



June 2012

Stock Market Review

During the month of June, the stock market swung between gains and losses as the uncertainty on the domestic political front dampened investors sentiments. Lack of any decisive progress on Pak-US diplomatic relations, selloff in the global equities, and deteriorating macroeconomic indicators kept investors from taking fresh exposures in the market. Depreciating Pak rupee prompted foreign investors to shed their position in equities. Trading volume reduced significantly during the month. Average trading volume was recorded at 81 million shares against 194 million shares during the previous month.

Pakistan's economy is facing headwind from yawning fiscal and external accounts deficits. Notably, financing this fiscal deficit entirely from the domestic sources is crowding out the more productive private sector besides fueling inflation. Moreover, this deficit monetization is feeding the inflationary expectations and thus challenging monetary management by the SBP. Non-materialization of the budgeted foreign flows during the out-going Fiscal year has exerted pressures on the external accounts and Net Foreign Assets (NFA) of the banking system and FX reserves. Reduction in the FX reserves has also exerted pressures on the PAK rupee. Moreover, dwindling Investment to GDP ratio due to exorbitant Government borrowing and structural issues is curtailing productive capacity of the economy. Federal budget for FY 2012-13 was unveiled with very ambitious targets. However, apparently the budget offers incentives for the development of the capital markets.

Construction and Material sectors lagged the market due to talks of selling by the foreign investors. Key Oil and Gas Exploration companies under-performed due to Sharp decline in the crude oil prices. Curtailment of Gas supply, increase in gas Cess and concerns on the fertilizer off-take held back the performance of the fertilizer stocks. Electricity sector performed better due to attractive dividend yields and sanguine valuations. Banking stocks remained under pressure due to foreign selling on lower volumes.

As per our estimates, stocks in KSE-30 Index are valued at 7.2X estimated earnings on average. In our view, progress on the Pak-US diplomatic relations, Inflation and interest rate outlook, foreign financial and capital inflows will be the key drivers of the market.

Fixed Income Review

FY12 ended with Policy Rate at 12% as compared to 14% at the start of the year. This is in line with average CPI of 11% for FY12 against 13.66% for the previous year. However, persistent Government borrowing especially during second half of FY2012 is feeding inflationary expectations, and hence interest rate outlook. This phenomenon is also evident in T-Bills rates. Scheduled repayments of foreign loans during FY 2013 are a serious concern. In this backdrop, materialization of foreign inflows is all the more important for current account and fiscal account during FY2013. However, there are two silver linings, healthy workers' remittances and recent downward trend of international crude oil prices. 6-Months KIBOR, the benchmark lending rate closed the year at 12.06%, down from 13.78% at the beginning of the year.

Interest rates in the interbank inched up at the end of the month reflecting tight liquidity conditions. Trading activity of TFCs in the secondary market remained healthy during the month, with total traded value reported by MUFAP at Rs 1,222 mln. Banking sector bonds contribution in the total traded value of private sector bonds was around 57% during June, while remaining volume was in Chemicals and Telecom sector bonds.

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 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 in the FY ended June 2012. The returns of these funds are expected to remain attractive, considering their very low credit risk profile and investment in securities and instruments with either short maturities or floating rate coupon rates.