

Stock Market Review

Local equities remained volatile during December, falling by as much as 5.7% during the month, but bounced back sharply in the latter half of the month to close above the psychological barrier of 40k at 40,471 points, up by 1.2% MoM. During CY17, the stock market performance was a tale of two halves whereby the first half saw the market hitting its all time high in the month of May but declined from there on, to close the year with a decline of 15.3%. Robust market performance during the first half was on the back of stable political and economic environment along with anticipation of net positive foreign inflows from upgrade into MSCI Emerging Market (EM) Index. However, rise in both domestic & regional political noise, and concerns over external account accentuated in the second half along with some negative one offs in key corporate earnings led to steep market decline in the latter half. Foreigners again remained net seller of US Dollar 487 million during CY17 amid concerns mainly over PKR devaluation. The main buyers during CY17 were Mutual Funds and Insurance companies with positive inflow of USD 217 million and USD 191 million, respectively.

During CY17, Engineering, Oil & Gas Exploration, Automobiles Assemblers, Food & Personal Care, Insurance, and Glass & Ceramics sectors performed better than the market while, Cement, Refinery, Pharmaceutical, Cable & Electric, and Power sectors lagged behind. Engineering sector exhibited robust performance as the sector has benefited from favorable regulatory regime (imposition of anti dumping duties), enhanced margins resulting in improved earnings and capacity additions. Oil & Gas Exploration sector also bounced back sharply during the calendar year as crude oil prices (Arab Light) continued their ascent, averaging USD53/barrel versus USD41/barrel (up around 30% YoY) and favorable change in pricing regime of a major E&P company. Automobile sector also fared better owing to stable exchange rate through most of the year keeping margins intact coupled with record high volumes. Among the laggards, Cement sector declined the most amid decline in earnings due to drop in cement prices and rise in coal prices despite record volumetric sales. Refineries remained under pressure as GRMs tapered off in the 2HCY17 and particularly after the abrupt decision of government to cease FO based generation lowering the throughput. Concern over margins due to threat of PKR devaluation resulted in de-rating of Pharma sector.

On the macro economic front, while GDP growth went up but so did the twin deficits (Fiscal & Current account). Inflation, after bottoming out in the previous year rose mildly to 4.1% during CY2017 on average, up by 33bps on a yearly basis. As a result, the central bank continued its easing monetary stance and kept the policy rate unchanged during the year. Fiscal deficit went up with revised deficit clocking in at 5.8% in FY17 compared to 4.6% in FY16 due to expenditure growth outpacing the revenue growth. The key concerning element remained the burgeoning current account deficit and its associated impact on the foreign exchange reserves, with import cover now falling to 13 weeks compared to 18 weeks at the start of year due to hefty rise in current account deficit during CY17. On the positive side, GDP growth rate is expected to continue its upward trend, helped by improving energy supplies, better law and order situation and is expected to settle at around 5.6% in the coming year.

Going forward, though we expect the continuation and even rise in domestic political rhetoric in the election year and escalation of geopolitical risk may be a cause of concern that may result in periods of volatility, the long term trajectory of the market remains sanguine, in our opinion. Improving macroeconomic outlook as the completion of CPEC projects draws near, attractive valuations especially relative to other Emerging Markets, robust corporate earnings growth, modest rise in inflation and interest rate outlook, and abundant local liquidity are likely to keep market buoyant and we expect the market to post healthy double-digit returns during CY2018.

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State Bank of Pakistan (SBP) continued its dovish monetary policy throughout the CY2017 with policy rate remaining unchanged. It was despite marginal uptick in average CY17 CPI inflation reading which clocked in at 4.10% vis-à-vis 3.76% in the preceding calendar year. Owing to static policy rate and significant liquidity injection by SBP, the yields on fixed income avenues remained largely flat during the year. After recording 3.97% YoY in Nov 17, monthly CPI for Dec 17 clocked in at 4.6%. Reiterating our view, we expect inflation to gather pace owing to impact of low base, rebound in global crude oil prices coupled with PKR depreciation (5% deval already seen in Dec-17 and 5-10% expected in CY18). Sovereign yields remained flat during the month with investors' preference tilted towards short tenors on the back of upside risk to inflation and interest rates. Also SBP through the open market operations managed the weighted average overnight repo rate close to the policy rate. We think interest rates have bottomed out now and due to expected rise in inflation, incessant government borrowing and rising private sector credit off-take, we expect around 100bps-150bps rise in SBP policy rate in CY18. In the above backdrop, we prefer floating corporate debt securities and shorter-term fixed income avenues considering unattractive term premium & expected increase in fixed income yields.

We have calibrated the portfolio of our money market and income funds based on our capital market expectations. We are closely monitoring the developments in the capital markets and will rebalance the portfolio accordingly.

Our Contacts

Contact our Investment Consultant for free Investment advice

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