

Asim Wahab Khan, CFA
Chief Investment Officer

During the outgoing week ending 15th July, post long Eid break, the stock market exhibited strong pull back as KSE-100 index increased by around 731 points, translating into a weekly return of 1.8%. Trading activity also picked up on a week on week basis, and most of the major sectors contributed positively to the index movement, with Banks, Cements and E&Ps taking the lead.

After long Eid holidays, the stock market started off the week on a positive note. Having met most of the conditions of the IMF, there was growing optimism that the country has inched closer to gaining approval of the IMF, which has been long due now. Secondly, the index rebound was triggered by healthy price upticks in heavy weight E&P stocks, as the ECC of the Cabinet decided to revise upward the gas prices for domestic as well as commercial and other categories of consumers. Much of the rate increase has been made to the commercial and industrial consumers. Though rates for domestic consumers have also been raised, steep increase has been made into the high consumption category. Though it will further accelerate inflationary pressures, the rationalization of tariffs was important to arrest the revenue shortfall of gas distribution companies and at the same time improve the cashflows of the entire energy chain and the energy sector stocks reacted positively on this development. The ongoing retreat in international commodity prices also breathed optimism in the market, as palm oil prices further corrected, and crude oil prices also continued their downward trend. As both commodities constitute a big chunk of imports, it will likely materially ameliorate our trade balance going forward. The government also did not miss the opportunity to pass on the impact of reduced oil prices and slashed retail fuel rates in the recent fortnightly price revision. Lastly and most importantly, the IMF finally reached a staff-level agreement with Pakistan on policies to complete the combined 7th and 8th reviews of Pakistan's Extended Fund Facility (EFF). Subject to Board approval, about USD 1,177 million (SDR 894 million) will become available, bringing total disbursements under the program to about USD 4.2 billion. Additionally, in order to support program implementation and meet the higher financing needs in FY23, as well as catalyze additional financing, the IMF Board will consider an extension of the EFF until end-June 2023 and an augmentation of access by SDR 720 million that will bring the total access under the EFF to about USD 7 billion.

In terms of trading activity during the week, Individual & Foreigners were the largest buyers with net inflows to the tune of USD 2 million and USD 1 million, respectively. On the contrary, Banks/DFIS & Insurance remained the largest sellers with net outflows of USD 1 million each.

Looking ahead, we are of the view that economic backdrop is set to improve going forward. Inflation is likely to remain elevated throughout the rest of the year with an accompanying tight monetary setting during the year. Though it will moderate economic growth, it will be more sustainable and durable. The key challenge has been on the external front and with signing of IMF staff level agreement and with global commodity super cycle showing signs of weakness, 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.

In terms of corporate earnings outlook, the recent budgetary measure (10% one-off tax) and the economic measures (Utilities and fuel price rationalization) will squeeze the near-term earnings profile of listed corporate sector. Furthermore, due to mounting inflationary pressures amidst steep devaluation seen in the last few months, demand and as well as margins of the corporates may also come under pressure. Having said this, we again re-iterate that current stock market valuations compensate for the risks highlighted. Any tangible improvement on economic front will trigger a strong relief rally.

Looking at the fundamentals, the valuations of stock market remain inexpensive. Corporate profitability growth is expected to grow by around 15% in FY22, despite imposition of 10% super tax. For FY23, we expect the growth to moderate to 9.1%. Due to lackluster market performance, Price-to-Earnings Ratio (P/E) has come down to a multi-year low of around 4.5 times (earnings yield of around 22%).

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.