

Stock Market Review

The stock market started off the month on a positive note given attractive starting valuations after a sizable 10% correction in the benchmark of KSE 100 index from its recent peak of 46,637 hit on April 6, 2018 and rising hopes of sizable inflows under tax amnesty scheme after much sought endorsement of apex court that would lend much needed support on the fiscal and external account fronts. However, investors' optimism began to fade amid notably three developments such as threat of Pakistan's inclusion on the dreaded FATF black list with associated economic & financial implications, continued heightened domestic political uncertainty ahead of upcoming general elections, and growing concerns over deteriorating external account imbalances and depleting foreign exchange reserves. Investors' anxiety was fueled by the potential risks to the economic growth trajectory and corporate earnings growth from recent policy measures such as a cumulative 75 bps hike in the policy rates with expectation of more to come in the near future, ongoing PKR devaluation, and upward adjustments in retail fuel prices that are aimed at containing the domestic demand pressure. During the month, the benchmark KSE 100 Index dropped by 2.2% while, the market closed FY2018 with a decline of 10%, first negative closing on a fiscal year basis since 2009. During the month, Foreign Investors remained net sellers during the month with an outflow of around USD 74 million along with Mutual Funds, Individuals, Brokers Propriety Trading, and Other Organizations with net selling of USD 10.3 million, USD 5.3 million, USD 9.4 million and USD 5.2 million, respectively. Largest monthly inflow was seen from the Insurance sector, with net buying to the tune of USD 56.9 million coupled with Companies and Banks with net inflows of USD 36.3 million and USD 10.7 million, respectively.

During the month, Banking, Oil & Gas Exploration and Production (E&P), Oil & Gas Marketing Companies, Fertilizer, and Technology & Communication sectors performed better than the market while, Automobile Assemblers, Cement, Textile Composite, Power Generation & Distribution, Chemical, Engineering, and Pharmaceuticals sectors lagged behind. Unfazed by the continued foreign selling, local investors accumulated position in the Banking sector given attractive valuations and sanguine earnings outlook on the back of rising interest rates. Undemanding valuations, ongoing PKR devaluation against the US Dollar, and firm global oil prices drew investors towards the Oil & Gas Exploration sector. In the risk-off scenario, Fertilizer sector out-performed the market amid visibility of earnings outlook and reasonable valuations. Depreciating Pak rupee and policy incentives for exports brightened the outlook of Technology & Communication sector due to sizable export earnings. New taxation measures announced in Finance Bill FY2019 that bars non-filers to buy new vehicles coupled with margin compression amid PKR devaluation clouded the earnings outlook of Automobile Assemblers sector. Rising risks to the profitability on account of unfavourable supply-demand dynamics as a result of massive capacity expansions, limited room to pass through the rising input cost due to elevated coal prices, and threat of potential price war kept the Cement sector under pressure. Power Generation & Distribution sector lost its luster amid rising interest rates. Engineering sector struggled amid rising input cost and demand side risks in case of slowing economic growth.

Looking ahead, the market may remain volatile during the period leading up to the general elections. While the news flow remains encouraging on the amnesty scheme, without any material inflows (repatriation), the tax collection alone will not be adequate to shore up the depleting reserves, in our opinion. Any fresh flows channeled into the equities may prove a major trigger for the market, which has again become attractive as captured in an inexpensive forward Price-to-Earnings multiple of 9. Long-term investors who have already lived through highly volatile period during FY2018, this is probably the wrong time to exit the market, in our view.

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After recording 4.2% YoY in May 2018, inflation as measured by the CPI for June 2018 clocked in at 5.2%. Inflation is anticipated to pick-up owing to depreciating Pak rupee, surge in domestic oil prices & its pass-through impact, and incessant government borrowing from the banking system amid shrinking Net Foreign Assets (NFA). During the period under review, sovereign yields settled according to the 50 bps increase in the policy rate by the SBP in its last monetary policy review at the end of May 2018. Investors' preference remained tilted towards short term government securities, foreseeing further upside risks to inflation and interest rates. We expect that interest rate hike cycle has further room to run given imminent risks to inflation and impulse to contain surging demand pressures to address the external account woes. More specifically, we expect 150-200 bps increase in policy rate during FY 2018-19.

During the outgoing month, SBP held two T-Bill auctions with a combined target of Rs. 550 billion against the maturity of Rs. 161 billion. In the first T-Bill auction, an amount of Rs. 1,314 billion was accepted at a cut-off yield of 6.76% for 3-month tenor and 6.85% for 6-month tenor, however no bids were received in 12 months tenor. In the second T-Bill auction an amount of Rs. 56 billion was accepted at the same cut-off yield of 6.76% for 3-month tenor. However, bids for 6 months tenor were rejected while no bids were received for 12 months tenor. Besides, in the PIB auction during the month, bids worth Rs. 9 billion were received for 3-year, 5-year and 10-year tenors against the target of Rs. 50 billion and maturity of Rs. 15 billion. The Ministry of Finance realized around Rs. 4 billion at a cut-off yield of 7.50%, 8.48% and 8.70% respectively, while no bid was received in 20-year tenor. The bid pattern was skewed towards 3-year tenor. Furthermore, SBP in the recent floating rate PIB auction dated June 27, 2018, attracted bids worth Rs. 122 billion. Out of the total bids around Rs. 15 billion was realized at a cut-off margin of 50 basis points over the benchmark (i.e. weighted average yield of the 6-month Market Treasury Bills).

We have calibrated the portfolio of our money market and income funds based on our interest rate outlook and remain alert to any developments that may influence our investment strategy.

Our Contacts

Contact our Investment Consultant for free Investment advice

Call 0800-20002 || SMS INVEST to 9995 || www.nbpffunds.com || info@nbpffunds.com