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Weekly Stock Market Commentary

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The outgoing week, ending 3rd June, remained disappointing for the equity market as the benchmark KSE-100 index fell sharply by 1,547 points, translating into a weekly drop of 3.6%. The selling in the market was broad based as almost all the sectors closed on a negative note.

Although the equity market started off the week on a positive note as the index surged on both Monday and Tuesday, helped by optimism that government has finally embarked upon the path to stabilize economy and revive IMF program. However, later during the week, spooked by unabated increase in yield on government papers, the investors resorted to indiscriminate selling in the market. In the latest auction held during week, the yield on short term papers further surged in the range of 55 to 75 basis points, with 3M, 6M and 12M yields at 15.25%, 15.25% and 15.50%, respectively, again creating a considerable spread over the Policy Rate, which was just revised upwards in the past week. During the week, the government and regulators have taken several important steps reversing the inexpedient subsidies which included further increase of the retail fuel prices by PKR 30 per liter, hike of around PKR 8 per unit in the base tariff of electricity for FY23, and 45% revision in gas tariff across Sui South and Sui North region (consumer gas price hike still awaited). While these are much need steps to remove overburdening & unsustainable subsidies, achieve macro-economic stability, and gain approval of IMF program, the investors were nervous about its short-term implication in terms of runaway inflation and impact on the interest rate outlook. The confidence of the investors was also shaken by the outlook downgrade by Moody's, though it has kept the rating unchanged for now. The downgrade does not come as a surprise given heightened external vulnerability risk and uncertainty around the ability to secure additional external financing. Inflation number for the month of May-22 was also reported during the week, which slightly undershot the expectations and clocked in at 13.8%.

In terms of trading activity during the week, Individuals & Companies emerged the largest buyers as each of them increased their equity holdings by USD 5 million. On the contrary, Insurance & Mutual Funds remained the largest sellers with net outflows of USD 8 million and USD 4 million respectively.

In terms of market outlook, we acknowledge heightened economic risks arising from deterioration on the external front due to elevated repayments on financial account in the short term, which is visible from country's USD bond yields & CDS spreads, that have reached alarming level. However, we contend that these risks would dissipate gradually with the resumption of the IMF program. 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 tight monetary setting for an extended period of time and also weigh on the corporate profitability going forward. Having said all this, we also reckon that current stock market valuations more than compensate for the risks highlighted. Any tangible improvement on economic front will trigger a strong relief rally. Likewise, the resumption of IMF program also remains a key trigger and extension in duration and size will also be looked favorably by the market. Side by side, the prospects of roll-over from the friendly countries and additional commitment from them also appears on the cards. Therefore, we continue to look favorably towards market, whereby we expect the market to provide around 15-20% upside in CY22.

Looking at the fundamentals, the valuations of stock market remain inexpensive. Corporate profitability remained sublime in CY21, as cumulative profits are estimated to have risen 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. 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 4.2 times (earnings yield of around 24%). 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.