May 2022

Stock Market Review

During the month of May-22, the benchmark KSE-100 index dropped by around 4.8% on a month on month basis, to 43,078 points.

Right from the start of the month, bears tightened their grip on the market as concerns over the delay in IMF program unhinged the investors' confidence. With appointment of new government, after VONC last month, PM Shahbaz Shareef and his FM Miftah Ismail were expected to take swift and decisive measures on the economic front in order to bring economic stability and to restore the IMF program. Since resumption of the program hinges upon implementation of prior conditions (removal of fuel & power subsidies) inordinate delay in meeting them soured investors' sentiments. Not only economic uncertainty intensified, it also casted doubt over continuity of current government, since any inaction on economic front would further exacerbate economic challenges. As a result, the negotiation between government & IMF remained inconclusive. This economic uncertainty also weighed on the currency market, whereby PKR fell sharply by 6% against USD. However, towards end of the month, the government finally raised prices of retail fuels, which sparked hope about revival of IMF program. During the month, MPC of SBP further raised Policy Rate by 1.5%, taking it to 13.75%. CPI inflation for May clocked in at 13.8%, highest in 28 months, and given impending price adjustments in retail fuels & power tariffs, near term inflation is expected to further shoot up. On positive front, the National Accounts Committee (NAC) released provisional GDP growth for FY22, estimated at 5.97%. Broad based growth was witnessed across all sectors (agricultural, industrial & services output rose by 4.40%, 7.19% & 6.19% respectively). Current account deficit (CAD) also brought some relief, as it fell sharply to USD 623 million in April-22, significantly below the last 10-month run-rate of USD 1.4 billion. Helped by around USD 250 million MoM decline in imports & record high remittances of USD 3.1 billion (up by around USD 300 million MoM), material improvement in CAD was witnessed. In a bid to further relieve pressure on CAD, government banned import of non-essential luxury items, which will help to some extent.

During the month, Auto Assemblers, Chemicals, Food & Personal Care, Oil & Gas Marketing, and Refinery sector stocks outperformed the market. On the contrary, Auto Parts & Access., Cable & Elec. Goods, Cements, Engineering, Insurance, Technology and Textile Composite sector stocks lagged behind. On participant-wise activity, Banks/DFIs and Individuals emerged the largest buyers, with net inflows of around USD 32 million and USD 5 million, respectively. On the other hand, net outflows of around USD 20 million and USD 12 million was seen from Mutual Funds & Insurance Companies.

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, indicating risk 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 tight monetary setting for an extended period of time. Having said all this, we opine 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 favourably by the market. Side by side, the prospects of roll-over from the friendly countries and additional commitment from them also appears likely under an IMF program. Therefore, we continue to look favourably towards market, whereby we expect the market to provide around 15-20% upside in CY22.

From fundamental perspective, market is trading at an attractive Price-to-Earnings (P/E) multiple of 4.3x, versus historical average of 8.2x. The market also offers healthy dividend yield of around 7-8%. Taken together, we advise investors with medium to long-term horizon to build position in the stock market through our NBP stock funds.

Money Market Review

Monetary Policy Committee (MPC), in the policy statement in May 2022, raised the Policy Rate by 150 basis points to 13.75%. The global inflation outlook intensified owing to Russia-Ukraine conflict, which has pushed all the central banks across the world to confront with multi-year high inflation and challenging outlook. Domestically, the deteriorated inflation outlook, due to i) depreciating Rupee, ii) increase in perishable food items prices and iii) reversal of electricity and fuel subsidies – is further subjected to risks from global commodity prices and domestic fiscal policy stance. However, the current account deficit continues to moderate and the trade deficit has shrunk 24% compared to last year in November. The inflation measured by the CPI clocked in at 13.8%. The net liquid foreign exchange reserves with SBP (as at 20-May-22) stand at around USD 10.1 billion. The fiscal consolidation along with the increase in policy rate is expected to help moderate the demand to a more sustainable pace while keeping inflation expectations anchored and containing risks to external stability.

Furthermore, higher input prices have enhanced working capital requirements and the secondary market yields, benchmark rates and cut-off rates in the government's auctions have risen sharply, particularly in the short-term. During the outgoing month, SBP held only one T-Bill auction with a target of Rs. 500 billion against the maturity of Rs. 279 billion. In the T-Bill auction, an amount of around Rs. 332 billion was accepted at a cut-off yield of 14.50%, 14.70% and 14.75% for 3-month, 6-month and 12-month tenures. In the PIB auction, bids around Rs. 98 billion were realized for 3-years and 5-years tenures at a cut-off yield of 14.00% and 13.19% whereas bids for 10-years and 15-years were rejected and no bids for 20-years and 30-years were received.

We have calibrated the portfolio of our money market and income funds based on our interest rate outlook and will remain alert to any developments that may influence our investment strategy.