

October 2018

Stock Market Review

The month of October can be characterized as a tale of two halves for the local bourse as the benchmark KSE 100 Index slumped by 10.3% during the first half followed by a robust 13.3% recovery during the latter half to finish the month with a gain of 1.6% from the last month's close. In the first half of the month, absence of any decisive plan for financing of large funding gap stemming from the unsustainably high current account deficit and lumpy foreign loan payments along with abysmally low FX reserves stoked anxiety in the market. However, initially, the value buying bucked the negative trend as the indiscriminate sell-off sent the market to a low of 36,663 points on October 16th and compressed the Price-to-Earnings to a bargain hunting level of 7.7 times. Later on, the announcement of Saudi financing facility to the tune of US \$ 6 billion perked up the mood of investors, fueling the ongoing rally, including a whopping one-day surge of 4.1% on October 24th, 2018. Meanwhile, the government requested the Saudi-like funding facility from the oil rich United Arab Emirates. Investors also started pinning hopes on the PM's visit to China to muster a sizable financial assistance. After some initial hesitation, the government finally decided to approach the IMF for a new financing package, realizing that besides immediate financial assistance IMF endorsement would lay foundation for securing financial flows from other global financial institutions such as the World Bank, Asian Development Bank, and Islamic Development Bank and facilitate access to the global capital markets.

Looking at the participant wise activity during the month, against the sizable net foreign selling to the tune of USD 86 million; Companies, Mutual Funds, and Insurance Companies remained large buyers, accumulating fresh position in equities to the tune of USD 33 million, USD 21 million, USD 13 million, respectively.

In terms of sectoral performance during the outgoing month, Cement, Fertilizer, Oil & Gas Exploration, Oil & Gas Marketing Companies, Power Generation & Distribution, Technology & Communication, and Textile Composite sectors out-performed the market. Among the laggards were Automobile Assemblers, Chemical, Commercial Banks, Engineering, Paper & Board, and Pharmaceutical sectors. The indiscriminate sell-off during the last couple of months through first-half of the outgoing month driven by clouded earnings outlook opened-up valuation gap that drew investors toward the Cement sector. Fertilizer sector performed better than the market on the back of better than expected earnings announcement and healthy payouts. Attractive valuations, robust earnings prospects, and being key beneficiary of currency devaluation led to the out-performance of E&P sector. Better than expected earnings announcements and improving earnings prospects driven by the fresh incentives doled out by the government resulted in the superior performance of the Textile Composite sector. Automobile Assembler sector lagged the market due to disappointing earnings reports driven by cost pressures and murky demand outlook as tax non-filers are barred from the purchase of new vehicle. Cheap valuations and a key beneficiary of interest rate hike cycle attracted investors towards the Banking sector. During the latter half of the month, investors accumulated fresh position in the beaten down Engineering sector.

Going forward, shifting developments on the domestic policy front and evolving external economic landscape may cause volatility spikes in the market sporadically. From the valuation stand point, the market is trading at a forward Price-to-Earnings multiple of 8.5 and offers a decent dividend yield of around 6%. We hold on to our prognosis that foreign money would start pouring into the market as the currency finds its equilibrium value post entry into the IMF program. Based on our estimates, corporate earnings are expected to grow at a double-digit rate for FY 2019 & 2020. We reiterate our constructive view on the market given attractive valuations; decent corporate earnings growth prospects; mitigating risks to the external account; and above all abundant local liquidity.

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The State Bank of Pakistan (SBP) in its bi-monthly Monetary Policy review increased the Discount Rate by 100 basis points to 9%. After recording 5.1% YoY in September 2018, inflation as measured by the CPI for the month of October 2018 clocked in at 7.0%, surpassing market estimates. The inflation trajectory is expected to remain upward owing to number of inflationary pressures including pass-through of the rise in international oil prices, second-round impact of hike in gas and electricity tariffs, increase in import tariffs, and currency devaluation. Investors' preference remained tilted towards short term government securities, foreseeing upside risks to inflation and interest rates. The FX reserves held by the SBP remained under pressure and stands at abysmally low level of USD 7.78 billion, equivalent to seven weeks of imports as of October 26th, 2018. However, we expect that receipt of pledged Saudi funding, some financial assistance from other friendly countries such as the United Arab Emirates & China would ease off pressure on the external account. That being said, structural reforms hold the key to restore durable financial stability. Based on our projections, Discount Rate is likely to peak at 10.5% by June 2019.

During the outgoing month, SBP held two T-Bill auctions with a combined target of Rs.3,950 billion against the maturity of Rs.4,254 billion. In the first T-Bill auction, an amount of Rs.2,670 billion was accepted at a cut-off yield of 8.80% for 3-month and 8.85% for 6-month tenors, respectively. In the second T-Bill auction, an amount of Rs.588 billion was accepted at the same cut-off yield of 8.80% for 3-month. In the PIB auction, bids worth Rs.7.3 billion were received for 3-year, 5-year and 10-year tenors while no bids were received for 20-year tenor. Furthermore, SBP rejected bids for floating rate PIBs in both the auctions held during the months.

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

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