



January 2012

Stock Market Review

The stock market swung between gains and losses during the first half of January 2012 amid noise in the domestic politics, gridlock in Pak-US relations and lack of any positive trigger. However, we witnessed sharp rebound in the market during the second half of the month driven by some let up in inflationary pressures, improvement in Pak-US relations, and reduction of political uncertainties. Acceptance of the SECP's proposals regarding the Capital Gains Tax (CGT) perked-up investors' confidence in the market. Moreover, better than expected earnings reported by the majority of the companies further boosted investors' sentiments. Combination of all these factors paced the market recovery during the latter half of the month. The month started with KSE- 30 Index at 10,179 levels and after touching a low of 10,060 levels closed the month at 11,173 levels. Overall, during the month KSE-30 Index advanced around 9.76%.

Macroeconomic indicators are depicting mixed picture. External accounts have weakened due to widened trade deficit and muted foreign flows. On the other hand, inflationary pressure has come off appreciably due to either stabilization or reduction of majority of commodity prices. This deceleration in inflation has generated optimism in market that central bank may cut Policy Rate in its upcoming monetary policy announcement of February. During the outgoing month, trading activity picked up following the much awaited relaxation in CGT. Average Daily Trading volume for the month was recorded at around 75 million shares versus 42 million shares during the previous month.

Banking, Chemicals, and Construction and Material sectors led the market recovery. On the other hand, Oil and Gas, Food Producers and Electricity sectors lagged the market. Banking stocks advanced due to sanguine valuations and expectations of healthy earnings announcements and payouts. Key fertilizer companies rallied on the back of strong earnings reports that resulted in out-performance of the Chemicals sector. Healthy profits announcements driven by improved operating margins resulted in the out-performance of Cement sub-sector. Lagged performance of Oil and Gas sector was due to disappointing results from exploration blocks of key Oil and Gas Exploration companies.

Going forward, key triggers for the stock market will be: Foreign Portfolio Investment (FPI) activity, US-Pakistan diplomatic relations, Economic and interest rates outlook and domestic political situation.

Fixed Income Review

The first month of CY 2012 started with all possible uncertainties in the market. As an indication we have seen 10-year PIB trade at 11.9% to go back above 13%, revisit 12.2% and last traded at 12.6%. These are very volatile moves in the fixed income arena and show the short-term nature of the market psyche, amid economic vulnerabilities. The fear on current account deficit (1.8% of GDP in first six months of FY 2012) given low cotton prices and high oil prices, start of IMF repayments from February 2012, Government's reliance on scheduled banks and SBP to cover fiscal imbalance, structural impediments to economic growth like energy deficit and low productivity all exacerbate the woes. Single digit inflation number and steady flows of remittances though provide a breather. This environment at minimum calls for acute prudence in fixed income investments from the two major risks in this asset class; credit risk and interest rate risk. With flight to quality in Treasury Securities, corporate debt market has essentially dried over the last few years. This is both in primary market (IPOs of TFCs) and secondary market activity.

Market volumes of TFCs reported by MUFAP remained thin in January as well. Total traded value reported by MUFAP for January 2012 was Rs 682 mln, as against a value of Rs. 870 mln in December 2011. Banking sector bonds accounted for 84.24% of the traded value.

Average YoY inflation (CPI) for July to December 2011 was 10.9%, as against previous year number of 14.3%. Average month-on-month inflation (CPI) during the first six months of FY 2011-12 was 0.8% which translates into an annual inflation number of 9.6%. This is in line with the headline YoY CPI number of 9.7%. However, we are of the view that this trend may not be sustainable on back of vulnerabilities in Fiscal Account, pressure on PKR, and Current Account Deficit. In the last available M2 (Money Supply) data of January 20, in the current fiscal year net Government borrowing from scheduled banks has risen by 45%, including 28% one time conversion of energy sector related circular debt from loans to Government Securities. Net Government borrowing from SBP increased by 15.5% during this period.

NAFA Government Securities Liquid Fund is the only 'AAA(f)' rated money market fund in Pakistan greater than Rs 10 billion in size. The last three funds in fixed income category launched by NAFA, namely NAFA Savings Plus Fund, NAFA Riba Free Savings Fund and NAFA Financial Sector Income Fund, are also performing well posting double digit returns. In the current economic environment as mentioned above, the returns of these funds are expected to remain attractive, considering their very low credit risk profile and floating rate linked investments.