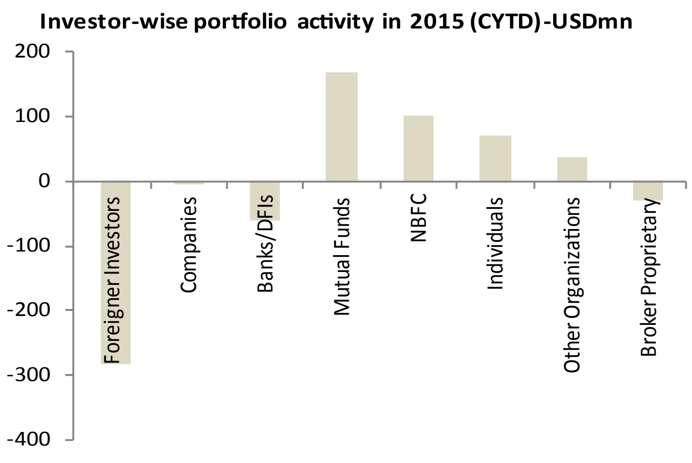
Dr. Amjad Waheed, CFA
Chief Executive Officer

Pakistan Stock Market Outlook

The local stock market has remained in the doldrums in CY15, returning a paltry 0.4% year-to-date. It is pertinent to mention that our NAFA Stock Fund has delivered 7.3% return during calendar year-to-date, net of mangement fee and all other expenses. There has been little progress on key structural reforms in the country related to broadening of tax base; electricity generation and distribution; and privatization and/or restructuring of loss-making State Owned Enterprises (SOE). However, the economy is in a better shape helped by a dramatic fall in global commodity prices, notably crude oil and base metals. Headline inflation continues to remain benign, external account position has strengthened, foreign exchange reserves are at a record high, fiscal deficit is contained, and GDP growth is expected to marginally improve due to lower input costs. So why has the stock market performance been lackluster despite (i) improving economic fundamentals; (ii) reasonable valuations as captured in 8.4x forward earnings estimates; (iii) record-low interest rates; and (iv) easy liquidity conditions? We ascribe the above to two key factors: (i) significant net foreign selling; and (ii) short-term corporate earnings slowdown led by energy and bank stocks.

Despite improving prospects of broader economy, the Karachi Stock Exchange, being dominated by banks and energy stocks, has witnessed a slowdown in profitability growth due to an earnings drag created by sharply lower oil prices and interest rates.

Foreign investors have been selling in the emerging markets on fears of a sharp economic slowdown led by China, rising pressures on the currencies amid expected US Federal Reserve interest rates lift-off and heavy redemptions by oil-based sovereign wealth funds. Following the aforesaid trend, foreign investors have pulled out USD 280 million (PKR29.5billion) during calendar year-to-date from the Pakistani stock market.



Source: NCCPL

Going forward, we expect foreign selling to gradually subside as: (i) investors realize improving growth prospects of the domestic economy in low commodity prices environment; (ii) Pakistan re-enters widely tracked MSCI EM Index in Mid-2016; and (iii) corporate earnings resume their double digit growth as impact of commodity price and interest rate decline dissipates.

On the corporate earnings prospects, the crude oil prices have come down to US$40/barrel from US$100/barrel last year driven by a combination of supply gut; and expected demand slowdown from slowing emerging economies, notably China. Consequently, interest rates have also declined to mid single digits impacting profitability of commercial banks. We strongly feel that oil prices are bottoming out in view of decent demand growth and expected supply cut by a sharp decline in rig count of the US Shale producers and budget cuts by conventional oil producers. In view of the foregoing, we expect double-digit earnings growth to resume driven by a gradual recovery in oil prices and interest rates over the next 6-12 months.

The stock market has performed exceptionally well over the last 5-years delivering a healthy 23% average return per annum. We expect that the stock market is poised to deliver a decent double digit return going forward, which will still be higher than the 4-7% yield expected on the bank deposits and treasuries.