



October 2014

Stock Market Review

During the month of October, the stock market volatility spiked owing to delay in materialization of budgeted foreign flows amid noise in the domestic politics, net selling by the foreign investors and lower than expected corporate earnings announcements by most companies in the ongoing results season. However, during the latter half of the month, the market staged a recovery and the benchmark KSE-100 Index advanced by around 2% to close at 30,377 levels and KMI-30 Index advanced by around 1% to close at 48,699 levels. Towards the end of the month, investors' sentiments were buoyed by expectation of a policy rate cut in the upcoming monetary announcement scheduled in mid-November mainly due to (i) controlled inflation, (ii) benign near-term inflation outlook amid sizable anticipated cut in domestic oil prices, and (iii) expected improvement in external account on account of SPO of Oil & Gas Company, floatation of Sukuk in international market and release of 3rd and 4th tranche by IMF. Foreigners were net sellers during the month with net outflows recorded at US \$ 31 million versus net inflow of US \$ 53 million during the previous month.

Construction & Materials, Automobile & Parts, Electricity, and Pharma & Bio Tech sectors out-performed the market, while Banking and Oil & Gas sectors lagged the market. Better than expected corporate results and attractive double-digit dividend yields amid falling interest rates drew investors towards the power sub-sector. Automobile & Parts sectors out-performed due to expectation of healthy sales volume and margin improvement resulting from JPY weakening. Bull Run in the Pharma sector continued on speculation of new drugs introduction by some major players. Cement stocks also rallied driven by healthy sales numbers and strong earnings growth resulting from falling coal prices and steady demand. Sell-off in the Oil & Gas sector was witnessed following steep fall in oil prices and upcoming Secondary Public Offering of OGDC.

As per our estimates, the market is now trading at 8.5 times 12-months forward earnings. We believe that the market will take direction from Inflation and interest rate outlook, foreign portfolio investment activity, development on the domestic political front, and financial & capital inflows. We are closely monitoring the developments in capital market and will alter the allocation of our equity funds accordingly.

Fixed Income Review

Inflation as measured by CPI clocked at 5.8% in October in line with broad market expectations. Over the last one year, we have witnessed a shift in government borrowing from short-term T-Bills to long-term PIBs to reduce rollover or refinancing risk that pushed up the yields on the PIBs from 80 basis points to 100 basis points. Resultantly, spread of 3 years PIBs over T-Bills increased to around 2.6% making PIB very attractive investment avenue for medium to long term investors. Concomitantly, the outstanding stock of PIBs increased from PKR 1.3 trillion in December 2013 to PKR 3.5 trillion in September 2014, which increased the liquidity and depth of the sovereign bond market.

SBP conducted a PIB auction on 22 October 2014 wherein only PKR50 billion was accepted against participation of Rs. 332bn at a cut-off yield of 12.48%, 12.98% and 13.45% for 3, 5 and 10 year tenors, respectively. Following this auction, the yields in the secondary market dropped sharply and saw a low of around 11.3%, 11.5% and 12.3% for 3, 5 and 10 year tenors. The recent reversal of yields in PIBs can be attributed to 1) view of the market players that Government has again changed its borrowing mix from higher cost PIBs to lower cost T-bills as it has already significantly reduced rollover or refinancing risk 2) anticipation of an interest rate cut in the upcoming monetary policy announcement scheduled in November on the back of further decline in inflation due to low oil prices as well as expectation of improvement in external account position due to privatization receipts and issuance of dollar denominated Sovereign Sukuk.

In the three T-Bills auctions during the month, MoF accepted Rs.347 billion against the target of Rs.550 billion and maturity of Rs.483 billion. The cut-off annualized yields for the last T-Bill auction was noted at 9.96%, 9.95% and 9.98% for 3, 6 and 12 month tenors respectively. SBP conducted its first Islamic Open Market Operation (OMO) during the month. In the OMO (Bai-Mujjal – Outright Purchases of GIS) dated October 27, 2014, SBP accepted all amount (Rs 39.4 billion) in one year tenor. In the other OMO (outright purchase of Government Ijara Sukuk), SBP accepted an amount of Rs 38.4 billion against offered amount of Rs 40.5 billion.

We have adjusted the maturity of our money market and income funds based on the 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

Call 0800-20001 || UAN 111-111-632 || sms NAFA INVEST to 8080 || www.nafafunds.com || info@nafafunds.com

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