NBP Fullerton Asset Management Limited
(Formerly National Fullerton Asset Management Limited)

Capital Market Review

August 2010

Stock Market Review

The country faced unprecedented floods during the month of August 2010 causing severe damage to agriculture and infrastructure. As a result, the Stock market remained subdued during the month. The month started with KSE-30 Index at 10483 level and shed around 1040 points to reach 9443 levels on August 16, 2010 on very low trading volumes. Announcement of some relief packages and financial help from the coalition partners and multilateral agencies helped improve investors' confidence. The stock market recovered around 363 points to reach 9806 levels as on August 20, 2010. Investors' sentiments were further shaken due to impact of this flood on economic growth, domestic liquidity, inflation and external account. Overall, KSE-30 Index decreased by 7.47% during the month.

Oil and Gas, Construction and Material, Industrial Engineering, Chemical and Electricity sectors outperformed the market during the month. While, Fixed Line Communication, Banks and Automobile and parts sectors lagged the market. The index heavy weight Oil and Gas Exploration sub-sector outperformed the market due to healthy earnings growth and attractive dividend yields on selective companies. Oil and Gas Marketing sub-sector underperformed due to disappointing result by the key companies. Fertilizer sub-sector performed well due to healthy corporate earnings and attractive dividend yields in an uncertain economic environment. Selective companies in the power sub-sector performed better than the market due to stable earnings and higher dividend yield. Banking stocks underperformed due to lower than expected corporate earnings and concern over higher provisioning number due to expected rise in Non Performing Loan. Net Foreign Portfolio Investment (FPI) activity remained low during the month and was recorded at around US $ 41 million. Trading activity reduced further and Average Daily Traded Volume was recorded at around 57 million shares versus around 69 million shares during the previous month.

Going forward, the key triggers for the market are: (i) inflation trend; (ii) progress on the financing product; (iii) foreign aid / grants; (iv) foreign portfolio investment and (v) the law and order situation.

Fixed Income Review

The month of August remained tainted with flood related news and the estimated losses of crops and infrastructure. In the last monetary policy announcements, SBP hiked the discount rate by 50 bps indicating an end to the 20 month monetary easing cycle. Furthermore, risk of resurgence of inflation, Ramazan impact on prices, supply shortages due to floods and zero uptick in fiscal discipline have all influenced SBP's stance. Risk to the economy cannot be ignored, however, the quantum can only be judged once more concrete numbers surface and what needs to be seen is how much of foreign flows offset this impact. Relaxation of targets and IMF conditionalities are being contemplated and market participants will focus on what actually materializes, especially in terms of power tariff hike, fiscal deficit target and government borrowing from SBP.

Inflation (YoY) for July declined to 12.3% from 12.7% during June mainly due to higher base effect and lower oil prices, however, this trend is likely to reverse in the coming months due to reasons given above. Current account deficit for July deteriorated by about 44% over June and workers remittances were lower by about 6%. The money market remained fairly liquid during August as SBP conducted regular OMOs to manage the liquidity. Remittances, foreign inflows and frequent SBP injections are expected to continue and market liquidity will hence remain upbeat.

Trading was actively seen in a few Banking Sector TFC's whereas, overall activity in majority of issues remained dull. Apart from the pricing issues of the non traded TFCs, no sharp movement in prices was observed. A leasing sector TFC and a real estate sector TFC have requested investors for rescheduling. We advise that income funds' investors should take a longer term view in order to take advantage of the attractive yields on debt issues. Conversely, for investors with a shorter investment horizon, NAFA Government Securities Liquid Fund and NAFA Savings Plus Fund continue to post satisfactory returns in line with the market.

In the T-bills auctions of July, SBP accepted Rs. 200 billion (combined for both auctions) versus the target of Rs. 200 billion. The cut off yields for the last auction of the month were noted at 12.52%, 12.66% and 12.79% for the 3 months, 6 months and 12 months T Bills, respectively. These were considerably higher than the cutoffs observed during July owing to hike in discount rate. Going forward, interest rates are not expected to ease as Government borrowing remains excessive and serious measures for fiscal discipline have not emerged.