

Stock Market Review

During the outgoing month, amid thin trading volumes the stock market remained in the bearish mode as the benchmark KSE-100 Index fell sharply by 1,963 points (5.8%) on a month-on-month basis. The market participants seemed grappling with the slowing economic activity amid increasing cost of doing business, rising cost of capital, tapering of consumer demand, and cut in public sector spending. In the ongoing corporate results season, subdued earnings posted by the companies belonging to the cyclical sectors manifest the extent of demand destruction and cost pressures that sent jitters in the market. Onerous taxation measures announced in the Federal Budget and drive against the documentation of the economy with its short-term negative implications for the corporate profitability also weighed on the investors' sentiments. Attractive returns on the fixed income avenues such as T-Bills, PIBs, Fixed Income Funds, and National Saving Schemes (NSS) have further reduced the appeal of equities. Amid pervasive pessimism, investors opted to exit the market despite compelling valuations resulting from the indiscriminate selling off of equities. Instead, investors preferred to stay on the side-lines, awaiting positive catalyst. The only positive development of the month was a reportedly successful visit of the PM to the United States of America where the two sides expressed the desire to improve strategic relationship.

During the month, Chemical, Banking, Fertilizer, and Oil & Gas Exploration performed better than the market. On the contrary, Automobile Assemblers, Power Generation & Distribution, Technology, Oil & Gas Marketing Companies, Textile Composite sectors performance lagged behind. Looking at the participant-wise activity during the month of July, Foreign Investors emerged as the largest buyers in the market, accumulating fresh positions to the tune of USD 30 million. Alongside, Individual Investors also added fresh equities to the tune of USD 15 million. Mutual Funds remained the main sellers in the market, offloading equities to the tune of USD 44 million. Similarly, Companies sold equities worth USD 9 million.

What lies ahead? As we see it, the indiscriminate sell-off has opened up valuation gap in the broader part of the market that is currently at extremely attractive Price-to-Earnings (P/E) multiple of 6 and offers around 6% dividend yield. We reckon that the prevailing valuations are reflective of bearish sentiments of the market participants after lackluster performance of the equities over the last two years as well as the tightening policies pursued by the incumbent government with its implications for the economic growth and corporate profitability. Despite slowing economic growth, helped by the Index heavy Oil & Gas Exploration, Banking, and Fertilizer sectors, corporate earnings are expected to grow at double-digit rate for FY2020 and FY2021. The IMF has already released first tranche of around USD 1 billion and start of financial flows from other multilateral agencies such as the ADB, IDB, and World Bank; and issuance of Bonds/Sukuk in the global financial markets would boost the confidence of investors. Taken it all together, we maintain our sanguine outlook on the market given: (i) attractive valuations as captured in the P/E multiple of 6.0; (ii) robust expected corporate earnings growth, as per our estimates; (iii) abundant local liquidity; and (iv) against the foreign portfolio outflows during the last three years, increasing odds of resumption of foreign portfolio inflows.

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After recording 8.9% YoY in June 2019, inflation as measured by CPI for July 2019 clocked-in at 10.3%, driven by higher food and fuel prices. The inflation outlook is subject to number of upside risks stemming from: (i) expected rationalization of taxes, (ii) potential adjustments in utility tariffs and (iii) volatility in international oil prices. Despite the improvement in current account and noticeable increase in official inflows, financing of current account deficit remained challenging. Consequently, SBP reserves stood at USD 7.76 billion; which are below the standard adequacy levels. We estimate average inflation at 12.3% for FY2020 due to lagged impact of currency devaluation, rise in utility tariffs & petroleum product prices, and its second-round impact. Resultantly, we expect a further 50-100 basis points hike in interest rates.

During the outgoing month, SBP held three T-Bill auctions with a combined target of Rs. 2,700 billion against the maturity of Rs. 1,700 billion. In the first T-Bill auction, an amount of Rs. 111 billion was accepted at a cut-off yield of 12.75% for 3-month tenor. However, no bids were received for 6-month tenor and SBP rejected bids for 12-month tenor. In the second T-Bill auction, an amount of Rs. 2,211.9 billion was realized wherein the cut-off yields were noted at 13.75%, 13.95% & 14.10% for 3-month, 6-month and 12-month tenors, respectively. In the third T-Bill auction, an amount of around Rs. 854 billion was realized wherein cut-off yields for 3-month and 6-month tenors remained unchanged at 13.75%, and 13.95% whereas yields for 12-month tenors increased by 14bps to 14.24%. In the PIB auction, bids worth around Rs. 172 billion were realized for 3-year, 5-year and 10-year tenors at cut-off yields of 14.25%, 13.80% and 13.55%, respectively; while no bids for 20-year tenor were received. Furthermore, SBP in the recent floating rate PIB auction dated 24-July-19, attracted bids worth Rs. 128 billion. Out of the total bids, only Rs. 84.15 billion was accepted at a cut-off margin of 75 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.