



October 2011

Stock Market Review

The stock market portrayed a lukewarm trend during October 2011. Key determinant factors were Foreign Portfolio Investment outflows, fluid domestic political situation, profit taking during the results season and apprehensions regarding US-Pakistan diplomatic relations. The KSE-30 index started the month at the 11,220 levels. Following slowdown in inflationary numbers and the higher than expected 150bps cut in the SBP discount rate, the stock market rallied during the first half of the month. The market was led by selected stocks in the fertilizer sector, which benefited the most from the increase in urea prices. The KSE-30 index reached the 11,634 level on October 10, 2011, up 3.7% since the start of the month. Subsequently, the market weakened taking cue from the turmoil in global financial markets, mixed corporate results announcements and gas supply concerns to fertilizer and key industries. The widening current account deficit during 1QFY12 and political rallies by opposition parties also hurt investor sentiment. However, towards the end of the month the market recovered on support by local institutions. The KSE-30 closed the month at the 11,243 level, increasing by 0.20% during the month.

At the start of the month, the State Bank of Pakistan reduced the discount rate by 150bps to 12% p.a. citing lower inflation and slowdown in government borrowing. The SBP also cited dwindling private sector credit and falling real private investment expenditures as reasons for the rate cut. Following change in the CPI calculation methodology, inflationary numbers are expected to be lower during the next few months. Therefore, another slash in the discount rate before the end of the current calendar year is a strong possibility. Foreigners were net sellers in the market with net outflows recorded at US\$ 82.2 million during October 2011 as against outflow at US\$ 4.8 million during September 2011. Trading activity improved considerably during the month. Average Daily Trading volume was recorded at around 92 million shares versus 72 million shares during the previous month.

The Oil & Gas, Chemical and Construction & Materials sectors performed better than the market while Banks, Industrial Engineering, Food Producers and Fixed Line Communication sectors lagged the market. Banks under-performed on mixed quarterly results announcements despite SBP relaxing the Forced Sale Value benefit to the sector. The Oil & Gas sector out-performed on strong results announcements and prospects of sizeable discoveries. The Construction & Materials sector performed better than the market on healthy 1QFY12 financial results along with improved profitability prospects going forward. The Chemical sector was buoyed by key stocks in the fertilizer sector that benefited from improved margins and healthy sales trend.

Going forward, following the conclusion of the quarterly results season the key drivers of the stock market will be: Foreign Portfolio Investment (FPI) activity, US-Pakistan diplomatic relationships, Economic and interest rates outlook and relaxation in the capital gains tax regime for stock market investors.

Fixed Income Review

State Bank of Pakistan cut its Discount Rate to 12% p.a. from 13.5% p.a. on October 8, 2011. Given the magnitude of Policy Rate adjustment in one go, it was an historic announcement. While this indicates possibility of further easing in next Monetary Policy due at November-end, the trend may not be sustainable during the second half of FY 2012, on the back of vulnerability of Fiscal and Current Account Deficits. 6-Month KIBOR, the benchmark of lending rates in Pakistan has dropped to 11.91% at October-end from 13.25% at September-end. In the two T-bills auctions of October, SBP cumulatively accepted Rs. 291 billion against the target of Rs. 435 billion. The cut off yields (p.a.) for last T-bills auctions were noted at 11.87%, 11.92% and 11.94% for the 3 months, 6 months and 12 months maturities respectively.

On the corporate debt sphere, market volumes reported by MUFAP remained thin in October as well. Total traded value reported by MUFAP for October 2011 was Rs 716 mln, as against a value of Rs. 886 mln in September 2011. Banking and Chemical sectors bonds accounted for 71.65% and 21.09% of the traded value respectively.

YoY Inflation (CPI) for September 2011 was 10.5%, while month-on-month inflation in September 2011 was 1.0%. Last three months i.e. (July – September 2011) average monthly increase in CPI is 1.23%. Government borrowing from the scheduled banks is consistently increasing to finance fiscal deficit. In first 106 days of the current fiscal year, net Government borrowing from scheduled banks has risen by 20.56% or Rs 288 billion. In current quarter, SBP has targeted raising Rs 1,070 billion against maturities of 997 billion. Current Account Deficit stood at 2% at the end of the first quarter of FY 2012 as against 1.1% for the same period last year, which confirms that last year's (FY 2011) marginal surplus was a one time event.

NAFA Government Securities Liquid Fund is the only 'AAA(f)' rated money market fund in Pakistan greater than Rs 10 billion in size. Last two funds in fixed income category launched by NAFA namely NAFA Riba Free Savings Fund and NAFA Savings Plus Fund, are also performing well, posting double digit returns. In the current economic environment as mentioned above, the returns of these funds are expected to remain attractive, considering their very low credit risk profile. NAFA's management has started monthly distributions (dividends) in these three funds since beginning of current fiscal year. For investors with long investment horizon of three or more years, our other income funds offer very attractive yields as TFC prices are at a significant discount.

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