February 2011

Stock Market Review

The market depicted an extremely bearish trend during the month of February 2011. Investor confidence was shaky on the combined effect of the volatile domestic political situation, concerns of selling by foreign investors, diplomatic row with the US, and threat of deterioration on the macroeconomic front. Political tensions in the Middle East that contributed to the surge in international crude oil prices have unnerved investors both locally and abroad. Further, investor sentiment was dampened as Capital Gains Tax modalities are still vague. Furthermore, with the corporate results season nearing its end, the market was devoid of positive triggers going forward. On the other hand, during the month there were significant developments on the Margin Trading System (MTS) with the product expected to be launched in March 2011.

The month started with the KSE-30 Index at around 12009 levels. The market maintained a downhill course with the KSE-30 plunging to the 10611 level intra-day low on February 25, 2011. This depicted an 11.6% decline from the beginning of the month. Institutional support was minimal although some value hunting was seen when the KSE-30 Index was around the 11000 point levels. Overall, the KSE-30 Index closed the month at the 10940 point levels, down 8.9% during the month. Another concern for investors was the possible rise in domestic petroleum prices going forward. This will have serious implications for the inflationary trend and the Central Bank's monetary stance. Key indicators on Pakistan's external front remain positive. The country's foreign exchange reserves have soared to the US$ 17.4 billion level and the current account deficit during FY11 to date stands at US$ 81 million.

Inflation as measured by CPI was recorded at 14.2% YoY for January 2011. Net Foreign Portfolio Investment (FPI) inflows sharply dried up during the month. During February 2011 Net FPI was recorded at around US$ 5.50 million, as against US$ 63.10 million during January 2011. Trading activity decreased significantly and Average Daily Traded Volume during February 2011 was recorded at 95.6 million shares, compared to 170.14 million shares in January 2011.

The Power and Fertilizer sub-sectors out-performed the market. The Banking, Oil & Gas and Construction & Materials sectors under-performed the market. The Power sub-sector performed better than the market as investors focused on yield plays in the volatile situation of the market. The Fertilizer sub-sector performed better on the back of strong FY10 results announcements and dividend payouts. The Banking sector under-performed on lack of any excitement in the sector. The Construction & Materials sector under-performed on weak earnings prospects going forward. The Oil & Gas sector lagged the market on the impact of mounting circular debt and squeeze in refineries margins.

Going forward, we believe that the following key factors will drive the stock market: (i) Foreign Portfolio Investment (FPI) activity; (ii) launch and response to the Margin Trading System; (iii) events in the Middle East and North Africa; (iv) Pakistan's relations with the US; and (v) macroeconomic situation.

Fixed Income Review

In the money market arena, there has been some respite in liquidity lately, owing mainly to some retirement in commodity linked credit and improvement in workers remittances from abroad. Recent T-Bill auctions have shown almost all the participation in three month T-Bills while there has been little participation in 6 months and 12 months papers. Hence, the money market is anticipating rate hike in at least one of the next two Monetary Policy Statements (MPS) due at end-March and end-May. On the corporate debt area, there has been a slight improvement in market's demand for debt securities of high rated issuers'. Many of the non-performing securities have been restructured within this fiscal year. The sustainability on economic and political fronts, resolution of energy sector related circular debt, fiscal deficit and inflation numbers will mainly determine the future path of interest rates and hence the future returns of money market and income funds.

The overall direction of inflation during the ongoing Fiscal Year is upwards. The average inflation (YoY CPI) for the first seven months has been 14.5% as against 10.8% for the same period a year ago. The SBP estimate for the average CPI for FY 2011, as mentioned in its latest MPS, is 15-16%. The recent spike in international oil prices is also a concern for inflation and balance of payments. As per last available Money Supply data up-to Feb 12, 2011, the net outstanding Government sector borrowing from scheduled banks is Rs 1,049 billion, an increase of Rs 246.5 billion or 31% in current Fiscal Year. This data suggests that Government borrowing from the scheduled banks is on the rise, which can only be matched with market appetite by offering high yields on Government Securities. This is also crowding out the more productive private sector credit as Government is deemed to be a safe borrower in comparison with the private sector.

Simultaneously, a few positive developments have been encouraging. Firstly, the current account deficit for the first seven months of FY 2011 i.e. July-January, is a mere USD 81 million (-0.1% of GDP), as against a deficit of USD 3,052 mln (-3.0% of GDP) for the same period a year back. This is attributable mainly to healthy exports (growth of 20.3%) and higher workers' remittances (a 17.7% rise). Secondly, Government borrowing from State Bank of Pakistan has been constrained in the last two months, such monetization otherwise could have fueled further inflation and associated expectations. This is also necessary as it keeps a check on fiscal deficit. However, Government's stance to continue with power subsidies is undermining this development.

The money market fund and non-TFC income funds with short maturities i.e. NAFA Government Securities Liquid Fund (NGSLF), NAFA Savings Plus Fund (NSPF) and NAFA Riba Free Savings Fund (NRFSF), all continue to post competitive double digit returns. These funds are expected to benefit further due to their short-term maturities in the current interest rate environment. The market has consistently reposed confidence in NGSLF, an ultra low credit-risk fund rated 'AAA (f)', as indicated by its increasing Fund Size (over Rs 10 billion). This is a reflection of the market's focus on safety of investments. For longer-term investors, our Income / Aggressive Income funds offer very attractive yields with investment horizon of three or more years.