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Weekly Stock Market Commentary

October 08, 2021

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During the outgoing week, lukewarm activity was witnessed at the local bourse as the benchmark KSE 100 Index lost 394 points (a decline of 0.9%) on a week-on-week basis. To put things into perspective, during CY21 through October 8th, the market has delivered a meagre 1.6% return. What has caused this lackluster market performance despite attractive market valuations, robust economic activity and much better Covid-19 situation in the country? In our view, this anemic market performance is attributable to the following factors: concerns on the corporate profitability after a sharp currency devaluation & steep surge in global commodity prices; worries over the Balance of Payment (BoP) position after a large Current Account Deficit (CAD) of USD 1.5 billion in August 2021 and USD 838 million in July 2021; shifting Pak-US relations amid the developments in the neighboring Afghanistan with possible spillover effects on Pakistan. In addition to this, according to the market talks, leveraged positions of retail investors, who received margin calls after continuous decline in the Index also weighed on the market performance. However, from the fundamental perspective, we see the current market levels as a buying opportunity for investors with medium to long-term investment horizon.

Regarding participant-wise activity during the week, Companies emerged as the largest sellers in the market, liquidating their equity holdings to the tune of USD 16 million. Alongside, Foreigners were other main sellers, offloading shares worth USD 4 million. On the other hand, Individuals stood as the largest buyers in the market, accumulating shares worth USD 7 million. Likewise, Mutual Funds and Other Organization were other major buyers, adding their equity positions by USD 4 million and USD 3 million, respectively.

Going forward, we maintain our positive view on the stock market. Our sanguine outlook on the market is supported by: extremely attractive market valuations; strong economic activity; easier financial conditions; and plentiful market liquidity. On the economic front, the recent currency devaluation is unlikely to derail the ongoing growth momentum. Regarding corporate profitability, barring short-term pressure in a few cyclical sectors, we expect healthy corporate profitability as companies are gradually passing on the increasing input costs to maintain profit margins due to strong consumer demand. Moreover, many Index heavy sectors such as Oil & Gas Exploration, Textile Composite, and Technology & Communication are net beneficiary of currency devaluation and other sectors such as Commercial Banks and IPPs are currency neutral. To curtail import-based consumption demand, the SBP has let the currency devalue by over 10% since May-21. In addition to this, the SBP has also broadened the scope of 100% cash margin requirement on imports and the government has levied regulatory duties on non-essential imported items. In the same vein, in its recent bi-monthly review held on September 20th, 2021, the benchmark Policy Rate was increased by 25 bps to 7.25%. While acknowledging the needed appropriate policy mix, the SBP cited that "*looking ahead, in the absence of unforeseen circumstances, the MPC expects monetary policy to remain accommodative in the near term, with possible further gradual tapering of stimulus.*" In our view, the SBP would gradually dial back the prevailing ultra-loose monetary accommodation that is unlikely to lead to disruptive financial tightening.

Pakistan-IMF talks under article IV began on October 4th for the pending 6th review of the economy. The successful completion of the review will pave the way for the release of the USD 1 billion under the USD 6 billion Extended Fund Facility (EFF) and facilitate flows from other multilateral agencies such as the Asian Development Bank, World Bank, and Islamic Development Bank. The large currency devaluation under flexible exchange rate regime, beginning of monetary tightening cycle with a token 25 bps hike in the Policy Rate by the SBP, and recent increase in PDL ahead of negotiation show the intent of the government for resumption of stalled IMF programme.

From the fundamental standpoint, the market is trading at an attractive forward Price-to-Earnings (P/E) multiple of 5.8x, versus 10-year average of 8.3x. The market also offers a healthy 5.8% dividend yield. Given a strong investment case for equities, we advise investors with medium to long-term investment horizon to build position in the market through our NBP stock funds.