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During the outgoing week ending 2nd September, the stock market receded slightly and the benchmark KSE-100 index shed around 282 points (0.7%) on a week on week basis. Except for cement and engineering sectors, other key sectors closed in red. In terms of Index movement, heavy weight commercial banks and oil & gas sector dragged down the index.

The muted performance of the market during the week can mainly be attributed to the cautious approach of the investors amidst wide spread flash floods in the country owing to unprecedented monsoon rainfalls. In addition to the irreparable human life loss, the economic loss is also significant. Though it is still a little early to quantify the damage inflicted upon livestock, crops, households and infrastructure, but initial estimates are not encouraging. Some industries, which depend heavily on farm economics, are already facing pressure in terms of demand and have already started to observe non-production days, as per their notices sent to the PSX. Investors remained particularly concerned about the impact of floods on the health of the banking sector, fearing deterioration in the loan quality. Construction sector stocks caught the attention of investors, as investors hoped that rehabilitation of the infrastructure and households will give an impetus to the demand. During the week, the country received USD 1.16 billion from the IMF, as loan tranche of Extended Fund Facility (EFF), but it failed to excite the investors. Inflation, as measured by CPI surged to multi decade high level of 27.3% for the month of Aug-22, which also dented the sentiments. The disruption and damage to crops will likely keep inflation elevated in coming months. Trade deficit for the month of August narrowed by 27% on a yearly basis, declining to USD 3.2 billion, owing to curbs imposed on imports and modest energy imports.

In terms of trading activity during the week, Banks/DFIs & Individual were the largest buyers with net inflows to the tune of USD 3 million & USD 2 million. On the contrary, Insurance remained the largest sellers with net outflows of USD 7 million. Alongside, Foreigners also sold stocks worth USD 1 million.

Going forward, we acknowledge the economic challenges facing the economy, further aggravated by the recent floods. Large swathes of farmland have been inundated, crops have been washed away, infrastructure has been damaged and areas have been cut off. Not only it will moderate the already feeble economic growth, it will also result in acute supply disruption in the short term resulting in spiraling prices of food items. We have already started to see its impact and it is likely to remain so for a few months before the next harvest. As a consequence, inflation is likely to increase further. Moreover, it might have implications on the trade balance as well, depending upon the extent of crop damage and extent of economic slowdown. Having said this, we reckon that it will be a short-term phenomenon and after some weeks, as the rehabilitation begins, we will begin to see demand recover. So, near terms earnings of few sectors such as textile & cyclicals may come under pressure. However, looking beyond, we believe that the demand should recover and hence we continue to see healthy growth in listed corporate space. Furthermore, the fundamentals of the market (Price-to Earnings ratio and Price-to-Book ratio) are such that any recovery in demand would reflect in the price performance.

Looking at the fundamentals, Price-to-Earnings Ratio (P/E) of the market is at multi-year low of around 4.4 times (earnings yield of around 23%). There is a strong investment case for equities. Therefore, we advise investors with medium to long-term investment horizon to build position in the stock market through our NBP stock funds.