



May 2013

Stock Market Review

The stock market performance remained astounding in May as depicted by 14.96% rise in the benchmark KSE-100 Index during the month. A decisive victory by main opposition party, PML-N, at the center in the general elections has instilled hopes that the new government, through better governance and policy initiatives, would pull the country out of the current economic quagmire. Thus, stock market investors, led by enthused foreigners, have taken large fresh positions at the local bourses. Foreign investors' activity remained very robust during the month with total net foreign inflows recorded at USD271mn (including one-off Unilever proceeds of USD 178mn). Average daily volumes and value traded also considerably improved to 341mn shares and PKR10.1bn respectively from 176mn shares and PKR6.0bn in the previous month. The KSE 100 Index started the month at 18,982 and closed May at 21,823 level.

Oil & Gas and Electricity sectors outperformed the market on hopes that the new government, with resolution of power crisis as its top priority, will quickly address the chronic circular debt issue afflicting the companies in the energy chain. Despite Net Interest Margin (NIM) erosion fears, banks also performed well on hopes of a revival in private sector credit demand and improvement in operating environment due to expected uplift in macroeconomic environment. Fixed Line Communication sector also did well on hopes of a favorable resolution of the International Clearing House (ICH) controversy and amicable settlement of PTCL property transfer issue between Etisalat and the new government. However, Chemicals sector lagged the market on apprehensions that fertilizer companies could face headwinds due to diversion of gas to the power sector and any exorbitant hike in feedstock gas prices in the upcoming bi-annual revision. Food Producers sector also took a breather after a strong bull-run witnessed in the previous few months.

As per our estimates, currently the stock market is trading at 8.3x forward earnings on average, offering 6.4% dividend yield. Going forward, the stock market will take direction from federal budget slated to be announced by mid-June, upcoming monetary policy announcement, any development on IMF program or an alternate funding arrangement and foreign portfolio inflows.

Fixed Income Review

Following a clear mandate won by pro-business PML-N in the recently held national elections, the market broadly expects a rate cut in the upcoming monetary policy review meeting. This view has been further enforced by further decline in headline inflation to around 5.1%YoY in May, rendering real interest rates considerably positive, and market gossips that the new government would avoid an IMF bail-out for now through oil-based assistance from Saudi Arabia and some other foreign inflows (CSF, Etisalat).

In line with the above, considerable interest has been observed in longer tenor papers, which is also apparent from latest bidding pattern of T-bills and PIBs. In the last T-bill auction, banks overwhelmingly bid for the longer-term paper, while negligible interest was observed in 3-month tenor (Participation: 3M: 0.36%, 6M: 14.41%, 12M: 85.23%). In the most recent PIB auction, an amount of Rs. 37.2bn was accepted against the target amount of Rs. 25bn at a cut-off yield of 10.05%, 10.44% and 11.10% in the 3 year, 5 year and 10 year tenors respectively. Furthermore, secondary market yields on longer tenor instruments have declined due to higher investor participation, while those on short-term papers have increased due to tight liquidity conditions and shifting investor preference.

During the month, SBP continued to pursue its liquidity tightening policy via reduction in size of injections through Open Market Operations (OMO), which decreased to Rs. 335bn by month end versus Rs. 385bn at the end of April. The cut-off rates for the OMO injection have also increased to 9.48% p.a from 9.20% p.a last month. However, huge increase in government borrowing related to budgetary support from SBP in the last few weeks has had a salutary effect on local market liquidity conditions.

We think the market expectations of a rate cut are based on mere optimism rather than any change in economic fundamentals. In our opinion, SBP will opt for status quo in the next monetary policy review meeting in view of the still unattended risks on the fiscal and external side and expected uptick in inflationary pressures in 2HCY13. At present, we are maintaining short maturities of our money market funds and will wait for visibility of concrete policy actions by the government to address the aforesaid macroeconomic issues before altering our view.