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A Subsidiary of National Bank of Pakistan

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Heavy Correction at the Local Bourses – a buying opportunity

Defying improving fundamentals, the stock market underwent heavy correction in March with the benchmark KSE-100 Index falling by 10.1% during the month that unnerved the investors. The key reason for the aforesaid sharp decline was 1) hefty foreign selling reportedly by a hedge fund facing heavy investor redemptions 2) selling by weak retail investors and mutual funds in the falling market. However, the fundamentals of the stock market and the economy are intact. A combination of attractive valuations, improving macroeconomic indicators and monetary easing underpins our sanguine view on the market.

The worldwide plunge in commodity prices, particularly energy, has put Pakistan's economy in a sweet spot. Headline inflation has hit low single digits; the current-account deficit is shrinking; rupee has been stable; fiscal deficit remains well-contained and GDP growth is picking up due to lower input costs and higher household incomes. The economy seems to be on an increasingly sounder footing as the sharp decline in oil prices provides multiple benefits to a country that imports four-fifths of its oil, relies significantly on erstwhile expensive furnace oil to run its power plants, and doles out huge energy subsidies.

Moreover, key economic indicators have further improved since January (see table) when the stock market hit an unprecedented high of 34,827.

- Inflation has declined to 2.5% in March from 3.9% in January.
- SBP has cut its policy rate by 50bps to 8.0%.
- IMF has approved the seventh tranche amounting to US $500mn of the Extended Fund Facility (EFF) loan following a successful review.
- Current account deficit has shrunk to US $ 1.6bn in 8Months of FY15.
- Forex reserves have increased to US $ 16.1bn in March
- Moody's has upgraded outlook on Pakistan's Foreign Currency Government Bonds to Positive from Stable.
- Pakistan's sovereign debt Credit Default Swap (CDS) spreads have significantly narrowed by 169bps to 443 bps from 612 bps on January 28, 2015.
- 10-Year PIB yield has declined to 9.4% by March-end from 9.8% in January.

Key indicators have improved since January

	Mar-15	Jan-15
KSE-100	30,234	34,444
Market PE	8.3x	9.5x
Inflation	2.5%	3.9%
SBP discount rate	8.0%	8.5%
Foreign Exchange Reserves (USDbn)	16.1	15.2
Import cover(weeks)	16.7x	15.2x
Moody's outlook	Positive	Stable
Current account deficit-YTD (USDbn)	-1.6	-2.4
BOP surplus-YTD(USDbn)	1.3	0.5
10Y PIB yield	9.4%	9.8%
Pakistan 10Y CDS	443bps	612bps*

*January 28, 2015
Source: KSE, PBS, SBP, Bloomberg, NAFA

After the recent rout, local equity market valuations have become extremely attractive. At current levels, the stock market trades at 8.3 times next year earnings and offers a dividend yield of 6.5%. The above is a 41% discount to the regional market average PE of 14 times. Further, the dividend yield is over two times the regional average of 2.9%.

We have largely maintained exposure in equities in our equity related funds and portfolios during the month considering the present investment landscape. We advise investors that this correction is a short term phenomenon and an opportunity for the value investors to build positions in the market considering the favorable investment backdrop for equities. We also recommend investors to consider our NAFA Stock Fund and NAFA Multi Assset Fund for investment in equities as these funds have out-performed their respective benchmark and peer average by a large margin during the last 5-year period.