

Stock Market Review

The Stock market remained buoyant during the month of July 2010. The month started with KSE-30 Index at 9557 level and touched a low of 9415 levels on July 6, 2010 on abysmally low trading volumes. However, local investors cheered positive developments on leveraged product and foreign investors' activity. Further, release of healthy economic export numbers of US \$19.6 billion during FY 10, less than expected YOY CPI inflation at 11.7% and impressive 14% growth in remittances for FY 10 at US \$ 8.9 billion boosted the investor confidence. Furthermore, announcement by World Bank of US \$ 6 billion support over the next few years also improved the investors' confidence. Investors are expecting healthy corporate earnings in the result season that started towards the end of the month. As a result, KSE-30 Index gained by around 11.3% to 10483 levels from July 6 levels. Overall, KSE-30 Index increased by 9.7% during the month.

In its recently announced Monetary Policy statement, SBP unexpectedly hiked Policy rate by 0.50% to 13% from 12.5% due to government's tight fiscal position.

Oil and Gas, Banks, Automobile and Parts and Chemicals sectors lagged the market during the month. While, Fixed Line Communication; Construction and Material; and Personal Goods sectors outperformed the market. The index heavy weight Oil and Gas Exploration sub sector underperformed the market due to selling by local investors despite positive developments in selective companies. Oil and Gas Marketing sub sector underperformed due to lingering inter corporate circular debt issue. Cement sub sector performed better than the market due to firm cement prices and approval of construction of Diamer Bhasha dam. Banking stocks underperformed due to 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 \$ 42 million. Trading activity remained abysmally low during the month at around 69 million shares versus around 100 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 portfolio investment and (iv) the law and order situation.

Fixed Income Review

During July, most of the provisional economic numbers were released for FY10. GDP growth for FY10 bounced back to 4.1% from 1.2% in FY09. Current account deficit improved by 62%, CPI inflation for the year was 11.7% (20.8% in FY09), Forex reserves were higher by about 28% at USD 16 bn, PKR dropped by 4.9% in FY10 versus 18.1% in FY09. Fiscal deficit is expected to be around 6.2% of GDP in FY10 which is a major deviation from the target of 5.1%. On the whole, the latter half of the year witnessed significant foreign inflows in the shape of IMF loans, Coalition Support Fund, Developmental aid and loans. Low tax collection, High Government borrowing and low credit to private sector were key areas of concern.

The money market again remained fairly liquid during July as USD 710 million was received by SBP from ADB, USAID and World Bank. Inflation for June declined to 12.7% and is expected to ease further in July on the back of higher base effect and lower oil prices. General interest rate level in the market continued its upward trend due to consistently high Government borrowing.

In the TFC market, trading volumes were lackluster, however no sharp movement in prices was observed. A textile sector TFC and a fertilizer sector TFC that were classified as non-performing during June are in advance stage of restructuring as majority of the investors have agreed to the restructuring terms. We advise that income funds' investors should take a longer term view in order to take advantage of the attractive yields on debt issues. 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.

The SBP increased the Discount rate by 50 bps to 13.00% in its monetary policy announcement on 30th July 2010. In the T bills auctions in July, SBP accepted Rs. 229.9 billion (combined for both auctions) versus the target of Rs. 185 billion. The cut off yields for the last auction of the month were noted at 12.10%, 12.37% and 12.46% for the 3 months, 6 months and 12 months T Bills, respectively. These were marginally higher than the cutoffs observed during June owing to strong borrowing demand. Going forward, interest rates are not expected to ease as Government borrowing remains excessive and serious measures for fiscal discipline have not emerged.