NBP FUNDS
Managing Your Savings

December 2018

Stock Market Review

December proved a challenging month for equity investors both at the local bourse as well as globally albeit for different reasons as the benchmark KSE 100 Index tumbled by 8.5% to close at 37,067 points just shy of recent trough level of 36,663 hit on October 16, 2018. With this lacklustre showing during December, the market finished CY18 with a decline of 8.4%, resulting in two consecutive years of negative returns. The dismal performance of equities in December is attributable to continued tightening policies such as more than expected 150 bps hike in the policy rate in the last monetary policy review and weakening of PKR/US parity to 139 from 132 at the end of November with its implications for economic growth and corporate profitability. Above all, inordinate delay in entry into a fresh IMF programme to finance funding gap in the external account prompted investors to stay on the side-lines rather than committing fresh capital into equities. The underperformance of index heavy Oil and Gas Exploration & Production sector amid an 11% decline in Arab Light oil prices during the month that came on the heels of a massive 21% slump in November also contributed to the recent rout in equities. The unabated foreign selling also soured the sentiments of local investor.

During the outgoing month, along with foreign selling of USD 28 million, Mutual Funds emerged as the largest sellers in the market, off-loading equities worth USD 35 million. On the contrary, Individuals, Insurance Companies, and Companies remained buyers in the market, accumulating fresh position amounting to USD 23 million, USD 21 million, USD 21 million, respectively.

In terms of sectoral performance during the outgoing month, Auto Assembler, Cement, Engineering, Oil and Gas Exploration & Production, Oil & Gas Marketing Companies, Technology & Communication, and Textile Composite sectors lagged the market. On the other hand, Chemical, Fertilizer, Paper & Board, Pharmaceutical, and Power Generation & Distribution sectors performed better than the market. Clouded demand outlook and diminishing profit margin amid rising input cost led to the subdued performance of Auto Assembler sector. Risks to the demand due to slowing economic growth coupled with the massive planned capacity additions contributed to the lagged performance of the Cement sector. Engineering sector remained under-performer due to demand pressure and competition from imports. Under-performance of E&P sector is attributable to the sharp correction in global oil prices. A massive decline in a select stock resulted in the lagged performance of Technology & Communication sector. Textile Composite sector took a breather after witnessing out-performance during the last couple of months. Strong profit margins attracted investors towards the Chemical sector. Talks of resolution of GIDC issue, earnings sustainability, and healthy pay-outs restored the lust of Fertilizer sector during the recent sell-off. Power Generation & Distribution sector being the defensive play outperformed the market.

What lies ahead? A hefty 30% correction from its all-time high level of 52,876 hit on May 24, 2017 has opened up valuation gap in the broader part of the market, which currently trades at an attractive forward Price-to-Earnings multiple of 7.6 and offers around 6% dividend yield. As we see it, the current valuations are reflection of bad economic prospects and corporate fundamentals. We believe that the recently undertaken policy measures along with the of late decline in global oil prices would help ease off pressure on the external account that in turn would revive investors' interest in the market. In addition to this, after a sizable 26% devaluation during CY18, PKR is near its equilibrium value based on Real Effective Exchange Rate (REER) and we believe that any material development on securing of fresh IMF package would catalyse interest of foreign investors in the market. We expect double digit corporate earnings growth for the next two years. Taken together, in our view, the market holds potential to deliver around 15-20% return in CY2019.

Money Market Review

The State Bank of Pakistan (SBP) hiked the policy rate by a cumulative 4.25 percent during the calendar year with the major increase happening in the latter half of the year owing to near term challenges facing economy such as rising inflation, an elevated current account deficit, and low foreign exchange reserves. We anticipate inflation to remain on the upward trajectory and peak at around 10% by 2019 mid and then ease off gradually due to stability in exchange rate, easing of demand pressure, and higher base effect. The sovereign yields responded to the increase in the policy rates at the end of last month as yield on 3-month T-bill inched up by 77 bps to trade at 10.3% at December end. Similarly, the yield on 10-year PIB was noted at 13.16%, showing an increase of 94 bps during the month. With the objectives to further contain demand pressure, foreseeing near-term upside risks to the inflation, and restore financial stability, we believe that the central bank would continue the monetary tightening stance and we see 100-150 bps increase in the policy rates during CY19.

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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