



August 2012

Stock Market Review

During the month of August the stock market continued its bullish trend spurred by the higher than expected 150bps cut in the discount rate by the SBP. Positive sentiment was also fuelled by sturdy corporate earnings and payouts and amelioration in the political climate emanating from the Supreme Court extending till September 18, 2012 the deadline for implementation of verdict on NRO. The State Bank's decision to cut the policy rate seems to be entirely driven by the decline in inflation (CPI). Institutional and Foreign Portfolio Investment (FPI) activity also remained healthy despite the Holy month of Ramadhan. Average daily trading volumes during August stood at 156 million shares, 73% higher compared to 90 million shares in the previous month. FPI inflows during August also marginally improved MoM to US\$ 49.3 million. The KSE-100 Index started the month at the 14577 level. The Index rose by 1.3% till the monetary policy announcement on August 10th. Following the interest rate cut, the Index cumulatively rose by 4.3% to the 15,391 level at the end of the month. Overall, during August the KSE-100 soared by 5.6%.

The YoY inflation as measured by CPI for August clocked in at 9.1%, which is lower than the market expectations. This has further boosted positive sentiment in equities and reinforces prospects of continuation of the accommodative monetary stance by the SBP. The results season has also contributed to the positive market direction with most corporate announcements being in line or exceeding expectations. Further, on the external front, improved relations with India and continuing dialogue with the United States were also positive contributors for the market.

Oil & Gas, Construction & Materials, Personal Goods, Electricity and Automobile & Parts sectors performed better than the market. On the other hand, Chemicals and Banking sectors lagged the market. The Oil & Gas sector was fuelled on account of the results excitement, higher crude oil prices and announcement of Petroleum Policy. The Construction & Materials sector was boosted on strong results announcements and continued positive fundamentals. In the Personal Goods sector, Textile sub-sector stocks performed well on the back of rise in cotton prices. Sentiment was positive towards Electricity sector stocks owing to their high dividend yields. The Banking sector significantly lagged the market following squeeze of interest margins following the policy rate cut. The Chemicals sector under-performed on weak urea sales in July and August and build-up of fertilizer inventory and imports by the Government.

As per our estimates, stocks in KSE-30 Index are valued at 8.0x estimated earnings on average. In our view, the market will take direction from results announcements, settling of the political dust, situation on the economic front and channelization of foreign flows.

Fixed Income Review

The highlight of the month was the historic 1.50% policy rate cut by State Bank of Pakistan. This was considerably more than the market expectations of 0.5% reduction. SBP in its monetary policy statement mentioned its expected inflation range for FY13 at 10% to 11%. The headline YoY CPI for July 2012 was 9.6% while that of August 2012 was 9.1%. After the reduction in Discount Rate on August 10th, the 6-months T-Bills traded at above 10.4%. Keeping in view elevated oil prices and scheduled foreign loan repayments during the prevailing fiscal year, we are of the view that this easing in the monetary policy may be unsustainable. This view is further augmented by heavy Government borrowing from the SBP, which is generally inflationary. The very high Government borrowings from the scheduled banks is also being partly funded by SBP through weekly open market operations which currently stands at over Rs 350 billion. The following table depicts pressures on SBP net monetary reserves position at the end of FY 2012. Persistent growth trend in workers' remittances, however, has been the most notable positive development.

Reserve Money (State Bank of Pakistan)

	30-Jun-12		30-Jun-11		YoY Growth/(Decline)
	Rupees in millions	%	Rupees in millions	%	
Net Foreign Assets	388,572	17.8%	613,998	31.2%	-36.7%
Net Domestic Assets	1,800,301	82.2%	1,351,835	68.8%	33.2%
Total Reserve Money	2,188,873	100%	1,965,833	100%	11.3%

Trading activity of TFCs in the secondary market remained healthy during the month, with total traded value reported by MUFAP at Rs 541 mln. Banking sector bonds contribution in the total traded value of private sector bonds was around 41% during August, while remaining volume was in Chemicals and Telecom sector bonds.

NAFA Government Securities Liquid Fund remains the only 'AAA(f)' rated money market fund in Pakistan greater than Rs 10 billion in size. The last four funds in fixed income category launched by NAFA, namely NAFA Savings Plus Fund, NAFA Riba Free Savings Fund, NAFA Financial Sector Income Fund and NAFA Money Market Fund are all performing well posting double digit returns since their inception. However, after the reduction in discount rate of 1.5% during August 2012 sustainable returns of these funds going forward will be lower by roughly the same magnitude. In any case, over the long run the returns of these funds will remain attractive considering their very low credit risk profile and investment in securities and instruments with limited exposure to interest rate risk.