

## Stock Market Review

After rising handsomely by 8.1% during September, the rally at the local bourse picked-up steam during the outgoing month as the benchmark KSE-100 Index rose by a hefty 2,125 points (6.6%) on a month-on-month basis. Key catalysts? On the economic front, encouragingly, the Current Account Deficit (CAD) in 1QFY2020 has clocked-in at USD 1.55 billion versus USD 4.29 billion in 1QFY2019. Sovereign yields continued the downward trend and in the recent T-bills auction on 23rd October, yields on 3-month, 6-month, and 12-month tenors declined by 0.39%, 0.26% and 0.68%, respectively. Similarly, in the PIB auction held on 30th October, yields on 3-year, 5-year, and 10-year PIBs declined by 115 bps, 90 bps, and 90 bps to 11.8%, 11.6%, and 11.35%, respectively. Sharp decline in the sovereign yields and significantly improving CAD has created room for the Policy Rate cut in the upcoming bi-monthly Monetary Policy Review in November 2019. After some initial knee jerk reaction, investors looked past the FATF's conclusion where Pakistan was given February 2020 as the final deadline to complete its full action plan. Market participants also ignored the so called Azadi-march/sit-in by the opposition parties. In the ongoing corporate results season, the Index heavy companies belonging to the defensive sectors such as Oil and Gas Exploration & Production and Fertilizer sectors posted strong results with healthy payouts that provided support to the market.

During the month, Foreign Investors and Insurance Companies were the main sellers in the market, off-loading positions to the tune of USD 13 million and USD 7 million, respectively. On the contrary, Individuals and Other Organizations were the major buyers in the market, accumulating positions to the tune of USD 13 million and USD 9 million, respectively. Cements, Chemicals, Engineering, Foods & Personal Care, Oil & Gas Marketing Companies, Pharmaceuticals, and Transport sectors performed better than the market. On the contrary, Automobile Assembler, Banks, Glass & Ceramics, Paper & Board, Power Generation, and Textile sectors lagged behind.

What is next? We reiterate our positive view on the stock market. The key catalysts for the market would be the move by the central bank in the upcoming Monetary Policy Review in November and progress on issuance of the Euro Bonds/Sukuks to shore up the FX reserves. We expect year-on-year CPI inflation at 10% for October 2019 due to base effect and project it to peak at around 12% in January 2020. From the valuation perspective, despite a strong 19% recovery from its recent low of 28,765 points on August 16, 2019, the market is trading at a cheap forward Price-to-Earnings (P/E) multiple of 6 (Earnings Yield of 17%) and is offering an attractive dividend yield of 7%. While slowing economic activity has hurt the profitability of the cyclical sectors, overall, the profitability of the corporate listed sector remains resilient helped by the Index heavy Oil & Gas Exploration, Banking, Fertilizer, and Power sectors. We expect corporate earnings to grow at double-digit rates for 2020 and 2021. Furthermore, odds are increasing for the continuation of net foreign buying in the market. Declining yields on the fixed income avenues have made a strong case for flow of funds to equities.

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After recording at 11.4% YoY in September 2019, inflation as measured by CPI for October 2019 is expected to clock in at 10%. Inflation is likely to peak at around 12% in the beginning of CY2020, and we expect a sharp decline in inflation in CY2020. In our view, significant improvement in CAD situation, and sharp decline in sovereign bond yield have made a strong case for the Policy Rate cut sooner than later. SBP has stated that the positive impact of recent stabilization measures has started to materialize gradually. The SBP through its Monetary Policy Committee (MPC) highlighted that the interbank foreign exchange market has adjusted relatively well and with the continued adjustment in the current account, the rupee has strengthened modestly against the US dollar. The current account deficit is also showing signs of improvements and we expect this trend to continue. The floatation of bonds in the international market is expected to lend support to the SBP's net liquid foreign exchange reserves that stood at around USD 7.91 billion at October end.

During the outgoing month, SBP held two T-Bill auctions with a combined target of Rs. 1.6 trillion against the maturity of Rs. 2.9 trillion. In the first T-Bill auction, an amount of Rs. 811 billion was accepted at a cut-off yield of 13.69%, 13.55% and 13.47% for 3-month, 6-month and 12-month tenors, respectively. In the second T-Bill auction, an amount of Rs. 622 billion was accepted at a cut-off yield of 13.3% for 3-month and 6-month tenors and 12.79% for 12-month tenor. In the PIB auction, bids worth Rs. 126 billion were realized for 3-year, 5-year and 10-year tenors at a cut-off yield of 11.8%, 11.6% and 11.35%, respectively; while bids for 20-year were rejected. Furthermore, SBP in the recent floating rate PIB auction dated 30-October-19, attracted bids worth Rs. 198 billion. Out of the total bids, only Rs. 54 billion was accepted at a cut-off margin of 31 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.