Capital Market Review

May 2011

Stock Market Review

The stock market remained choppy during the undergoing month ahead of the Federal Budget for FY 2011-12. The month of May was marked by the Osama bin Laden fiasco and concomitant tensions in US - Pakistan relations; rumors of new taxes in the upcoming budget; and terrorist attack on the Naval base. Both local and foreign investors remained cautious about the developments on the law & order situation and domestic political front; outcome of the Pakistan-IMF talks; and US-Pakistan relations. However, possibility of exemption of Capital Gains Tax on stocks in the upcoming budget and release of partial payment of Energy related circular debt brought some excitement among the local investors. The month started with KSE-30 Index at around 11,716 levels and after touching a low of 11,334 levels on May 4, closed the month at 11,762 levels. Overall, during the month KSE-30 Index increased by around 0.40%.

State Bank of Pakistan kept the Discount Rate unchanged at 14% in its recently announced Monetary Policy announcement. Inflation as measured by the CPI came in at 13% during April 2011 year-on-year basis on the back of surge in food and energy components. However, despite meager financial inflows, external accounts showed significant improvements on the back of the substantial growth in exports and record workers' remittances. Foreign Portfolio Investment (FPI) remained subdued during the month and Net FPI was recorded at US$ 26.37 million. Trading activity remained thin and Average Daily Traded Volume during the month was recorded at around 71.4 million shares, compared to around 75.5 million shares in the previous month.

During the month, Oil & Gas, Industrial Engineering, Fixed Line Communication and Financial Services sectors out-performed the market. Whereas, Banking, Chemicals and Electricity sectors lagged the market. Release of payment of Circular debt to Oil Marketing Companies and attractive valuations of the key companies in Oil and Gas Exploration sub-sectors contributed to the outperformance of Oil and Gas sector. Curtailment of Gas to key companies in the fertilizer sub-sector and rumors of removal of subsidy on the feedstock prices in the upcoming budget kept the fertilizer stocks under pressure. Rumors of enhancement of the tax rates on the banking sector in the upcoming budget and rising trends of NPLs weakened investors' confidence. Investors avoided taking positions in the Cement stocks due to weak dispatches' numbers.

Going forward, we believe that the following key factors will drive the stock market: (i) Foreign Portfolio Investment activity; (ii) measures in the upcoming Federal Budget; (iii) Pak-US relations; (iv) law and order conditions and (v) Bilateral and Multilateral financial inflows.

Fixed Income Review

After retirement of around Rs.120 billion by Government in energy sector related Circular Debt at start of May, the money market became very liquid in first half of the month. However, subsequent to outflows of GOP Ijara Sukuks coupled with market realization that SBP targets in T-Bill auctions are higher than maturities in the remaining quarter and PIBs auction, the market reversed very swiftly. This resulted in some mark-to-market losses for the Funds carrying T-Bills. However, the T-Bills auctions bid pattern suggests market continues to prefer six months and one year T-Bills over three month papers. In the two T-bills auctions of May, SBP cumulatively accepted around Rs. 413 billion in pass-through bids against the target of Rs. 350 billion. The cut-off yields for the last auction of the month were noted at 13.21%, 13.60% and 13.84% for the 3-months, 6-months and 12-months T-Bills respectively. The State Bank kept the Policy / Discount rate at 14% in its bi-monthly Monetary Policy Statement on May 21, 2011. On the corporate debt sphere, there continues to be a marginal improvement in the market's demand for debt securities of high rated issuers, although now at lower volumes. Total traded value reported at MUFAP for May was Rs 414 mln against Rs 1,188 mln in the previous month. Banking sector TFCs contributed 59.42% and 76.67% respectively in April and May traded value.

Inflation, as measured by CPI, averaged 14.1% for the first ten months of FY 11 against 11.5% for the same period a year ago. 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. As per last available Money Supply data net Government borrowing from the scheduled banks has increased by around 49% in the current fiscal year to Rs 1,194 billion from Rs 803 billion in the previous year. This is also crowding out the more productive private sector credit. The average 3-months T-Bill rate during Jan-May 2010 was 12.01%, while it is 13.26% for the same period this year.

NAFA's money market fund i.e. NAFA Government Securities Liquid Fund (NGSLF) and income funds with short maturities and no TFCs, i.e. NAFA Savings Plus Fund (NSPF) and NAFA Riba Free Savings Fund (NRFSF), all continue to post competitive double digit returns. These funds are expected to benefit further due to their short-term maturities in the current interest rate environment. For longer-term investors with investment horizon of three or more years our Income / Aggressive Income funds offer very attractive yields. Effective June 4, 2011, all money market and income funds managed by NAFA will be open for investments and redemptions on Saturdays also.