May 2019

Stock Market Review

May 2019 can be characterized by a tale of two halves for the local bourse. The benchmark KSE 100 Index fell sharply by 6.8% during the first half of the month as fears of stringent conditions associated with the bailout package from the IMF with its implications for economic growth and corporate profitability gripped the market. However, the market bucked the trend and a handsome gain of 4.9% was witnessed in the latter half of the month. We attribute this recovery to the announcement of reactivation of market support fund that perked up investors' interest in the market. Shrugging off overblown concerns on the tough conditionalities associated with the bailout package from the IMF, smart money poured into the beaten down part of market as indiscriminate panic selling sent the Price-to-Earnings to a screaming 6.3 times forward earnings. In the process, the market made a new low of recent correction of 33,167 points on May 17th 2019. Overall, during the month, the Index lost 810 points (2.2%) to finish the month at 35,975 points.

During the month, Automobile Assembler, Chemical, Engineering, Fertilizer, Pharmaceuticals, Technology & Communication, and Textile Composite sectors performed lagged the market. On the other hand, Cement, Banking, Oil & Gas Exploration, and Power Generation & Distribution sectors performed better than the market. Looking at the participant-wise activity during the month, Mutual Funds and Insurance Companies remained major sellers in the market to the tune of USD 40 million and USD 16 million, respectively. On the contrary, Foreign Investors, Companies, Banks/DFIs, and Individual Investors emerged as large buyers in the market accumulating fresh positions to the tune of USD 18 million, USD 13 million, USD 11 million, and USD 8 million, respectively.

Looking ahead, we acknowledge that the market may exhibit large swings sporadically amid evolving domestic economic policies and geopolitical developments. From the valuation stand point, the stock market is trading at a compelling forward Price-to-Earnings multiple of 6.9, reflecting challenging economic outlook and subdued investors' sentiments driven by policy uncertainty and dismal performance of the stock market over the last two years. Despite slowing economic growth, corporate earnings are still expected to grow at double digit rate for 2019 and 2020 helped by index heavy Oil & Gas Exploration and Banking sectors the former being the beneficiary of currency devaluation and firm global oil prices and the latter of rising interest rates. We expect the market to restore its lustre for Foreign Investors given attractive valuations, the Rupee near its equilibrium value, and the beginning of oversight of the IMF. Taken it all together, we advise investors to hold their positions in the stock market, keeping their long-term investment objectives in mind.

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The State Bank of Pakistan (SBP) in its bi-monthly Monetary Policy Statement increased the Policy Rate by 150 bps to 12.25% to address underlying inflationary pressures emanating from (i) recent exchange rate depreciation; (ii) an elevated fiscal deficit and its increased monetization, and (iii) potential adjustments in utility tariffs. After recording 8.80% YoY in April 2019, inflation as measured by CPI for May 2019 is expected to clocked in at 9.2% and it is anticipated to remain on the upward trajectory. The upside risks to the inflation emanates from: (i) increase in tax rate/expansion of scope of taxes and other levies, (ii) potential adjustments in utility tariffs (iii) volatility in international oil prices; and (iv) incessant fiscal borrowing by the government from the banking system. On account of foreign debt repayments and a still large current account deficit, FX reserves holding of the SBP declined to USD 8.01 billion as of May 24, 2019 from USD 8.78 billion at end-April 2019.

During the outgoing month, SBP held two T-Bill auctions with a combined target of Rs. 1,800 billion against the maturity of Rs. 2,678 billion. In the first T-Bill auction, an amount of Rs. 588 billion was accepted at a cut-off yield of 11.25% for 3-month respectively. In the second T-Bill auction, an amount of Rs. 3,140 billion was realized wherein cut-off yield was noted at 12.75% and 12.80% for 3-month and 6-month tenors, respectively. In the PIB auction, bids worth around Rs.135 billion were realized for 3-year, 5-year and 10-year at a cut-off yield of 13.7%, 13.8% and 13.6%, respectively; while no bids for 20-year were received. Furthermore, SBP in the recent floating rate PIB auction dated 29-May-19, attracted bids worth Rs. 68.5 billion. Out of the total bids, only Rs. 20 billion was realized at a cut-off margin of 70 basis points over the benchmark (i.e. weighted average yield of the 6-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.