# Capital Market Review

NBP FUNDS
Managing Your Savings

July 2022

## Stock Market Review

During the month of July-22, the benchmark KSE-100 index fell by around 1,390 points, translating into negative monthly return of 3.3%.

The market remained in the positive territory during the first half of the month as there was growing optimism and signals from the Finance Minister that the country has met most of the conditions of IMF. Index rebound was also triggered by healthy price upticks in heavy weight E&P stocks, as ECC of the Cabinet decided to revise upward the gas prices for various categories of consumers. The step was important to arrest revenue shortfall of gas distribution companies and at the same time improve cashflows of entire energy chain. The energy sector stocks reacted positively to this development. Staff-Level Agreement (SLA) with IMF was reached mid of the month to complete the combined 7th & 8th reviews of Extended Fund Facility. Subject to Board approval, about USD 1.2 billion will become available while IMF Board will also consider an extension of EFF until end-June 2023 and an augmentation of access by SDR 720 million that will bring total access under the EFF to about USD 7 billion. However, unexpected result of by-elections on 20 seats in Punjab where PTI became largest party in the province by trumping PML-N and bagging 15 seats, sparked uncertainty over continuity of the present government set-up. This political uncertainty brought forth economic uncertainty, as investors appeared wary of the ongoing precarious economic situation. During the month, SBP raised the Policy Rate by further 125 basis points, taking the benchmark rate to 15%. Inflation reading for the month of July-22 clocked in at 24.9% driven by high food and energy price increments on a yearly basis. Owing to sharp increase in current account deficit (CAD) of USD 2.3 bn in June (FY22 CAD of USD 17.4 bn, up from USD 2.8 bn in FY21) and accompanying decline in SBP reserves, there was immense pressure on Rupee, that fell massively by 17% during the month under review and shook the confidence of the investors. Rising yields on some of Pakistan's international Sukuks and Eurobonds that reached alarming level of around 50% further unhinged confidence as it also fuelled the solvency concerns of the country. Thus, the KSE-100 index fell by around 2,000 points during the second half of the month, to settle at 40,150 points.

During the month, Commercial Banks, Food & Personal Care, Glass & Ceramics, Oil & Gas Exploration, Oil & Gas Marketing, and Technology & Communication sector stocks outperformed the market. On the contrary, Auto Assemblers and Parts & Access., Cable & Elec. Goods, Cements, Engineering, Fertilizers, Pharmaceuticals, Refinery sector stocks lagged behind. On participant-wise activity, Individuals & Foreigners emerged the largest buyers, with net inflows of around USD 9 million and USD 7 million, respectively. On the other hand, net outflows of around USD 12 million and USD 8 million were seen from Mutual Funds & Insurance, respectively.

The key economic challenge has been on the external front and with signing of IMF SLA and with global commodity super cycle waning gradually, we remain cautiously optimistic on the ability of the country to steer through the ongoing challenges. With IMF deal, flows from friendly countries will also follow through and the resumption of multi-lateral funding will also materialize that will help shore up FX reserves. Inflation is likely to remain elevated throughout the year with an accompanying tight monetary setting. Though it will moderate economic growth, it will be more sustainable and durable. In terms of corporate earnings, we acknowledge that backdrop remains challenging due to recent budgetary measures (10% one-off tax) and the economic measures (utilities and fuel price rationalization). Furthermore, due to mounting inflationary pressures amidst steep devaluation seen in the last few months, demand and as well as margins of cyclical corporates may also come under pressure. However, for other sectors that remain insulated from demand pressures, and are beneficiary of PKR devaluation and Interest rate upcycle like Oil & Gas, Power Generation, Fertilizers, Technology, and Commercial Banks, we expect robust earnings growth going ahead, offsetting the decline in cyclical sector profitability. Therefore, we expect that overall corporate profitability would continue to grow, albeit at a modest pace. The recent corporate result announcements also strengthen this view, where companies have posted record pre-tax earnings. We again re-iterate that current stock market valuations compensate for the risks highlighted and any tangible improvement on economic front is expected to trigger a strong relief rally.

From fundamental perspective, market is trading at an attractive Price-to-Earnings (P/E) multiple of 4.2x, 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

During the outgoing month, Monetary Policy Committee (MPC) raised policy rate by 125 basis points to 15 percent. Also, interest rates on EFS and LTFF loans were linked to the policy rate to strengthen monetary policy transmission, incentivizing exports by offering a discount of 500 basis points relative to the policy rate. Amid exceptionally challenging and uncertain global environment, inflation is at multi-decade highs in most countries and central banks are responding aggressively, leading to depreciation pressure on most emerging market currencies. The headline inflation rose significantly to 24.9 percent in July - associated with the broad-based increase of energy (reversal of energy subsidies), food and strong demand-supply shocks. This unwarranted fiscal impulse was compensated in the recent budget by targeting a primary surplus of 0.2% of GDP, on the back of higher tax revenue. For FY23, headline inflation is projected to remain elevated at around 20 percent – subject to the risks arising from global commodity prices, domestic fiscal policy stance in election year, and FX reserves position. The net liquid foreign exchange reserves with SBP also shrunk to USD 8.6 billion (as at 22-Jul-22) against USD 9.8 billion in June.

SBP held two T-Bill auctions with a target of Rs. 1,150 billion against the maturity of Rs. 985 billion. In the first T-Bill auction, an amount of around Rs. 479 billion was accepted at cut-off yield of 15.75%, 15.80% and 15.94% for 3-month, 6-month and 12-month tenures. In the second T-Bill auction, an amount of Rs. 966 billion was accepted at the same cut-off yield of 15.75%, 15.80% and 15.94% for 3-month, 6-month and 12-month tenures, respectively. In the PIB auction, bids around Rs. 145 billion were realized for 3-years and 5-years tenures at cut-off yield of 14.00% and 13.45% 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.