

December 2016

## Stock Market Review

Helped by the robust rise of over 12% during December 2016, the local bourse (KSE-100 Index) closed CY16 with a staggering return of 46%. It may be mentioned that the market posted a meager 2% return during CY15. The distinguishing feature of this stellar performance of the market during the year is that it came in the face of unabated foreign selling to the tune of US \$ 339 million, adding up to a cumulative foreign portfolio outflow of US \$ around 650 million during the last two years. We attribute this exceptional performance of the stock market to multiple factors including (i) optimistic macroeconomic outlook on the back of kick-start of CPEC related investment in the energy & infrastructure projects; (ii) reclassification of PSX into MSCI Emerging Market index raising expectations of large portfolio inflows; (iii) sharp recovery in global oil prices that still hover at around 50% discount to their peak level; (iv) growing expectation of global policy shift from monetary accommodation to fiscal stimulus to reinvigorate economic growth; and (v) abundant local liquidity amid ultra-low yields on the fixed income avenues and inflows to equities on the back of new taxation measure for real estate & property market. In addition to the above, thaw in the domestic politics except some noise related to the start of hearing in the apex court against the PM & family linked to the widely known Panama Leaks; and smooth change in the military leadership buoyed investors interest in the market. Investors also ignored rising tension between Pak-India relations with unprovoked firing by the latter along the border and LOC.

Turning to the sectoral performance during the year, Oil & Gas Exploration, Oil & Gas Marketing Companies, Automobile Assemblers, Cement, Chemical, Engineering, and Textile Composite sectors performed better than the market, while Fertilizer, Power Generation & Distribution, Commercial Banks, and Paper & Board sectors lagged behind. Attractive starting valuations and improving earnings outlook on the back of sharp recovery in the global oil prices resulted in the robust performance of the E&P sector. OMC sector out-performed driven by earnings growth due to healthy volumetric growth, expected increase in retail fuel margins which are linked to inflation and expected inventory gains. Robust volumetric growth and improving earnings outlook amid weakening Japanese Yen against the US Dollar drew investors towards the Auto Assembler sector. Cement sector continued the bull run during the year amid strong domestic demand and healthy profit margin. Attractive starting valuations, abatement in the foreign selling, and strong earnings growth of the select companies revived investors' interest in the Textile Composite sector. Subdued earnings outlook driven by the lackluster off-take and falling international prices resulted in the lagged performance of the Fertilizer sector. Despite strong run in the latter half on the expectation of uptick in inflation & interest rates the Banking sector finished the year with under-performance. Stagnating near-term earnings growth of a key company and uncertainty on the PPA extension of another large player resulted in the lackluster performance of the Power Generation & Distribution sector.

Going forward, we hold a positive outlook on the stock market premised on the improving macroeconomic outlook, reasonable relative valuations, robust corporate earnings growth, benign near-term inflation & interest rate outlook, abundant local liquidity, and expectation of foreign inflows from the funds tracking MSCI EM index. However, we acknowledge that volatility may rise after the recent tranquility driven by global policy uncertainty and rising domestic political rhetoric before the election year. We expect the market to post healthy double-digit returns during CY2017.

## Money Market Review

Driven by steep fall in inflation and improving external account, SBP slashed the policy rate by 25 bps during the year to 5.75%. Inflation as measured by the CPI clocked in at 3.7% for December 2016. Led by the healthy flows in the financial account the SBP foreign exchange reserves stand at around USD 18 billion, equivalent to over 20 weeks of import bill. However, sluggish exports growth and tapering remittances pose risk to the medium term sustainability of the Balance of Payment position. Economic growth is likely to reach 5% mark driven by strong consumption and healthy private & public investment. Going forward, we expect inflation to pick up from the current levels on the back of pass-through of recent recovery in global oil prices, reversal of base effect, measured PKR depreciation, and healthy growth in money supply. We expect around 50-100 bps increase in the policy during CY2017 led by up-tick in inflation and probable pressures on the external account.

In line with the reduction in policy rate, T-bills yields declined by around 35-40 bps during the year. Similarly, PIB yields also responded accordingly with yield on 10 year PIB closing the year at 8.52% after hitting a bottom of 7.45% in July 2016. During the year, SBP held 26 T-Bill auctions with a combined target of Rs. 5,200 billion and a maturity of Rs. around 4,500 billion. In the last T-Bill auction of the year, an amount of Rs. 152 billion was realized against the target of Rs. 200 billion and maturity of Rs. 126 billion at a cut-off yield of 5.99% and 6.01% for 3 and 06 months tenor while the bids in 12 months tenor were again rejected. The bid pattern remained skewed towards 03 months tenor as compared to 06 months tenor while the PIB auction was scrapped.

We are closely monitoring the developments in the capital markets and our portfolios will be rebalanced based on our economic & interest rate outlook.

## Our Contacts

**Contact our Investment Consultant for free Investment advice**

Call 0800-20002 || sms NAFA INVEST to 8080 || [www.nafafunds.com](http://www.nafafunds.com) || [info@nafafunds.com](mailto:info@nafafunds.com)

**Disclaimer:** This publication is for informational purposes only and nothing herein should be construed as a solicitation, recommendation or an offer to buy or sell any fund. All investments in mutual funds are subject to market risks. Past performance is not necessarily indicative of future results. Please read the Offering Documents to understand the investment policies and the risks involved.