

Stock Market Review

The stock market depicted a robust performance during the month of July-20 as the benchmark KSE-100 Index surged by a massive 4,837 (14.1%) on a month-on-month basis. Significant foreign currency inflows from multilateral agencies starting from the last week of June helped push the SBP reserves beyond USD 12 billion that had fallen to under USD 10 billion in June that set the stage for this big up month. Likewise, the record amount of workers' remittances which clocked in at USD 2.5 billion for June that led to the Current Account Deficit (CAD) under USD 100 million for the month also uplifted the market sentiment. Consequently, CAD for FY2020 narrowed to a merely USD 3 billion compared with USD 13.4 billion in FY2019. Moreover, the market also cheered encouraging development on the Covid-19 front, whereby the country appears to have controlled the pandemic as the active cases in the country have been reduced from 108,642 on 1st July to merely 25,177 on 30th July. Along with this, the fatality rate has also improved significantly and ratio of new infections to tests has also fallen consistently to low single digit. Consequent pick-up in economic activity powered the rally at the local bourse. To provide continued policy support to the economy, the central bank further reduced mark-up rate on investment under Temporary Economic Refinance Facility (TERF) to 5% from 7% and on Long-Term Financing Facility (LTFF) to 5% from 6%.

During the month, Automobile Parts & Accessories, Cements, Engineering, Glass & Ceramics, Refineries, and Technology sectors performed better than the market. On the contrary, Fertilizers, Food & Personal Care, Oil & Gas Exploration, Pharmaceuticals, and Power Generation sectors lagged behind. On participant-wise activity, Foreign Investors remained major sellers in the market, liquidating stocks worth USD 68 million. Alongside, Banks/DFIs also sold stocks amounting to USD 14 million during the month. On the contrary, Insurance Companies were the largest buyers with net inflows to the tune of USD 34 million. Likewise, Companies, Individuals and Mutual Funds also added new positions of around USD 20 million, USD 17 million and USD 15 million, respectively.

Despite an impressive start of the year FY2021, whereby the market is up by a significant 14% in July, we reiterate our sanguine view on the stock market going forward. Our optimism stems from the major achievement on the pandemic front. And, as the economic activity is picking up pace, we expect limited damage to the corporate profitability of listed space. And on the Covid-19 vaccine development front, as many as six vaccines are in third stage of the trials and many more are in various development stages. From the valuation standpoint, the market is trading at an undemanding Price-to-Earnings multiple of 7.8x and offers a healthy 5.3% dividend yield. In our view, the case for flow of funds towards equities from alternate fixed income avenues has strengthened given the large 6.25% reduction in the Policy Rate by SBP. Empirical analysis also suggests that equities perform well in a declining inflation and interest rate environment.

Taken it all together, we advise investors to stay the course and ignore the short-term market volatility and consolidate position in equities, focusing on their long-term investment objectives.

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To support growth and employment, while keeping inflation expectations anchored and maintaining financial stability the SBP in its unscheduled MPC meeting held on June 25th, slashed the Policy Rate by 1%. Furthermore, SBP has seen an improvement in its foreign exchange reserve as World Bank has given \$500 Million for budgetary support to Pakistan. Inflation for July clocked-in at 9.3% against the market consensus of 8.8%. However, going forward, inflation is likely to moderate due to improvement in supply side disruption after reopening of economy, still a weak demand outlook, expectation of stable currency, and low base effect. The Policy Rate after peaking at 13.25% has come down to 7% that in our view has bottomed out. The Current Account Deficit (CAD) has narrowed to USD 3bn (1.3% of the GDP) in FY20 that is expected to widen to a still manageable level of USD 4.4 bn (1.6% of the GDP) in FY21.

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.