



May 2012

Stock Market Review

During the month of May the stock market exhibited lot of volatility. The month started on a positive note and the market extended the gains of the last couple of months. However, lack of progress in Pak-US diplomatic relations, turmoil in the global equity markets, and pressures on the Pak rupee unnerved the local investors. The uncertainties associated with the upcoming Federal budget further jittered the local investors. However, foreign investors took fresh positions in the market. The month started with KSE-100 index at 13,990 levels and after touching a high of 14,701 levels on May 7, 2012, closed the month at 13,787 levels. Overall, during the month the market decreased by 1.5%. Trading activity remained healthy with average daily trading volume at 194 million.

Macroeconomic indicators have depicted deterioration. The current account deficit for the period July to April 2012 has increased to US \$ 3 billion against the surplus of US \$ 466 million in the corresponding period last year. This, together with anemic financial flows has exerted pressures on the FX reserves and the Pak rupee. Similarly, fiscal deficit has swelled due to exorbitant increase in current expenditures. Financing of this yawning fiscal deficit from the domestic sources due to muted foreign flows is crowding out the private sector and fueling inflationary pressures. Therefore, materialization of the targeted foreign flows will be the key determinant of the inflation and interest rates outlook.

The Oil and Gas, Banking and Chemicals sectors lagged the market. On the other hand, Industrial Engineering, Food Producers, and Electricity sectors performed better than the market. The talks of the increase in taxes on the Banks treasury investments weakened investors' sentiments in the sector. Combination of subdued off-take numbers, increase in input cost and price pressures kept investors from taking positions in the fertilizer sub-sector. Due to attractive dividend yields and sanguine valuations investors took fresh position in the Electricity sector. Healthy dispatches, declining coal prices in the international markets and expected decrease in FED in the upcoming federal budget improved investors' sentiments in Cement sub-sector.

As per our estimates, the stock market is valued at 7.4X 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

The last T-Bills auction held on May 30, 2012 witnessed an interesting bid pattern, where more than 99% of the bids were placed in 3 months tenor. This signals an uptick in the interest rates going forward. Incessant Government borrowing from SBP (net increase of Rs 390.5 bln or 32.5%) and scheduled banks (net increase of Rs 694.4 bln or 49.5%) during FY 2012 is fuelling inflation expectations. Depleting FX reserves are exerting pressures on the Pak rupee and during FY 2012, Rupee has depreciated by more than 9% against US Dollar in inter-bank market. Therefore, materialization of foreign inflows remains the key determining factor for inflation expectations and policy Rate decision by State Bank of Pakistan. This is also critical for the twin deficits, current account and fiscal, to remain under manageable level. Inflation numbers for the first ten months of FY12 have largely remained within the SBP target, as the below table depicts.

Inflation Index	Headline - General CPI	Core inflation - NFNE	Core inflation - trimmed
Year on Year -April 2012	11.3%	10.9%	11.0%
12 months moving average	11.2%	10.3%	11.5%

Interest rates in the interbank markets remained at around the same levels during the month reflecting adequate liquidity in the system. Trading activity of TFCs moderated to pre-March 2012 levels, with total traded value reported by MUFAP of Rs 1,074 mln. Banking sector bonds maintained their monthly average contribution of over 70% in the total traded value of private 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. 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.

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