

Stock Market Review

During September 2010, the stock market depicted a sideways trend. The KSE-30 Index closed the month at 9674.34 points, marginally down by 0.26% compared to the 9699.78 level at the end of August 2010. The month started on weak investor sentiments resulting from the fluctuating political state of affairs and macroeconomic worries, particularly surge in CPI numbers. The KSE-30 Index lost a cumulative 1.55% and closed at 9548.97 points on September 3, 2010. The market recovered somewhat after the Eid holidays due to progress on the leverage product, sanguine corporate results expectations and as investors came to terms with the impact of the damage caused by the floods. The KSE-30 index rose to 9913.60 points on September 14, 2010. This portrayed 3.82% cumulative gain from the September 3rd levels.

In the monetary policy announcement on September 29, 2010, the SBP raised the discount rate by another 50 bps to 13.5%. Further monetary tightening is the consequence of higher inflationary numbers on the back of supply disruptions post-flood and crop damage as well as the continuous increase in government borrowing. With the hike in the discount rate, investors have focused on defensive stocks and yield plays. Net Foreign Portfolio Investment (FPI) activity declined during the month. Net FPI during September 2010 was recorded at around US \$ 22.35 million, 45.90% lower as against US \$ 41.32 million during August 2010. Trading activity remained sluggish. Average Daily Traded Volume during September 2010 stood at 60.77 million shares, almost flat compared to 56.52 million shares in August 2010.

The Oil & Gas sector out-performed the market as its sub-sectors performed better than the market. The Refineries sub-sector performed well on expectations of deregulation of petroleum pricing formula. The Oil and Gas Exploration sub-sector remained in the limelight on foreign interest and strong financial results expectations. The Oil Marketing sub-sector also did well on account of good financial results. Gas, Water and Multi-utilities Companies outperformed the market on higher earnings prospects resulting from the enhancement in allowable gas losses. The Chemical sector performed in line with the market as selected high dividend yielding stocks in the fertilizer sub-sector were in the limelight. The Construction & Materials sector marginally out-performed the market on improved prospects of cement demand in the aftermath of floods and better pricing.

Going forward, we believe that political and economic news flows will be the primary factors that will shape investor sentiments. Additional positive triggers could be rebound in foreign portfolio investment and acceleration in floods related aid flows. Moreover, progress with respect to the implementation and modalities of Margin Trading System would be a favorable development.

Fixed Income Review

September was a month looking beyond the panic from the floods and trying to gauge the impact of this disaster. It has been termed as the worst natural disaster of Pakistan and will have a lasting impact on the economy. Measures taken by the government in terms of diversion of funds and austerity in public expenditure has not been encouraging. After the 50bps hike announced by SBP in July, SBP has again raised the discount rate by 50 bps indicating medium term change in outlook. Current challenge for SBP on the monetary front is to find a balance in efforts to contain inflation alongside supporting economic growth. Budgetary deficit, additional taxes and quantum of foreign flows are key areas to watch.

Inflation for August sprung back to 13.2% from 12.3% during July mainly due to rising food prices; this trend is likely to continue in the coming months. Current account deficit for the first two months of FY 11 deteriorated by about 48% over the same period in FY 10. Workers remittances were sharply up by about 13% for the first two months of FY 11 compared to the same period in FY 10. The money market remained fairly liquid during September as SBP conducted regular OMOs to manage the liquidity.

TFC pricing issues continued during the month and most of the income funds faced volatility. Trading was actively seen in a few Banking and Telecom Sector TFCs whereas overall activity in the majority of issues remained low. A real estate sector TFC has been rescheduled. We advise that income funds' investors should take a longer term view in order to take advantage of the attractive yields on debt issues. Conversely, for investors with a shorter investment horizon, NAFA Government Securities Liquid Fund and NAFA Savings Plus Fund continue to post satisfactory returns in the range of 10% p.a. to 11% p.a.

In the T-Bills auctions of September, SBP accepted about Rs. 138 billion (combined for both auctions) against the target of Rs. 150 billion. The cut off yields for the last auction of the month were noted at 12.75%, 12.85% and 12.79% for the 3 months, 6 months and 12 months T-Bills, respectively. The three and six month cutoffs were considerably higher than the cutoffs observed during August in anticipation of hike in the discount rate. Going forward, interest rates are not expected to ease as Government borrowing is expected to remain excessive.