Capital Market Review

May 2010

Stock Market Review

During the month of May 2010, the Stock Market exhibited downward trend. The month started with KSE-30 Index at 10490 level. Stocks gained on the news of receipt of US $ 656 million for the military operation and touched 10690 levels on 5th May. Uncertainties over the levy of additional taxes in the upcoming budget and fear of selling by large foreign investors in the key holdings kept the local investors on the sideline. Uncertainty over the political front with the Supreme Court hearings on the corruption cases and 18th Amendment bill further weakened the investors' sentiments. As a result, the receipt of IMF tranche of US $ 1.2 billion and US $ 944 million towards the coalition support fund failed to improve the confidence of the local investors. Moreover, selling in the global markets due to the debt crises in some European countries spread to the local market as well. KSE -30 Index closed the month at 9243 level showing a decline of 11.88% during the month.

Oil and Gas, Fixed Line Communication, Electricity, Automobile and Parts sectors outperformed the market during the month. While, Banks, Chemicals, Construction and Materials sectors lagged the market. The index heavy weight Oil and Gas Exploration companies performed better than the market due to foreign buying. The falling cement prices and rumors of increase in the taxes in the upcoming budget resulted in the selling in the cement stocks. The news to slap additional tax on the banks earning spread exceeding 5% put pressure on the banking stocks. The lower off take numbers and gas supply cut to the fertilizer companies weakened the investor confidence in the sub sector. Net Foreign Portfolio Investment (FPI) activity remained subdued during the month and was recorded at around US $ 25.6 million versus US $ 81 million for the previous month. Trading activity declined significantly during the month with average daily traded volume recorded at around 101 million shares versus around 194 million shares during the previous month.

Going forward, the key triggers for the market are: (i) inflation trend; (ii) resolution of energy related circular debt issue (iii) progress on the leverage product; (iv) foreign portfolio inflows; (v) materialization of foreign assistance; and (vi) law and order situation. Valuations have become fairly attractive with the market placed at a forward PE of 7x and the dividend yield risen to 8.1% .

Fixed Income Review

The much awaited inflow of USD 944 million from US Coalition Support Fund (CSF) was received. In addition to this, the USD 1.2 billion IMF funding also materialized during May which included budgetary support funding of US$ 374 million. Improved liquidity has provided some respite to the market. CPI for April'10 stood at 13.3% YoY, up by 40bps as compared to that of March'10. Some relief is expected due to lower petroleum prices, however, this may be short lived as the government aims to apply a surcharge in the upcoming budget.

The monthly average remittances for the period July 2009-April 2010 registered an increase of 14.96 percent with the monthly figure increased to $730.67 million as compared to $635.56 million during the corresponding period of the last fiscal year. Additionally, as we have mentioned in our previous reports, both current account and trade deficit numbers continue to show improvement. However, despite all this, problems on the fiscal side have not been controlled. Infact, government borrowing shows no signs of decline and removal of subsidies are likely to keep inflation high, which is why the State Bank has opted to keep the discount rate unchanged.

In the TFC market a few issues (which were previously not traded) were traded at lower prices as price discovery took its toll. As panic selling has gradually disappeared in the market, we advise that income fund investors should take a longer term view in order to take advantage of the attractive yields on debt issues. Conversely, 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.

In the T bills auctions of May, SBP accepted Rs. 165 billion (combined for both auctions) versus the target of Rs. 135 billion. The cut off yields for the last auction of the month were noted at 11.92%, 12.09% and 12.19% for the 3 months, 6 months and 12 months T Bills, respectively. These were notably lower than the cutoffs observed during April which is the result of ample liquidity as mentioned earlier. Going forward, both inflation as well as interest rates are not expected to ease as Government borrowing remains high, fiscal targets remain unachieved and utility prices expected to continue to rise.