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Weekly Stock Market Commentary

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During the week ending October 16th, the stock market remained under pressure as the benchmark KSE 100 Index shed 634 points, a decline of around 1.6% on a week-on-week basis. The market started off the week on a faltering note as the Index lost around 792 points (1.9%) in the first two trading days of week. What has caused this lacklustre performance of the stock market? As we see it, investors opted cautious approach on rising political temperature in the country as manifested by the first rally of the recently-formed Pakistan Democratic Movement (PDM) in Gujranwala on Friday, demanding the ouster of Pakistan Tehreek-e-Insaf government. Another cause of concern for the investors was the upcoming meeting of the Financial Action Task Force (FATF) plenary scheduled for Oct 21-23 to decide whether Pakistan should be excluded from its grey list, based on the review of Islamabad's performance to meet global commitments and standards on fight against Money Laundering and Terrorist Financing (ML&TF). The ongoing corporate results season where majority of the companies have reported above expected showing also failed to lift market sentiments. However, given robust initial run from its lows hit in March 2020, we see this market correction as inevitable and healthy as all bull markets need to consolidate.

Looking at the participant-wise activity during the week, Banks / DFIs remained the largest buyers in the market, accumulating fresh positions to the tune of USD 8 million. Likewise, Insurance Companies also added equities amounting to USD 2 million. On the contrary, Mutual Funds emerged as the largest sellers in the market, trimming equity positions to the tune of USD 4 million. Alongside, Foreign Investors and Broker Proprietary Trading were other major sellers in the market, as each liquidated shares worth USD 3 million.

Going forward, we reiterate our positive view on the stock market over the medium to long-term. Our sanguine view on the market is underpinned by the improving economic prospects and attractive market fundamentals. On the pandemic front, despite some recent increase, the active cases of Covid-19 in the country stand at around 9,200 compared with the peak number of 109,000. On the vaccine development front, researchers are testing 45 vaccines in clinical trials on humans worldwide, with eleven vaccines under large-scale efficacy test and six approved for early / limited use.

Economic activity has picked-up pace as reflected by the frequently released economic data such as automobile sales, retail fuel sales, and cement dispatches. Large Scale Manufacturing Index (LSMI) increased by 3.7% during 2MFY21 that also corroborates increasing industrial activity. Notwithstanding recent elevated readings, we anticipate the CPI inflation to moderate to 8% in FY21 compared with 10.7% in FY20. We reckon that given uncertain global and local business environment, the central bank would maintain the prevailing supportive monetary policy regime in the near-term. External account, the Achille's heel of Pakistan's economy has improved significantly as during 2 months of FY21, the Current Account surplus stands at USD 805 million versus a Current Account Deficit (CAD) of USD 1,214 million during the corresponding period last year. This improvement largely owes to a hefty 31% increase in the workers' remittances amounting to USD 7.15 billion during 1QFY21. We anticipate the CAD to widen to a still manageable level of USD 4.4 billion (1.7% of the GDP) in FY21.

From the valuation standpoint, the stock market is attractive as captured by the forward Price-to-Earnings (P/E) multiple of 7.5, versus 10-year average of 8.5x. The market also offers a healthy dividend yield of 5.5%. Corporate earnings, the key determinant of the stock market performance are expected to grow at a healthy rate over the next two to three years. Historical analysis shows that the stock market has performed well during the period of low interest rates and manageable CAD.

The Bottom Line: We acknowledge that the stock market may remain sideways in the short-term amid rising noise in the domestic politics. However, the stock market is expected to deliver healthy double-digit returns over the medium to long-term driven by decent corporate earnings growth over the next two to three years; a healthy dividend yield; and some PE expansion. Therefore, we advise investors with the medium to long-term investment horizon to build positions in equities through our NBP stock funds.