



July 2012

Stock Market Review

During the month of July the stock market rebounded from the lackluster trend witnessed during the previous month amid positive developments on the Pak-US diplomatic relations associated with the restoration of NATO supply route, better than expected results announcements by the key companies, and positive trend in the global equity markets. Foreign investors also took fresh positions against the net selling during the previous month. Pakistan's sovereign rating downgrade by the Moody's rating agency added to the worries of the local as well as foreign investors. However, Standard and Poor's decision to maintain the rating of Pakistan helped restore the confidence of the investors. Investors are betting on the strong profit announcements in the undergoing result season. The month started with KSE-100 Index at 13,801 levels and closed the month at 14,577 levels, showing an increase of 5.6%.

The State Bank of Pakistan is scheduled to announce its Monetary Policy decision for the next two months on August 10, 2012. Wherein the market is expecting a cut in the Policy Rate by the SBP. Key consideration in this scenario is anchored inflation expectations despite excessive government borrowing from the banking system. The materialization of foreign flows from the Coalition Support Fund (CSF) to the tune of US \$ 1.2 billion and the Military aid from the US will buttress the deteriorating external accounts and the balance of the payment situation. Moreover, these inflows will improve the liquidity in the market and lend much needed support to the fiscal balance which is heavily relying on the domestic sources.

Banking, Construction and Material and Industrial Engineering sectors performed better than the market. On the other hand, Oil and Gas, Chemicals and Electricity sectors lagged the market. Sanguine valuations resulted in the out-performance of the banking sector. Construction and Material sector was among the best performing sector due to expectations of strong results announcements amid healthy profit margins. Strong sales growth of the tractors paced the gains of the Industrial Engineering sector. Non-availability of the Gas to the selected fertilizer companies clouded the outlook of the Chemical sector resulting in the lackluster price performance. The prolonged circular debt issue continued to haunt the performance of the power companies despite healthy earnings growth.

As per our estimates, stocks in KSE-30 Index are valued at 7.6x estimated earnings on average. In our view, materialization of the foreign flows, SBP's Policy Rate decision, and development in the domestic politics will be the key drivers of the market.

Fixed Income Review

During FY12 the M2 (Broad Money) which includes deposits and currency in circulation grew by Rs. 946 billion translating into 14% expansion. The major contributory factor in this monetary growth was Government borrowing which increased on net basis by 41% or Rs 1,237 billion. More importantly, the net foreign assets of banking system declined by 32.5%, while the net domestic assets grew by 20.3%. This phenomenon fueled the inflationary pressures and squeezed liquidity in the system. Therefore, during FY13 foreign inflows will be crucial to finance the yawning fiscal deficit. Moreover, due to scheduled payments to IMF these flows are important to shore up the FX Reserves and the Rupee.

Interest rates in the interbank inched downwards during the month on anticipation that SBP may reduce the Policy Rate in its upcoming bi-monthly announcement on the back of lower inflation numbers. This was evident in T-Bills auction bidding pattern which skewed towards one year and six month T-Bills as compared to interest in three month T-Bills observed in previous months. Considering future external loan repayments, and recent PKR depreciation, any such action by the Central Bank might be short lived.

Trading activity of TFCs in the secondary market remained healthy during the month, with total traded value reported by MUFAP at Rs 454 mln. Banking sector bonds contribution in the total traded value of private sector bonds was around 75% during July, while remaining volume was in Chemicals 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. The returns of these funds are expected to remain attractive in the long run, considering their very low credit risk profile and investment in securities and instruments with either short maturities or floating rate coupon rates.