June 2019

Stock Market Review

June 2019 remained a tough month for the local bourse as the benchmark KSE-100 Index fell sharply by 2,073 points (5.8%), taking the FY2019 decline to 19.1%. The KSE-100 Index closed the year at 33,902 points. Downward trend in the market was triggered by the negative news-flow surrounding the Federal Budget amid fears of stringent conditions associated with the bailout package from the IMF with its implications for economic growth and corporate profitability. As expected, it was a tax laden budget whereby the government targeted tax revenues of PKR 5.55 trillion for FY2020 as against the expected revenue collection of PKR 4.0 trillion in FY2019. On the positive side, GST rate was left unchanged at 17% and corporate tax rate was maintained at 29%. However, zero rating facility available to textile sector was proposed to be withdrawn while excise duty on cements was enhanced. We reckon that the policy measures undertaken in the Federal Budget such as broadening of tax base, withdrawing of some anomalous tax exemptions, rationalization of tax rates, and widespread drive towards the documentation of economy would be painful in the short run as it would slow down economic activity and stoke public anger. However, if these measures are implemented successfully and augmented by other long-standing structural reforms, this will put the economy on a self-sustaining growth path and lend durable financial stability. Meeting of FATF also highlighted that more efforts are required from Pakistan, while no noticeable activity from the much-touted market support fund also dampened investors' interest.

During the month, Refineries, Oil & Gas Marketing, Cement, and Engineering sectors' performance lagged the market. On the other hand, Insurance, Power Generation & Distribution, Technology, Fertilizer and Chemical sectors performed better than the market. Looking at the participant-wise activity during the month of June, Mutual Funds and Brokers Proprietary liquidated shares to the tune of USD 19 million and USD 7 million, respectively. Foreign Investors also emerged as seller, offloading equities worth USD 5 million. On the contrary, Banks/DFIs, Companies, and Individuals were large buyers in the market, accumulating fresh positions to the tune of USD 17 million, USD 9 million, and USD 6 million, respectively.

Looking ahead, the IMF program is scheduled to be approved by the IMF board on 3rd July. In our view, the prevailing valuations of the market reflect tough conditions associated with the bailout package. From the valuation stand point, the stock market is trading at a compelling forward Price-to-Earnings multiple of 6.4, reflecting challenging economic outlook and subdued investors' sentiments driven by policy uncertainty. For long-term investors who have already lived through the painful period of the last two years, this is probably not the right time to exit the market, in our view. Taken it all together, we reiterate our constructive view on the market given attractive valuations, robust corporate earnings growth, ample local liquidity, and resumption of foreign portfolio inflows.

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After recording 9.1% YoY in May 2019, inflation as measured by CPI clocked in at 8.9% for June 2019. We anticipate inflation to remain on the upward trend due to number of upside risks: (i) pass through of new taxes/increase in tax rates; (ii) upward adjustments in utility tariffs; (iii) increase in retail fuel prices; and (iv) second round impact of the PKR devaluation. Resultantly, a further 100 bps hike in the interest rates cannot be ruled out.

During the outgoing month, SBP held two T-Bill auctions with a combined target of Rs. 1,000 billion against the maturity of Rs. 27 billion. In the first T-Bill auction, an amount of Rs. 100.1 billion was accepted at a cut-off yield of 12.75% for 3-month and a cut-off yield of 13.15% for 12-month tenors, respectively. However, SBP received no bids for 6-month tenor. In the second T-Bill auction, an amount of Rs. 3.7 billion was realized wherein cut-off yield was maintained at 12.75% for 3-month tenor while bids for 6-month and 12-month tenors were rejected. In the PIB auction, bids worth around Rs. 95.7 billion were realized for 3-year, 5-year and 10-year tenors at a cut-off yield of 13.7%, 13.8% and 13.7%, respectively. Furthermore, in the recent floating rate PIB auction dated 26-June19, bids worth Rs. 56 billion were received. Out of the total bids, only Rs. 15 billion was accepted at a cut-off margin of 75 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.