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Weekly Stock Market Commentary

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During the holiday shortened outgoing week, amid large intraday swings, the benchmark KSE-100 Index managed to increase by 261 points (0.7%) on a weekly basis. We see this recent elevated volatility of the market as a sign of consolidation after a staggering 48% rise off the market trough it made on March 25th, 2020. This sharp rise in the market also prompted some investors to opt for the profit taking. We also hear some investors saying that the market is disconnected from the economic fundamentals, which according to them are still weak and don't justify this rise in the market. Looking back, in our view, this remarkable performance of the market is attributable to better than expected developments on the public health front that paved the way for a relatively smooth re-opening of the business activities; an effective policy response by the fiscal and monetary authorities; and encouraging economic data.

Looking at the participant-wise activity during the week, Individual Investors remained the largest buyers in market, accumulating fresh positions worth USD 11 million. Alongside, Foreign Investors and Mutual Funds bought shares to the tune of USD 9 million and USD 6 million, respectively. On the contrary, Banks/DFIs, Insurance, Companies, and Broker Proprietary Trading off-loaded shares worth USD 11 million, USD 5 million, USD 4 million, and USD 3 million, respectively.

What the future holds for the market? We reiterate our view that the market would take cue from the path of the pandemic; and progress on the development of an effective & universally available vaccine, and associated global and local economic recovery. Despite some rise in daily new cases recently, the number of active cases of the Covid-19 in the country has dropped to 16,200 from the peak of 109,000. On the vaccine development front, there are more than 165 vaccines in the different stages of development, 31 are in human trials, and eight are at stage-III of large-scale efficacy test.

On the economic front, despite recent spike, inflation as measured by the CPI for FY21 is expected to moderate to 7% after clocking-in at 10.8% in FY20. To mitigate the impact of the Coronavirus-induced disruption to the economy, the SBP has slashed the Policy Rate by 6.25% to 7%. Helped by resilient workers' remittances and a relatively large contraction in the imports vis-à-vis exports, the Current Account Deficit (CAD) has narrowed to USD 3 bn (1.3% of the GDP) in FY20. We anticipate the CAD to widen to a still manageable level of USD 4.4 bn (1.6% of the GDP) in FY21.

From the valuation standpoint, despite a robust rally, the stock market is trading at an undemanding forward Price-to-Earnings (P/E) multiple of 8x and Price-to-Book value of 1.0x. The market also offers a healthy dividend yield of 5.2% that looks appealing compared with a paltry 7% yield on T-Bills. While Coronavirus induced slowdown in the economic activity would impact corporate profitability in the short-term, we expect strong corporate earnings growth over the next two to three years.

We acknowledge that after a sharp rally, the stock market may depict large swings sporadically, driven by development on the economic, health care, and geopolitical fronts locally and globally. That being said, we maintain our positive view on the stock market over the medium to long-term given: inexpensive valuations; benign near-term inflation outlook & accommodative monetary conditions; abundant local liquidity and paltry returns on the alternate fixed income investment avenues; a manageable Current Account Deficit (CAD) and fairly valued currency; and a healthy corporate earnings growth expected over the next two to three years.