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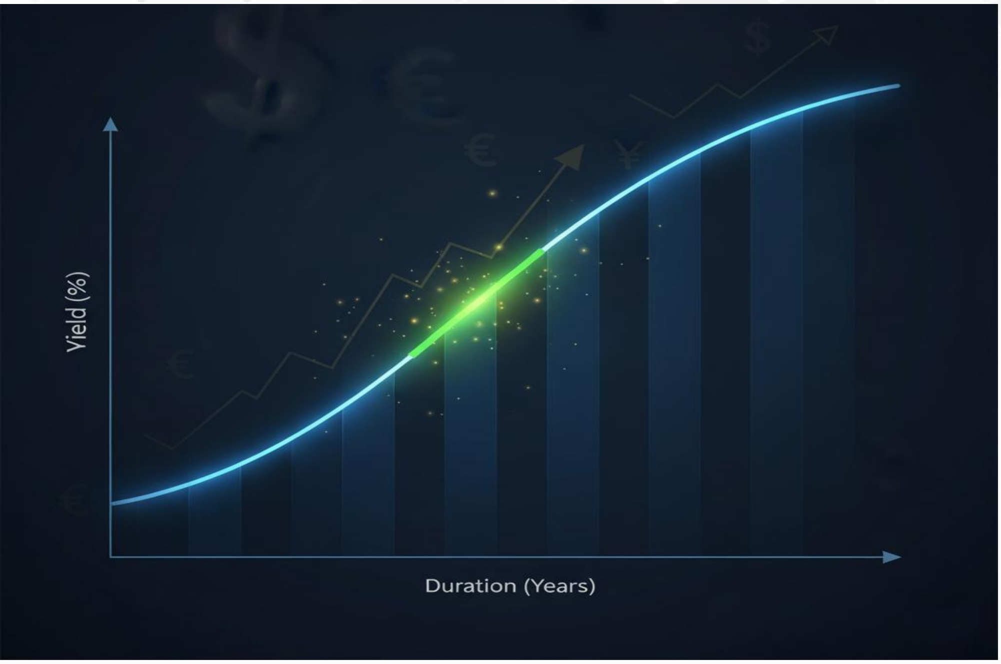


TRU Primer

7th Nov 2025

Intermediate Duration: The "Sweet Spot" for Fixed Income Investors

Amid evolving interest rate dynamics, the sweet spot for fixed income investors lies in the intermediate segment - balancing accrual yield, capital gain opportunity, and manageable risk. Short maturities face reinvestment hurdles, while long durations offer limited upside in today's curve.

Strategic yield curve positioning unlocks optimal risk-adjusted returns.

Intermediate Duration: The "Sweet Spot" for Fixed Income Investors

Introduction

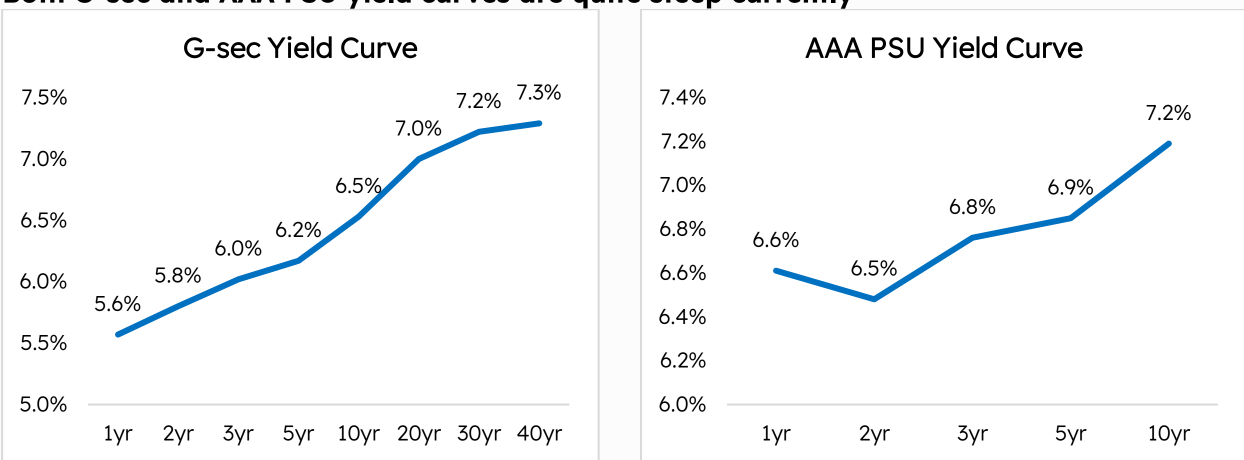
The RBI's Monetary Policy Committee (MPC) delivered a dovish pause at its October 2025 meeting, unanimously voting to keep the repo rate unchanged at 5.5%. While the MPC maintained its neutral policy stance, this decision was not unanimous as 2 out of 6 MPC members favoured shifting to an accommodative stance. Additionally, the RBI Governor noted that there is a scope for monetary policy to further support economic growth.

In this context, market participants are increasingly expecting additional repo rate cuts of 25–50 bps in the current cycle. The quantum and timing of rate cuts will depend on growth-inflation dynamics. Against this backdrop, we examine yields and spreads across segments to identify best risk-adjusted positioning for fixed income investors.

Choosing the "Sweet Spot"

Yield curve positioning is a critical strategy in fixed income allocation, as selecting the right segment of the yield curve strongly influences risk-adjusted returns. In this note, we identify the optimal 'sweet spot' for fixed income investors to target in the current interest rate environment.

Both G-sec and AAA PSU yield curves are quite steep currently



Source: Bloomberg, HDFC TRU; Note – Data as of 31st Oct 2025

Current spread in 5-year AAA PSU segment over corresponding G-sec is higher as compared to 5yr and 10yr median spread. However, current 10-year AAA PSU spread is higher than 5yr median but in line with 10yr median spread. This makes 5-year segment more lucrative from an accrual or carry perspective.

Segment	Current Spread (bps)	Median Spread (bps) over 5 years	Median Spread (bps) over 10 years
5yr AAA PSU	66	44	55
10yr AAA PSU	64	45	63

Source: Bloomberg, HDFC TRU; Note – Data as of 31st Oct 2025; Spread is calculated over corresponding tenure G-sec

We have recently highlighted that long duration strategy is not a preferred segment given the unfavourable bond demand-supply dynamics and expectations of softer FY26 nominal GDP growth (reducing the scope for fiscal consolidation). Read here.

In addition, we also note that long-term bond yields are largely driven by longer term growth-inflation expectations, and may not respond much to interest rate cuts, especially towards the end of the interest rate cut cycle.

We therefore believe that intermediate duration is more likely to benefit from further interest rate cuts and surplus banking system liquidity which typically accompanies easing monetary policy cycle.

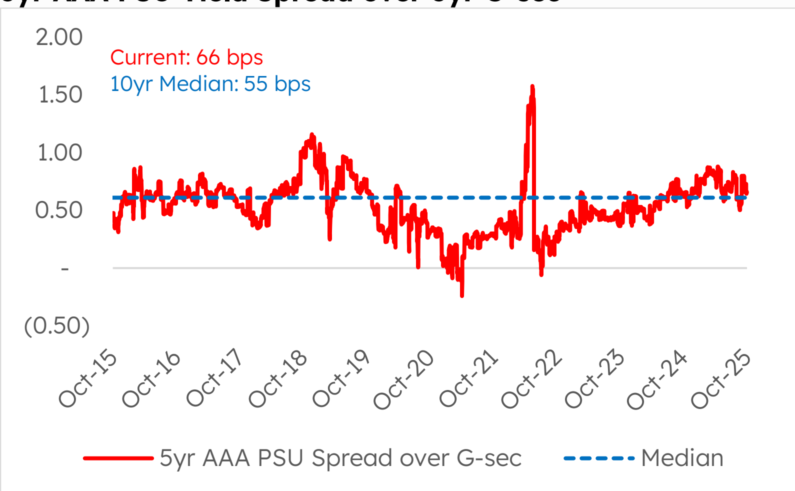
Comparative Analysis of Yield Curve Segments: Short, Intermediate, and Long Tenors

Segment	Key Considerations	Preference
1-Year (Short-Term)	• Low interest rate risk • Low accrual/carry • High reinvestment risk due to frequent rollovers	Less preferred due to high reinvestment risk and lower carry/accrual
5-Year (Intermediate)	• Stronger rate cut/ surplus liquidity transmission potential • Balanced interest rate sensitivity • Attractive carry/accrual and capital gain potential	Preferred segment for optimal risk-return balance
>10-Year (Long-Term)	• High interest rate sensitivity • Limited scope for yields to fall further	Less preferred due to limited upside and higher volatility

Source: HDFC TRU

Corporate Bond Spread Trend Analysis

5yr AAA PSU Yield Spread over 5yr G-sec

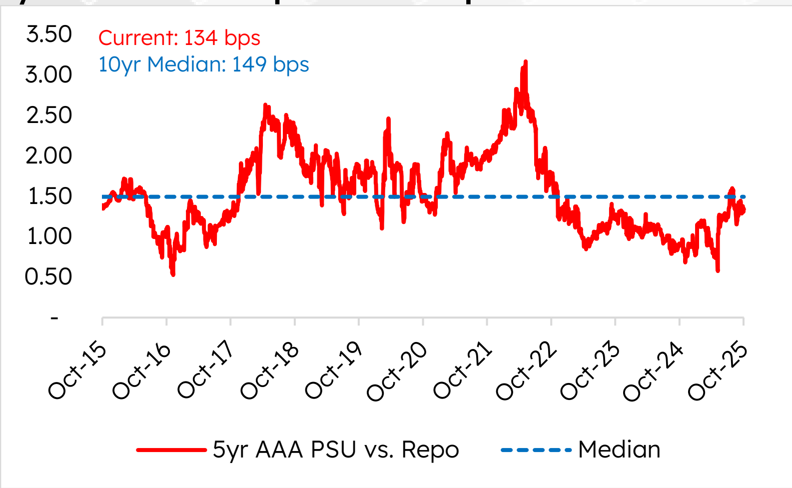


Source: Bloomberg, HDFC TRU; Note – Data as of 31st Oct 2025

The 5-year AAA PSU yield spread over corresponding G-sec is currently higher at **66 bps** vs historical median of **55 bps**.

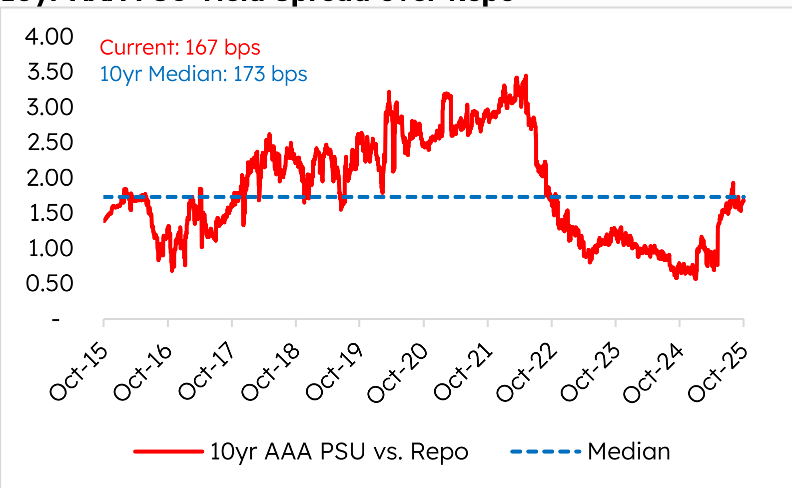
This provides some cushion for transmission of rate cuts and surplus liquidity to 5yr AAA PSU yields.

5yr AAA PSU Yield Spread over Repo



Source: Bloomberg, HDFC TRU; Note – Data as of 31st Oct 2025

10yr AAA PSU Yield Spread over Repo



Source: Bloomberg, HDFC TRU; Note – Data as of 31st Oct 2025

The 5-year AAA PSU yield spread over repo currently stands at **134 bps**, slightly lower than 10-year median of **149 bps**.

The 10-year AAA PSU yield spread over repo is currently **167 bps**, near its 10-year median of **173 bps**.

Our Preference:

While the spreads for both 5 and 10-year are around historical medians, **we favour the 5-year AAA PSU segment** due to its lower interest rate sensitivity and greater likelihood of benefiting from further rate cuts and surplus liquidity.

Out Take:

Current yield spreads in 5 and 10-year AAA PSU segments are aligned with historical norms, indicating fair valuation. With the possibility of further repo rate cuts and surplus liquidity, the 5-year AAA PSU segment stands out as an attractive avenue for capital gains, owing to its lower interest rate sensitivity and stronger transmission potential. Investors should remain vigilant on growth and inflation trends to strategically leverage these opportunities.

Avenues to take exposure to 5-year AAA PSU or equivalent segment

- Direct Bond Exposure
- Debt Mutual Funds – categories such as Corporate Bond, Banking & PSU
- Target Maturity Funds/Debt ETFs – available across tenures

Risks to our View:

- RBI may delay or decide against cutting repo rates.
- Liquidity conditions could tighten, leading to widening of corporate bond spreads.
- Excess supply in the corporate bond market may exert spread widening pressure.

These risks should be carefully monitored alongside the capital gain opportunities.

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