

March 2011

Stock Market Review

March 2011 the stock market recovered some of the value lost during the previous month, however, it remained volatile. Investor confidence improved due to settlement of Raymond Davis related diplomatic row with the USA, launch of much awaited Margin Trading System (MTS) and expectation of release of final tranche of IMF due to removal of GST subsidies. However, local investors remained cautious due to net selling by the foreign investors. Regional stock markets also remained under pressure due to fluid political situation in the Middle East and North Africa (MENA) region and disaster in Japan due to tsunami and earthquake. The month started with KSE-30 Index at around 10941 levels and after touching a high of 11890 levels on March 09, closed the month at 11561 levels. Overall, during the month KSE-30 Index gained around 5.67%.

The year on year Inflation for the month of February as measured by CPI reduced to 12.9%. The lower inflation numbers, improved external accounts and restrained government borrowing subdued the immediate risk to macroeconomic stability. As a result, State Bank of Pakistan in its recently announced monetary policy review kept the Discount Rate unchanged at 14% for the next two months. However, the risk of uptick in inflation remains due to rising crude oil prices and their second round impact on the other components of the CPI. Net Foreign Portfolio Investment (FPI) inflows precipitously declined during the month. During March Net FPI outflow was recorded at around US\$ 16.2 million, as against an inflow of US\$ 5.5 million during the previous month. Trading activity slightly improved and Average Daily Traded Volume during the month was recorded at 100.5 million shares, compared to 95.6 million shares in February 2011.

The Banking; Chemical; and Construction and Material sectors out-performed the market. Oil & Gas, General Industrials and Electricity sectors lagged the market. Banking sector's outperformance is attributable to better than expected payouts by the key players. The Fertilizer sub-sector performed better on the back of improved fundamentals. The expectation of healthy dispatches improved investors' confidence in the key companies in the Cement sub-sector. Despite strong performance of most of the stocks, the Oil & Gas sector lagged the market due to selling in the heavy weight Oil and Gas Development Company Ltd. (OGDCL) stock. The General Industrials sector under-performed due to removal of GST subsidy on the Tractors.

Going forward, we believe that the following key factors will drive the stock market: (i) Foreign Portfolio Investment (FPI) activity; (ii) Inflationary trends; (iii) events in the Middle East and North Africa (MENA); (iv) law and order situation and (v) macroeconomic situation.

Fixed Income Review

The State Bank of Pakistan (SBP) kept the Discount/ Policy rate unchanged at 14% in March, as was the case in January Monetary Policy Announcement. Resultantly, there has been a shift in market's preference for six months T-Bills as compared to earlier focus in three months paper only, witnessed during last six months. However, the liquidity conditions at the end of the month has been severely tight as indicated by very high overnight REPO rates. Presumably, the market over-committed to longer Government Securities, and consequently a drag on overnight liquidity surfaced. On the corporate debt sphere, there continues to be a marginal 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. A new stock market leverage product namely, Margin Trading System (MTS) has been launched. The risk management guidelines of MTS are more stringent as compared to previous leverage products. It is pertinent to mention that NAFA's Funds will provide financing at predetermined rate of return with no direct exposure to the stock market.

The average inflation (YoY CPI) for the first eight months has been 14.3% as against 11.1% for the same period a year ago. The recent rise in international oil prices is also a concern for inflation and balance of payments. As per Money Supply (M2) data up-to March 19, 2011, the net outstanding Government sector borrowing from scheduled banks is Rs 1,142.3 billion, an increase of Rs 339.5 billion or 42.29% in current Fiscal Year (FY). 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. The average 3-months T-Bill rates during Jan-Mar 2010 was 12.04%, while in this year is 13.33% for the same period. This is also crowding out the more productive private sector. Private sector credit growth as suggested by same M2 data is 6.71% in current FY as compared to 4.76% for the same period in previous FY, which is inadequate to stimulate or support economic growth.

Simultaneously, a few positive developments have been encouraging. Firstly, the current account deficit for the first eight months of FY 2011 i.e. July-February, is a mere USD 98 million (-0.1% of GDP), as against a deficit of USD 3,027 mln (-2.6% of GDP) for the same period a year back. This is attributed mainly to healthy exports (growth of 23.7%) and higher workers' remittances (a 20.3% rise). Secondly, Government borrowing from State Bank of Pakistan has been constrained in the last three months. Such monetization otherwise could have fueled further inflation and associated expectations. This is also necessary as it keeps a check on fiscal deficit.

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 in the range of 11%-12%. These funds are expected to benefit further due to their short-term maturities in the current interest rate environment. For longer-term investors, our Income / Aggressive Income funds offer very attractive yields with investment horizon of three or more years.