



First Capital
First Capital Research

“MID TENOR BULLS”

First Capital Fixed Income Report – 18th Oct 19

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1.0 Previous Recommendation

Jul 2019 Re Cap

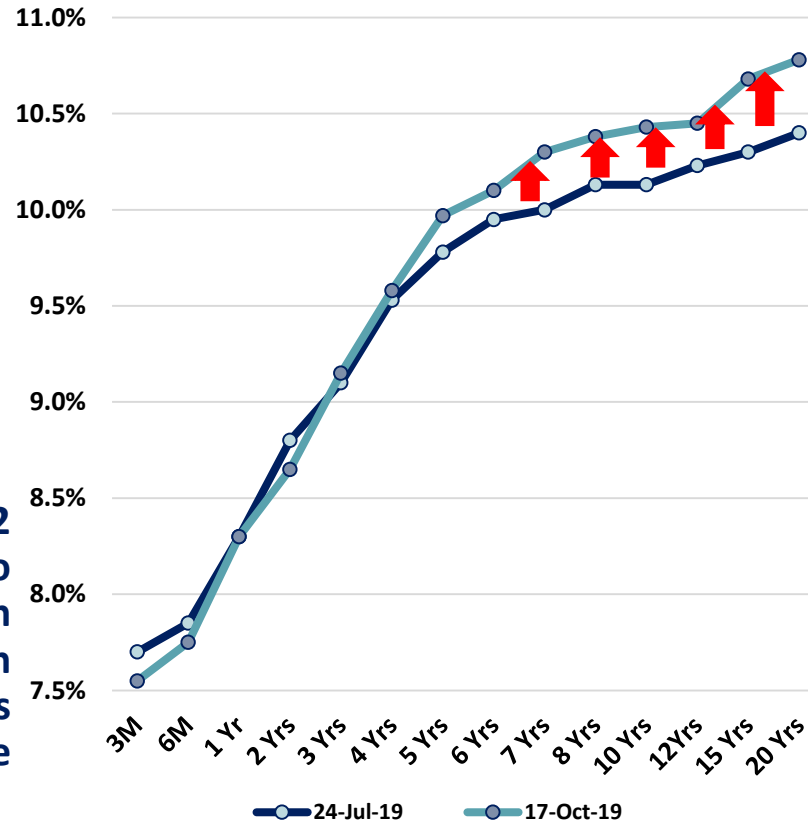
29th Jul Recommendations and Yield curve movement

Recommendation for 29th Jul 2019

– Portfolio Recommendation: **Reduce overall portfolio to 45% from 60%.**

- Decrease Carrying Portfolio to 30% from 50%.
- Increase Trading Portfolio to 15% from 10%.

We recommend to cut 2021 and 2022 maturities of the carrying portfolio amidst the significant reduction in yields while we recommend an increase in 2023 and 2024 maturities in the trading portfolio amidst the slight rise in yields.



Tenure			Current Yield	Recommendation
< 91 Days	< 3M	Short	7.70%	Sell
< 182 Days	< 6M	Short	7.85%	Sell
< 364 Days	1Y	Short	8.30%	Sell
01-May-21	2Y	Short	8.80%	Sell
15-Jul-22	3Y	Short	9.10%	Sell
15-Jul-23	4Y	Mid	9.53%	Buy
15-Mar-24	5Y	Mid	9.78%	Buy
01-Aug-26	7Y	Mid	9.95%	Hold
15-Jun-27	8Y	Mid	10.00%	Hold
01-Sep-28	9Y	Mid	10.13%	Hold
01-May-29	10Y	Long	10.13%	Sell
15-Mar-31	12Y	Long	10.23%	Sell
15-Jan-33	15Y	Long	10.30%	Sell
15-Mar-35	20Y	Long	10.40%	Sell

2.0 New Recommendation

Lengthen portfolio duration

Maintaining Bond Yield bands

In our last fixed income report on 29th July 2019, we downgraded our expectation in the FI Health Score due to lower liquidity and foreign selling. We recommended our investors to reduce overall portfolio exposure to 45% from 60% while we remain positive only on selected mid tenor maturities. Thereafter, yields spiked by 20-65bps in the overall yield curve on the back of foreign selling. During last two weeks foreigners sold LKR 25.1Bn with the surprise policy rate cut of 50bps by CBSL on 23rd Aug, one policy meeting ahead of our expectation.

Samurai Bond issuance to strengthen foreign reserves

Sri Lanka has appointed lead managers for a USD 500.0Mn equivalent Samurai bond which will have a guarantee from Japan Bank for International Corporation (JBIC). Sri Lanka's next international sovereign repayment is only due in Sep 2020 amounting USD 1.0Bn while 1Q and 2Q 2020 constitute USD 0.9Bn of SLDBs maturing. Raising funds well in advance for repayment is expected to significantly strengthen macro economic outlook for Sri Lanka and to reduce unnecessary volatility. We expect reserves to be c.USD 8.0Bn towards 2019-year end while maintaining above USD 7.0Bn by end of 1H2020.

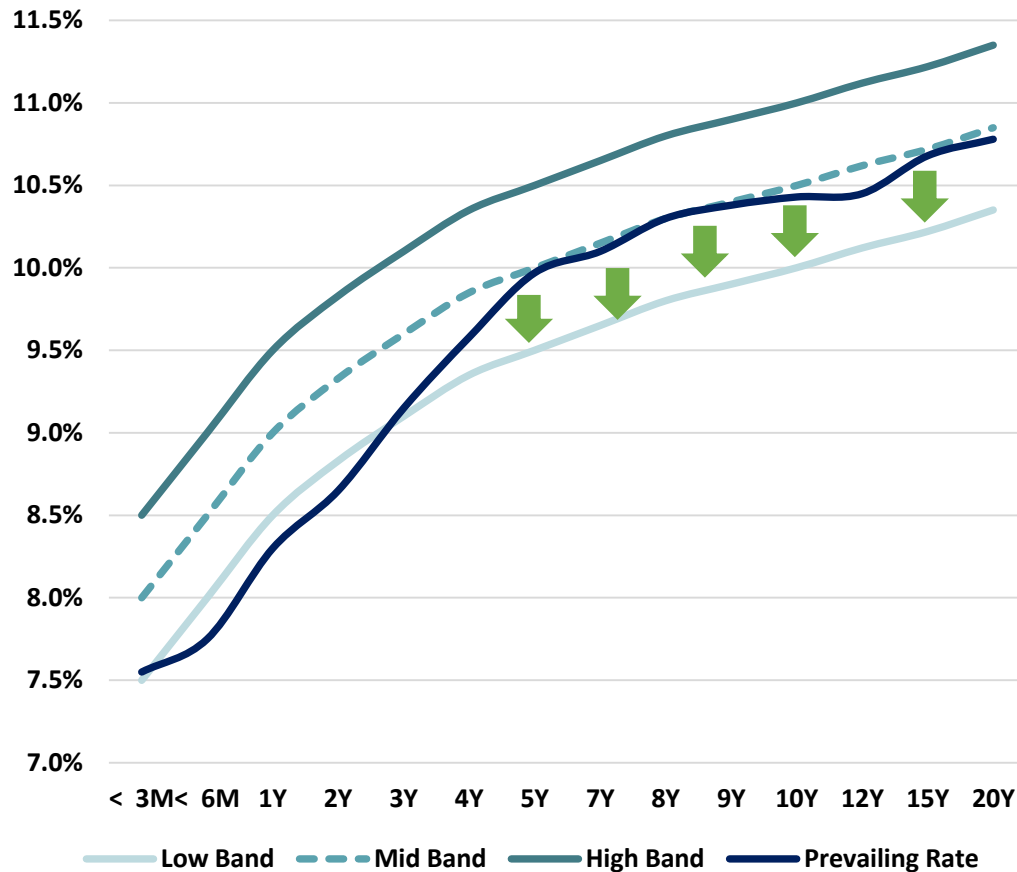
Liquidity to improve during 4Q2019

FCR expects market liquidity to improve and stay positive with the lower level of private credit growth. Post presidential elections, with the possible easing off political uncertainty and coupled with favourable macro environment, creates a strong case for foreign inflows potentially towards the end of 4Q2019.

Increase exposure in mid-long tenor bonds

We recommend investors to increase overall portfolio exposure to 50% from 45%. We recommend to cut short tenor maturities of the carrying portfolio amidst the significant reduction in yields while we recommend an increase in 2023 and 2024 maturities in the trading portfolio due to attractive yields.

Yield Curve Recommendation



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-Oct-21	2Y	Short	8.65%	Sell
01-Oct-22	3Y	Short	9.15%	Sell
15-Jul-23	4Y	Mid	9.58%	Hold
15-Sep-24	5Y	Mid	9.97%	Buy
01-Aug-26	7Y	Mid	10.10%	Buy
15-Jun-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-Mar-35	20Y	Long	10.78%	Buy

Portfolio Recommendation

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.

Fixed Income Portfolio Recommendation

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

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



3.0 Economic Health Score

Nov 2019 FI Health Score

Health score further improves toward 4QFY20

Primary Criteria	-	48	+ 02	- 01	-	49
Secondary Criteria	-	12	- 01		-	11

Economic Health Score (Nov 2019) - 60

[As against 68 in Sep 2019 & 53 in Sep 2018 (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 886.0Mn during the month of Sep to USD 7.6Bn from USD 8.5Bn.	13/15	-01	12/15
Liquidity	Liquidity remained volatile throughout the last 6-week period and currently below LKR 10.0Bn.	09/15		09/15
Inflation	CCPI rose by 5.0% in Sep as the price of food items rose notably while base effects to contribute adversely.	11/15		11/15
Foreign Activity	Net outflow of LKR 1.3Bn in government securities over the last 4 weeks; Foreign holding maintained around 1.98%.	04/10		04/10
Credit	Private credit increased by LKR 22.0Bn in Aug after recording a negative credit growth in Jul.	06/10	+02	08/10
CBSL Holdings	CBSL sold its treasury bill stock steadily mopping up liquidity generated from dollar purchases.	05/10		05/10

Primary Criteria - 48 + 02 - 01 = 49

Changes to Health Score – Secondary Criteria


Criteria	Update	Current Score	Add / Deduct Score	New Score
Rating Outlook	No major changes.	02/05		02/05
External Environment	Rupee started to weaken from 10 th Oct to close at LKR 181.90 on 18 th Oct mainly due to higher demand for dollar.	02/05	-01	01/05
BoT & BoP	Trade deficit fell to USD 540Mn in Aug 2019, from USD 717Mn in July 2019.	03/05		03/05
Political Risk	Political stability reinstated to some degree ahead of the Presidential election in 2019.	03/05		03/05
Investor Confidence	BCI recording a marginal drop of 4bps to register 90 in Sep with election preparations kicking into high gear.	02/05		02/05

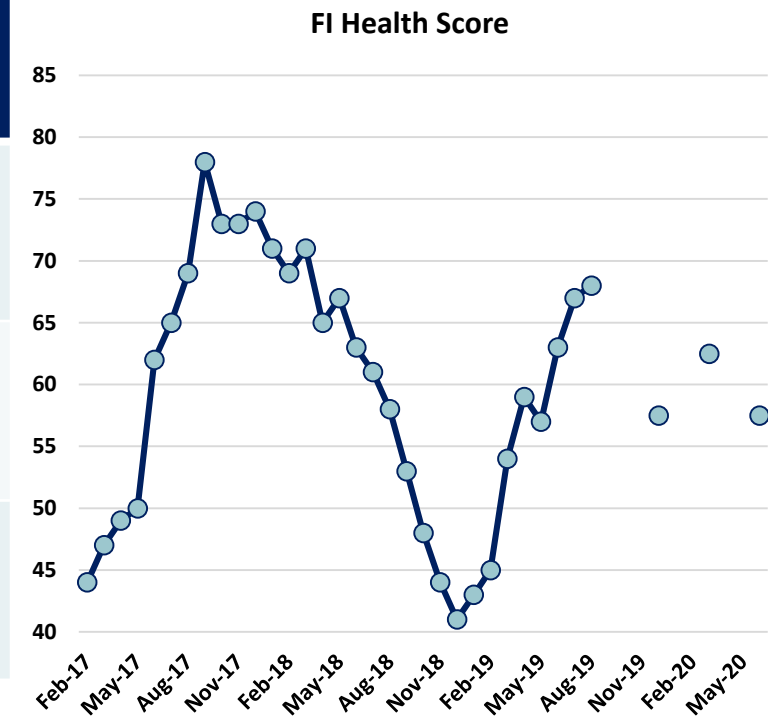
Secondary Criteria - 12 - 01 = 11

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

9th Nov 2018 - **Reduce overall portfolio to 40% from previous 60%.** Cut Trading portfolio to 5% from 25%. Carrying portfolio to be maintained at 35%.

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 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 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%.

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