NBP Fullerton Asset Management Ltd.
A Subsidiary of National Bank of Pakistan

Dr. Amjad Waheed, CFA
Chief Executive Officer

Don't Get Spooked By Market Swings

Local equities exhibited extreme volatility during August as captured in around 3,100-point (9%) wild swing in the benchmark KSE 100 Index during the month. The above was driven by emerging fears of a global economic slowdown and deflation; unexpected devaluation of the Chinese Yuan, raising fears of a currency war; a sharp drop in global commodity prices, especially oil; and heavy battering received by regional currencies and bourses earlier in the month. Notwithstanding some rise in volatility, we hold a positive view on the local stock market in the medium- term premised on (i) reasonable valuations; (ii) improving security situation; and (iii) an upbeat macroeconomic outlook, the three key determinants of long-term local equity market performance.

Following launch of Operation Zarb-e-Azb and implementation of National Action Plan, the security situation in the country has considerably improved. There has been a marked decline in suicide attacks, target killings and other terrorist-related incidents. A recent OICCI survey with leading foreign investors in Pakistan on matters related to security shows a positive change in Pakistan's security environment. The survey reveals that 74 percent of the respondents mentioned a reduction in security incidents. Seventy three percent responded that, compared to the situation in 2013, their staff people feel more comfortable in their commutes to the workplace and back.

The landmark decision by the Judicial Commission, constituted to probe PTI allegations of mass rigging in the 2013 general elections, that polls were in large part organized and conducted fairly and in accordance with the law has removed a major source of political uncertainty, and strengthened legitimacy of the federal government enabling it to focus on pressing economic issues. We believe that the recent de-seating of two PML-N MNAs, including the National Assembly speaker, by an election tribunal will have limited political repercussions for the ruling party given its strong majority in the lower parliament and strong public support in Punjab. However, widening investigations by federal agencies against corruption in Sind province has created some political noise.

On the macroeconomic front, we anticipate GDP growth to further accelerate to 4.5% in FY16 on the back of strong performance by construction, transport and communication sectors. Due to low oil prices and contained money supply growth, headline inflation is also likely to remain subdued at 5% during the current fiscal year. External account should also remain robust due to lower oil prices, healthy remittances, rising FDI and official loans.

We expect foreign exchange reserves to cross USD22bn mark by FY16 end. Being a net commodity importer and an economy mainly reliant on domestic demand for economic growth, Pakistan should greatly benefit from lower commodity prices and should be less affected by a global slowdown.

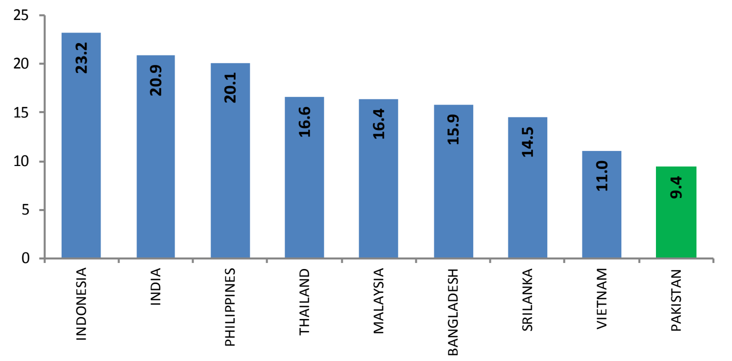
Current market valuations as captured in the forward Price to Earnings ratio of 9.4 are also quite attractive compared to regional market valuations and muted yields on the alternative fixed income avenues. Though earnings growth for the next four quarters would slowdown to 8.4%, mainly due to a slump in banking, and oil & gas sector profits driven by lower interest rates and oil prices respectively, we expect double-digit earnings growth to resume in the subsequent years. Further, excluding the aforesaid sectors, earnings growth over the next four quarters is expected to be a healthy 14.6%. However, going forward we may experience bouts of volatility in the market driven by global policy uncertainty and evolving developments in the ongoing drive against corruption. That said, we recommend that investors should focus on improving macroeconomic fundamentals andattractive stock market valuations and should build position in equities if their investment horizon is 2-years & above.

Macroeconomic outlook remains upbeat

	FY2015	FY2016E
GDP Growth	4.2%	4.5%
Foreign Exchange Reserves (USD bn)	18.7	22.6
Import Cover (number of weeks)	20.9	25.8
Current Account Deficit as % of GDP	0.8%	0.5%
Fiscal Deficit as % of GDP	5.3%	4.7%
Inflation	4.6%	5.0%
SBP Discount rate	7.0%	7.0%

Source: SBP, Economic Survey, Annual Plan 2015-16, NAFA Research

KSE trading at a sizeable discount to peers



Source for Regional PER: Bloomberg