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Weekly Stock Market Commentary

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The stock market during the outgoing week ending 17th June remained sideways. The benchmark KSE-100 index rose slightly by 126 points, or 0.3% on a week on week basis.

After the announcement of federal budget FY23, the market started off the week on a frail note. The budget was a tough balancing act for the coalition government, keeping in view that IMF needed to be taken on board and with eye on elections that are merely a year away from now. While the direction of the budget appears right, achieving the macro targets and implementation of new taxation measures will remain a key challenge. Firstly, in terms of new revenue measures, the government has tried to bring the evasive real estate sector into the tax net. Secondly, it has again attempted to bring the retail trade sector (other than Tier–1 retailers) in tax net through imposition of flat tax proposed to be charged on the basis of electricity consumption. Other key revenue measures include imposition of poverty alleviation tax to the tune of 2% and enhanced tax rates on banking sector. The market participants appeared unsure if the budget will be able to win the approval of the IMF, since there were no other major taxation measures. Due to these concerns and due to expected increase of around 5-10% tax rate on banking sector companies, the stock market came under pressure as the week began. Large cap stocks, especially banks, which were already at trough valuations, took major beating and the index tumbled by around 1,135 points (around 2.7%) on Monday. However, later on we saw some recovery in the subsequent days triggered by three major events. Firstly, there was news that China has agreed to roll over USD 2.3 billion loan to Pakistan, and in the second phase it would disburse another USD 2.5 to 2.8 billion to the country. Secondly, the government during the week, completely eliminated the subsidy on retail fuels, by further increasing the Petrol and Diesel prices by PKR 23 and PKR 59 per liter, that sparked hope of the revival of IMF program. Lastly, the market also gained strength from the positive conclusion of FATF Plenary meeting, where the watch-dog has acknowledged the completion of Pakistan's action plans and has authorized an onsite visit to Pakistan, as a final step to exit from the FATF's grey list.

In terms of trading activity during the week, Companies & Individuals were the largest buyers with net inflows of USD 11 million and USD 6 million, respectively. On the contrary, Insurance & Brokers Prop remained the largest sellers with net outflows of USD 6 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. Furthermore, the continued 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. However, we contend that these risks would dissipate gradually with the resumption of the IMF program. We also believe 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 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 financial crisis time in Jan-09. The market also offers healthy dividend yield of around 7-8%.

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

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