March 2019

Stock Market Review

Amid large swings and thin trading volumes, the benchmark KSE-100 Index closed the outgoing month with a decline of 405 points (1%) on a month-on-month basis. The market looked past the positive developments such as increase in SBP's reserves to double-digit after almost a year as the country received commercial loan from China equivalent to USD 2.2 billion and USD 1 billion from the United Arab Emirate; and a massive drop in Current Account Deficit (CAD) for February that clocked in at mere USD 356 million mainly due to a massive 20% MoM decline in imports. Instead, concerns on the economic growth and corporate profitability came to fore as LSM for January 2019 witnessed a large 4.6% contraction on a YoY basis, taking 7MFY2019 decline to 2.3%. The SBP also revised down its economic growth projection for FY19 to 3.5%-4% driven by slowing economic activity and dismal performance of the major crops. This slowing economic growth coupled with rising interest rates and despite significant improvement, a still large current account deficit prompted investors to stay on the sidelines. Adding to investors' angst was the news surrounding the simultaneous scrutiny done by the Financial Action Task Force (FATF) and its affiliate Asia Pacific Group (APG), calling Pakistan's case more complex, while the country will have to submit another compliance report on terror financing. In line with the market expectation, the SBP in its bi-monthly monetary policy on March 29, lifted the Policy Rate by 0.5% to 10.75% driven by continuing underlying inflationary pressures, elevated fiscal deficit, and high current account deficit.

Looking at the participant-wise activity during the month, Foreigners and Mutual Funds emerged as large sellers in the market, offloading positions worth USD 18 million and USD 11 million, respectively. On the contrary, Broker Proprietary Trading, Insurance Companies, and Bank/DFIs emerged as main buyers, accumulating equities worth USD 10 million, USD 9 million, and USD 7 million, respectively. During March, Banking, Auto Assemblers, Fertilizer, Paper & Board, and Pharmaceuticals sectors performed better than the market while, Cement, Engineering, OMCs, Power Generation & Distribution, and Textile Composite sectors lagged behind.

Going forward, after a sizable 7% correction from the recent high of 41,614 hit on February 4, 2019, the market is trading at an attractive Price-to-Earnings (P/E) multiple of 7.5 and offers a handsome 5% dividend yield. Led by the Index heavy E&P and banking sectors, we expect corporate earnings to grow at double-digit for CY19 and CY20. We expect continuation of improvement in external account position due to the recently enacted tightening policies with some more to come as well. Above all, against unabated selling during the last three consecutive years, the odds of resumption of foreign portfolio inflows have risen given attractive valuations and subsiding risk of disruptive currency devaluation after a massive 26% adjustment in PKR/USD parity during CY18. We expect that the bailout package with the IMF will be signed by May 2019, which would pave the way for securing flows from other multilateral institution such as the ADB, IDB, World Bank as well as taping the international capital markets. Taken together, we advise investors to consolidate their position in equities as market is well poised to deliver healthy returns in CY19 given attractive starting valuations and waning headwinds.

Money Market Review

After recording 8.2% YoY in February 2019, inflation as measured by the CPI for March 2019 clocked in at 9.4%. Inflation is expected to remain on the upward trajectory owing to upward adjustments in administered prices of electricity and gas, significant increase in perishable food prices, and the impact of continued exchange rate depreciation. After 50bps increase in the Policy Rate to 10.75%, we expect interest rates to peak with an expected further 50bps hike in the coming months as the real interest rates are in the positive territory even accounting for upside risks to inflation and also considering negative implication of high interest rates on the fiscal position. During the month, sovereign yields started reflecting a possible hike in the Policy Rate by the SBP as 6-month T-Bill increased by 35 bps to 11% and 10-year PIB yield inched up by 26 bps to 13.12%.

During the outgoing month, SBP held two T-Bill auctions with a combined target of Rs. 750 billion against the maturity of Rs. 615 billion. In the first T-Bill auction, an amount of Rs. 14.0 billion was accepted at a cut-off yield of 10.55% for 3-month. In the second T-Bill auction, an amount of Rs. 11.5 billion was realized wherein cut-off yield was maintained at 10.55% for 3-month tenor. In the PIB auction, bids worth around Rs. 105 billion were realized for 3-year, 5-year and 10-year at a cut-off yield of 12.23%, 12.64% and 13.15%, respectively. However, the bid pattern skewed towards 3-year tenor. Furthermore, SBP in the recent floating rate PIB auction dated March 20th attracted bids worth around Rs. 68 billion. Out of the total bids, around Rs. 7.4 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 remain alert to any developments that may influence our investment strategy.