



October 2012

## Stock Market Review

During the month of October the stock market depicted positive trend with some volatility. Policy rate cut by SBP in its last monetary policy statement and expectations of further monetary easing; better than estimated earnings announcements by selected sectors; and positive foreign investors' activity cheered up the local investors. On the other hand, clouded outlook of the fiscal and current accounts unnerved the investors. The month started with KSE - 100 Index at 15,445 levels and after rising by 3% closed the month at historical high levels of 15,910. As per our estimates the stock market is valued at 6.9 times estimated earnings on average. Trading activity remained healthy with average daily trading volume at 124 million shares. During the month net Foreign Portfolio Inflow was recorded at around US \$ 39 million against the US \$ 12 million during the previous month.

In its bi-monthly monetary policy announcement of October 2012, State Bank of Pakistan reduced Policy Rate by 50 bps to 10% from 10.5% amid significant reduction in inflation and improved external account position. Year-on-year (YOY) inflation as measured by CPI for the month of October clocked in at 7.7%. Market is expecting that it has created room for the central bank to undertake policy rate cut in its upcoming monetary announcement that is scheduled in the first week of December. However, latent risks to the fiscal accounts emanating from the fiscal slippages and current account due to heavy payments on the foreign loans during the undergoing fiscal year will also be the key consideration of the SBP in its policy rate decision.

Construction and Materials, Industrial Engineering and Food Producers sectors performed better than the market. On the other hand, Oil and Gas, Chemicals and Banking sectors lagged the market. Better than estimated earnings reports and optimistic earnings outlook resulted in the out-performance of the Construction and Material sector. Healthy earnings announcements and payouts attracted investors in the Food Producers sector. Lingering gas supply issues and muted off-take numbers kept investors from the fertilizer sub-sector. Banking sector under-performed due to expectations of earnings slowdown due to expected policy rate cut.

In our view, the market will take direction from upcoming elections announcement, inflation and interest rates outlook and foreign investors' activity.

## Fixed Income Review

We have witnessed downward trend in headline inflation during the undergoing fiscal year. It stood at 8.8% for the month of September 2012 and 7.7% for October. The State Bank of Pakistan announced its bimonthly monetary policy on October 5, 2012; wherein Discount Rate was cut by 50 basis points to 10% from 10.5% (market expectation was 100 bps cut) bringing the total cut during the fiscal year to 2%. Market expectations of further rate cut are reflected in the recent T-bills auctions and secondary market yields of T-bills which are down by around 60 basis points since the last Policy Rate cut.

In order to strengthen the market liquidity management, SBP has announced further measures. i) In order to curtail frequent access to SBP Overnight Reverse Repo and Repo facilities, if any eligible institution accesses the facility more than 7 times during a quarter, a spread of plus/minus 50bps will be charged over & above the applicable SBP rates. ii) Reserve maintenance period is increased to two weeks instead of one week. Cash Reserve Requirement (CRR) remains at 5% for all banks, however, daily minimum requirement is reduced to 3%.

Trading activity of TFCs in the secondary market remained healthy during the month, with total traded value reported by MUFAP at Rs 787 mln. Banking sector bonds contribution in the total traded value of private sector bonds was around 63% during October, while remaining volume was in Chemicals and Telecom sector bonds.

NAFA Government Securities Liquid Fund remains 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 healthy returns since their inception. The long run returns of these funds will remain attractive considering their very low credit risk profile and investment in securities and instruments with limited exposure to interest rate risk. However, in line with the decrease in the T-bills and KIBOR, the return on the money market funds and income funds are expected to decline in the short-term.