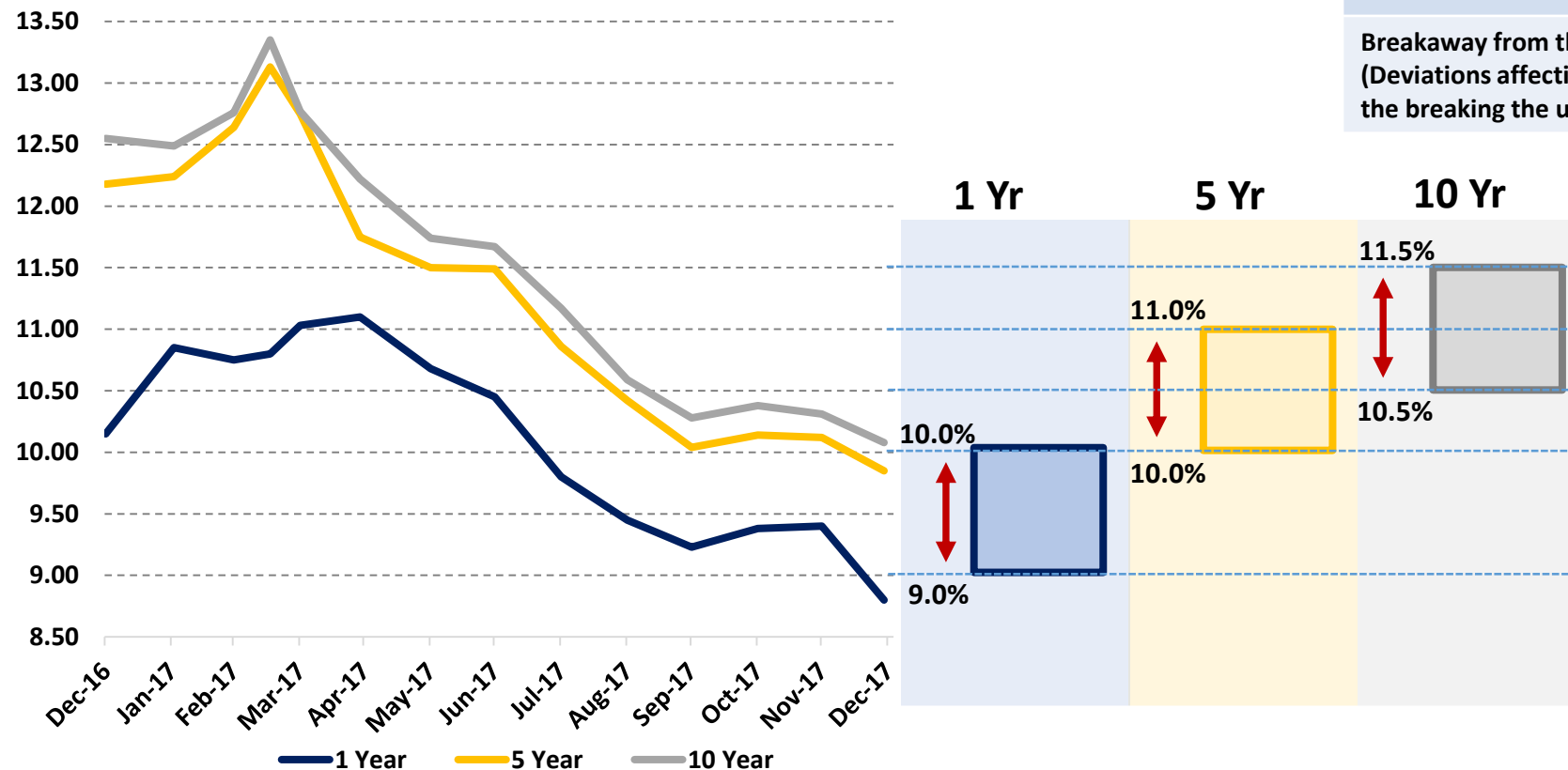


Current Period

Interest Rates to be Bearish towards 2Q-3Q2018 (12 months)

Expectations: **Bearish** towards 2Q-3Q2018

Jan 2018 – Dec 2018	Probability	Impact
Interest Rates to be upward trending towards 2Q-3Q2018 and reaching upper bands	65%	Moderately Bearish / Stable
Breakaway from the continuous reform program (Deviations affecting IMF program) may result in the breaking the upper bands	35%	Very 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

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