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During the outgoing week ending 27th May, the KSE-100 index fell by 239 points, translating into a weekly drop of 0.6%.

The stock market started off the week on a weak footing, as the benchmark KSE-100 index cumulatively fell by 1,150 points (2.7%) on Monday & Tuesday. The central bank in its MPC meeting further raised interest rate by another 150 basis points, taking the policy rate to 13.75%. Worryingly, the Central Bank omitted its guidance in terms of short-term inflationary outlook, which is concerning for investors and also weighed on the sentiments. Furthermore, the confidence of the market was shaken by the again deteriorating political environment whereby the ousted PM Imran Khan called for the long march to the capital city, in a bid to force the government into calling early elections. Since, the march did not convert into a protest and sit in, its impact was only transient. Moreover, during the week, the IMF staff concluded mission to Pakistan, whereby the country & IMF failed to reach staff level agreement. In the statement, IMF concluded that the mission held highly constructive discussions, and considerable progress was made, including on the need to continue to address high inflation and the elevated fiscal and current account deficits. The IMF team emphasized the urgency of concrete policy actions, including in the context of removing fuel and energy subsidies and the FY2023 budget, to achieve program objectives. Budget related news-flow also discomfited the investors, whereby the government is considering to levy additional taxes on many sectors where it thinks that companies are making abnormal profits. In the subsequent days, we saw some strong recovery and the market partially recovered the previous losses. It was triggered by price increase of PKR 30 per liter on all range of fuels, as the step ended the protracted policy inaction by the incumbent government. Not only it is the precursor of other policy measure which will follow, it will also pave the way for the resumption of IMF program, which is of paramount importance for the country, to stay solvent.

In terms of trading activity during the week, Individuals & Brokers Prop. emerged the largest buyers as they increased their equity holdings by USD 11 million & USD 3 million. On the contrary, Insurance & Mutual Funds remained the largest sellers with outflows of USD 8 million and USD 7 million respectively.

In terms of stock market outlook, we acknowledge the heightened economic risks arising from deterioration on the external front due to elevated repayments on the financial account in the short term, which is visible from country's USD bond yields & CDS spreads, which have reached unprecedented level, indicating high probability of insolvency. Furthermore, the incessant PKR devaluation, removal of fuel & power subsidies coupled with record high commodity prices are likely to result in overwhelming inflationary pressure, which are likely to keep monetary setting in tightening mode for extended period of time. Having said all this, we also reckon that current stock market valuations more than compensate for the risks highlighted. Any tangible improvement on economic & political front will trigger a strong relief rally. Therefore, we continue to look favorably towards 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 inexpensive. Corporate profitability remained sublime in CY21, as cumulative profits rose in excess of 48% on a yearly basis. The companies continue to post robust profitability during the 1QCY22 results, surpassing the previous level of profitability, surging further by around 33% on a yearly basis. As a result, the mostly looked at valuation metric, Price-to-Earnings Ratio (P/E) has come down to multi-year low of around 4.3 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%.

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.