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Weekly Stock Market Commentary

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The stock market remained under pressure during the outgoing week ending 13th May, as the benchmark KSE-100 index declined by 1,354 points, translating into a decline of 3% on a week-on-week basis. The selling was broad based as most of the sectors closed in red and in terms of sector contribution, Banks and Cements contributed the most to the index decline, while in terms of sectoral performance, cyclicals like Engineering and Cements underperformed the market by a wide margin.

Bears tightened their grip on the market in early trade on Monday as concerns over the delay in IMF program sent jitters in the market. The benchmark KSE-100 index fell by 1,448 points (3.2% DoD), as investors weighed the comments of the former FM over uncertainty surrounding the IMF program. The resumption of the program hinges upon implementation of tough prior conditions. As iterated in our previous notes, the government is required to increase the prices of petroleum products (current subsidy on retail fuel ranges from PKR 30 to 70 per liter), do away with the industrial amnesty scheme, reduce the circular debt of the power sector, increase electricity tariffs and fiscal savings. For various political reasons, the coalition government is finding it hard to implement these tough decisions, which is unnerving the investors, since continuity of IMF is crucial for the country to ensure that it remains solvent. The foreign exchange reserves which have fallen to an alarmingly low level (import cover of merely 6 weeks) coupled with sizeable outflows on the financial account in coming weeks and elevated current account deficit are factors affecting market performance. Meeting the IMF conditions will taper growth, and trigger another round of inflationary pressure, which is already running in double digit. However, the alternative (of not following IMF guidelines) will be a disaster thus any steps towards implantation of IMF conditions will be celebrated by the market.

In terms of trading activity during the week, Individuals and Mutual Funds emerged the largest sellers as they decreased their equity holdings by USD 10 million & USD 3 million. On the contrary, Banks and Other Organizations remained the largest buyers with inflows of USD 16 million and USD 2 million respectively.

Looking ahead, we remain cognizant of the challenging economic conditions amidst elevated global commodity prices and tough IMF conditions, which will bring about fresh round of inflationary pressure. The reserves of the central bank are barely sufficient to fund imports of 6 weeks, and the stubbornly elevated current account deficit has been tough to contain. The new PM and his economic team are trying to conjure some financial support from the friendly countries, especially KSA and China, but they have also linked the assistance to the resumption of IMF program. So, continuity of the IMF program remains of paramount importance. It, however, remains to be seen at what pace and magnitude the coalition government reverses the populist measures taken by the outgoing government and take other painful measures on the fiscal front. The upcoming fortnightly fuel price revision will be a litmus test in this regard. That said, we believe that the current stock market valuations more than compensate for the risks highlighted. Therefore, we continue to look favorably towards the market in terms of return, whereby we expect the market to provide around 20% upside in CY22.

Looking at the fundamentals, the valuations of stock market remain dirt cheap. Corporate profitability remained sublime in CY21, as cumulative profits of KSE-100 companies are estimated to have risen in excess of 48% on a yearly basis. The companies continue to post robust profitability in the ongoing 1QCY22 results, surpassing the previous level of profitability, surging further by around 33% on a yearly basis. On the other hand, performance of stock market has remained lackluster since start of CY22. As a result, the mostly looked at valuation metric, Price-to-Earnings Ratio (P/E) has come down to multi-year low of around 4.4 times (earnings yield of around 23%). The last time market traded at this level was post GFC time in Jan-09. The market also offers healthy dividend yield of around 7-8%. As we see it, the recent market valuations are equivalent to the crisis eras.

Therefore, given a strong investment case for equities, we advise investors with medium to long-term investment horizon to build position in the stock market through our NBP stock funds.