

September 2011

Stock Market Review

The stock market depicted positive trend with lot of volatility during the month. The month was marked by Supreme Court's hearing on deteriorating law and order situation in Karachi, unprecedented floods in Sindh, Pak-US row over Haqqani network, lower than expected inflation numbers for the month of August and rate cut on National Savings Schemes. The market rebounded sharply in the first half of the month led by Fertilizer sub-sector and key companies in the Banking & Oil and Gas sectors following a decline of 9% during the previous month. Investors' confidence shattered following US allegation on Pak intelligence agencies' relations with Haqqani network and the former issuing threats against the latter. Lower than expected CPI (inflation) for the month of August 2011 at 11.6% and decrease in profit rates on the National Savings Schemes underpinned the market view of Policy Rate cut in the upcoming monetary policy announcement. Consequently, investors took fresh positions in stocks offering healthy payouts belonging to Chemicals, Electricity and Oil and Gas sectors. Overall, during the month the KSE 30 Index gained by around 6.4% during the month.

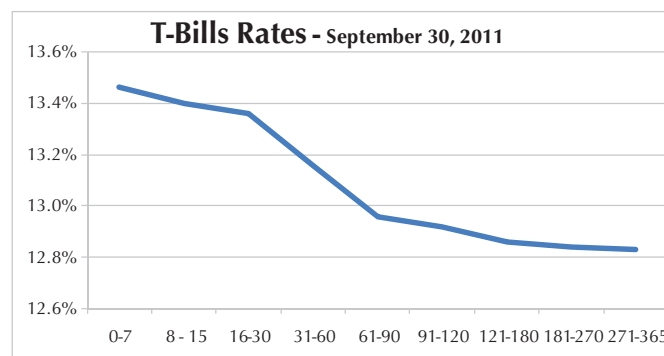
State Bank of Pakistan is expected to continue to follow easy monetary policy stance and decrease Policy Rate in its upcoming Monetary Policy Statement scheduled in October 2011. The key factor for this decrease would be the downward trend in inflation during the preceding months. However, downside risks to the economy are mounting due to absence of all forms of foreign flows and Government's heavy reliance on domestic resources to finance yawning fiscal deficit. Foreigners were net sellers in the market with net outflows recorded at US \$ 4.8 million. Trading volume improved substantially during the month. Average Daily Trading volume was recorded at around 72 million shares versus 49 million shares during the previous month.

Chemicals, Banking, Financial Services and Construction & Materials sectors performed better than the market while, Food producers and Industrial Engineering sectors lagged the market. Key triggers for the out-performance of Fertilizer sub-sector were higher than expected off-take numbers, strong primary margins and healthy payouts. Key companies in the Banking sector performed better than the market due to attractive valuations. Depressed sales numbers resulted in the lagged performance of the Industrial Engineering sector. News of the resolution of energy related circular debt by the government improved investors' confidence in the Oil and Marketing Companies.

Going forward, key drivers of the stock market will be: Foreign Portfolio Investment (FPI) activity; developments on diplomatic relations with US; bilateral and multilateral financial inflows; and inflation and interest rates outlook.

Fixed Income Review

The money market remained very tight during the whole month with overnight repo rates hovering just below the Discount Rate of 13.5%. This was because banks preferred to participate in longer maturity Government Securities on expected cut in the Discount Rate. As a result the yield curve of up to one year was classic text book like inverted (see chart). The last T-Bills auctions' bid pattern of September 2011 showed almost entire participation in one year T-Bill, while negligible amounts in six months and three months. The 10-year PIB and 1 year T-Bill traded as low as 12.80% p.a. at the month-end. In the two T-bills auctions of September, SBP cumulatively accepted Rs. 319 billion against the target of Rs. 280 billion. The cut off yields (p.a.) for last T-bills auctions were noted at 13.07%, 13.23% and 13.31% for the 3 months, 6 months and 12 months maturities respectively.



On the corporate debt sphere, market volumes reported by MUFAP remained thin in September as well. Total traded value reported by MUFAP for September 2011 was Rs 886 mln, as against a value of Rs. 577 mln in August 2011. Banking and Telecom sectors bonds accounted for 71.44% and 22.91% of the traded value respectively.

YoY Inflation (CPI) for August 2011 was 11.6%, primarily a result of change in CPI composition and base year, while month-on-month inflation in August 2011 was 1.4%. Government borrowing from the scheduled banks is consistently increasing to finance fiscal deficit. In first 79 days of the current fiscal year, net Government borrowing from scheduled banks has risen by 12.56% or Rs 176 billion. In next quarter, SBP has targeted raising Rs 1,070 billion against maturities of 997 billion, hence another rise of Rs 73 billion. Rising workers' remittances continue to provide a breather, as these have risen by 39.6% in July and August 2011 when compared with same period last year.

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.