

Is the Pakistani Stock Market Expensive?

The Pakistani stock market has risen by 38% over the last 12 months, and 37 over the last 6 months. Has the market become expensive as a result of this phenomenal rise and is this a bubble about to burst? To answer this question we will analyze the Pakistani stock market valuations relative to its historical levels and regional markets.

The Table below shows the historical valuations of some Asian markets, including Pakistan. The average price-to-earnings ratio of the Pakistani stock market over the 2000-2006 period has been 8.8 times. Presently, the market is trading at a price-to-earnings ratio of 12.1 times on FY 2008 earnings. The price-to-book ratio over the 2000-2006 has averaged 1.9 times for the Pakistani stock market, but it is presently trading at a price-to-book ratio of 3 times. Thus, the stock market seems over-valued.

The Table also examines the valuation of other Asian markets relative to their own historical averages and that of Pakistan. A major finding is that the valuations of the Pakistani stock market are still lower relative to other Asian countries. For example, whereas the price-to-earnings ratio of the Pakistan stock market is 12.1 times on 2008 earnings, the same ratio is 15.3 times for India. Another important finding is that over the last several years, Asian stock market valuations have risen relative to their historical levels. For example, the price-to-earnings ratio for the four Asian markets averaged 14.3 times over the 2000-2005 period, but rose to 18.2 times by 2006 – a

rise of about 28%. During the same time period, the price-to-earnings ratio for the Pakistan stock market rose from 8.4 times to 11.2 times – a rise of 33%.

The gradual rise in valuations of Asian markets is attributed to the re-rating of the Asian stock markets relative to the rest of the world. Asia is now being looked at as the engine of global growth, and this status is expected to continue for several decades. Due to the high economic and earnings growth expected in Asia, investors expect a double digit return from the Asian stock markets, and are therefore willing to invest in these markets even at higher valuations. On the contrary, investors only expect single digit returns from the Western stock markets. The West is experiencing low economic growth rate due to aging population, and slow down in the demand of products and services.

In FY 2007, Pakistan has received US\$ 6 billion of foreign investment, including about a billion dollar in the Pakistani stock market. This trend is expected to continue in the future as well.

To conclude, although stock market has become expensive as compared to historical levels, it is still cheaper relative to other Asian countries. Foreign and local investors are expected to continue to invest in Pakistan anticipating good economic and corporate earnings growth. However, considering the substantial rise in the market over the last six-months and the forthcoming elections, the market may consolidate at these levels for some time.

Table									
	Price to Earnings Ratio								
	00A	01A	02A	03A	04A	05A	Avg. 2000-2005	06A	% Chg
Pakistan	10.1	7.1	5.6	8.0	9.2	10.1	8.4	11.2	34.1%
India	15.6	13.8	13.6	19.0	17.7	20.2	16.6	22.9	
Indonesia	18.7	8.4	7.1	10.4	12.9	12.1	11.6	19.5	
Korea	8.1	15.2	11.4	13.9	8.2	12.3	11.5	11.9	
Malaysia	20.6	22.6	13.2	16.3	16.1	14.5	17.2	18.4	
Average (Excl. Pakistan)	15.8	15.0	11.3	14.9	13.7	14.8	14.2	18.2	27.7%
	Price to Book Ratio								
Pakistan	1.4	1.3	1.2	1.7	2.1	2.7	1.7	3.0	73.1%
India	2.7	2.1	2.2	3.8	3.6	4.4	3.1	5.2	
Indonesia	1.0	2.7	2.2	2.3	3.0	3.1	2.4	4.4	
Korea	0.8	1.3	1.2	1.5	1.4	1.9	1.4	1.7	
Malaysia	1.6	1.8	1.5	1.9	2.0	1.8	1.8	2.2	
Average (Excl. Pakistan)	1.5	2.0	1.8	2.4	2.5	2.8	2.2	3.4	56.5%