

Stock Market Review

Amid amplified volatility and lukewarm trading activity, April proved a challenging month for the equity investors as the benchmark KSE-100 Index plunged by 1,865 points (4.8%), wiping out all the early gains of CY19. The market started off the month on a bearish note as the Index fell by a hefty 1,727 points (4.5%) during the first six trading days. The outgoing month was eventful for the local bourse as Finance Minister Asad Umer announced to step down as a part of Cabinet reshuffle by PM Imran Khan followed by appointment of Dr. Abdul Hafeez Shaikh as his successor. Alongside, a five-member advisory board was also formed to look into the economic affairs of the country. The ongoing corporate results season with some better than expected announcements also could not change the bearish sentiments in the market. The lacklustre performance of the stock market is attributable to the growing concerns on the economic growth and corporate profitability driven by the slowing economic activity as reflected by contraction of Large Scale Manufacturing (LSM) sector & other incoming data and downbeat business & consumer sentiments. Adding to the investors' angst was delay in the entry into a bailout package with the IMF in the wake of large funding gap in the external account.

As we see it, investors' concerns on the slowing economic growth with its implication for the corporate sector's profitability and vulnerability on the fiscal & external account fronts are legitimate. As a consequence of tightening economic policies, we expect 3-3.5% GDP growth rate for FY2018-19. However, corporate earnings are still expected to grow at a double digit rate helped by robust profitability of the Index heavy Oil & Gas Exploration and Banking sectors where the former is main beneficiary of a massive currency devaluation and latter of rapid rise in interest rates. The IMF package is expected to be signed in the coming month that would provide much-needed immediate financial relief and pave the way for fetching flows from the World Bank, Asian Development Bank, Islamic Development Bank and international capital markets. In our view, this would go a long way in alleviating concerns on the Balance of Payment position, and boosting investors' confidence.

Looking at the participant-wise activity during the month, main selling was seen from the Mutual Funds and Insurance Companies to the tune of USD 27 million and USD 6 million, respectively. On the contrary, Companies, Banks/DFIs, Individual Investors, and Foreign Investors emerged as large buyers in the market accumulating fresh positions to the tune of USD 16 million, USD 13 million, USD 8 million, and USD 4 million, respectively.

What is next? From the valuation standpoint, the stock market is trading at an attractive forward Price-to-Earnings (P/E) multiple of 7.1 and offers around 5% dividend yield. As we see it, valuations appear to be largely reflecting slowing economic growth and challenges on the external and fiscal account front. To top it off, it is also a reflection of pervasive pessimism in the market after dismal performance of the stock market over the last two years and policy flip flops. However, as mentioned above, despite economic growth deceleration, corporate earnings are expected to grow at double digit rate during 2019 & 2020, thanks to strong growth in the profitability of Index heavy E&P, Fertilizer and Banking sectors. The ongoing tightening policies have started showing results as reflected by the significant improvement in the Current Account Deficit (CAD). Above all, we expect foreign portfolio inflow to resume in the market post entry into the bailout package with the IMF.

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After recording 9.4% YoY in April 2019, inflation as measured by the CPI for April 2019 clocked in at 8.8%. The inflation is anticipated to remain on the upward trajectory – owing to further hike in electricity & gas prices, significant increase in perishable food prices, lagged impact of exchange rate depreciation, incessant fiscal borrowing by the government, and volatility in international oil prices. Resultantly, we expect 50-100 bps increase in the Policy Rates. In the secondary market, despite 50 bps increase in the last monetary policy and upside risks to inflation and interest rates, yield on the PIBs witnessed a decline during the month. More specifically, yield on 3-year PIBs declined by 21 bps to 12% and 5-year PIBs by 28 bps to 12.3%. As we see it, this is a reflection of excessive demand versus the limited supply and expectation of decline in inflation and interest rates after peaking during CY19.

During the outgoing month, SBP held two T-Bill auctions with a combined target of Rs. 500 billion against the maturity of Rs. 397 billion. In the first T-Bill auction, an amount of Rs. 445 billion was accepted at a cut-off yield of 11.00% and 11.09% for 3-month and 6-month tenors respectively. However, SBP received no bids for 12-month tenor. In the second T-Bill auction, an amount of Rs. 623 billion was realized wherein cut-off yield was noted at 10.98% for 3-month tenor. The SBP rejected bids for 6-month, while no bids for 12-month tenor were received. In the PIB auction, bids worth around Rs. 163 billion were realized for 3-year at a cut-off yield of 12.20%; while bids for 5-year and 10-year tenors were rejected. Furthermore, SBP in the recent floating rate PIB auction dated 17-Apr-19, attracted bids worth Rs. 104 billion. Out of the total bids, Rs. 65.25 billion was realized at a cut-off margin of 70 basis points over the benchmark (i.e. weighted average yield of the 06-month Market Treasury Bills).

We have calibrated the portfolio of our money market and income funds based on our interest rate outlook and will remain alert to any developments that may influence our investment strategy.

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