

PM Disqualification: What is next for the Stock Market?

Sajjad Anwar, CFA
Chief Investment Officer

Over the last couple of months, heightened domestic political uncertainty related to the Panama Leaks Case against the Prime Minister and his family clouded the investment landscape, souring investors' sentiments. While it is not our role to wade into political debates, we feel that it is our obligation to help our clients think through the issues such as shifting domestic politics post disqualification of PM in a Panama Case verdict by the apex court that have economic and investment implications.

Friday, July 28th was an unprecedented day in the history of Pakistan as five members larger bench of Honorable Supreme Court unanimously disqualified PM Nawaz Sharif from holding public office and directed that criminal charges be filed against him and his family. It was also a testing day for investors as the market opened gap down and corrected by around 2% before the announcement of decision. Panic ensued post Supreme Court verdict and at a point in time the benchmark KSE-100 index slumped by as much as 3.8% from the previous day's close. Ostensibly, the decision was negative, but it also served to end an extended period of incertitude which kept investors on the sidelines. After initial knee jerk reaction, Investors' confidence begin to return amid the ruling party decision to respect the Supreme Court judgment instead of resorting to any violence or clash of institution with market regaining all the lost ground to close flattish.

We see the decision as beginning of long-awaited and much-needed process of accountability without fear and favors and supremacy of rule of law that will ultimately pave the way for the institutional strength. The clarity regarding the economic policies will emerge with the announcement of new prime Minister and a new cabinet.

As the amplified uncertainty diminished for now, with ample domestic liquidity and attractive valuation of the stock market, we expect a brief relief rally from the current levels in the near term. However, we may see episodic volatility spikes due to shifting domestic political situation, rising global policy uncertainty, and simmering geopolitics strains in the Middle East. Political noise may increase as the court has also ordered NAB to file reference against Mr. Nawaz Sharif and family in six weeks and conclude the trial in six months.

While risks to Balance of Payment (BoP) position has increased due to widening trade deficit that entails credible policy measures for medium term stability, we don't see crises situation in the near-term due to healthy reserve accumulation and capacity to finance current account deficit amid abundant global liquidity and country's capacity to borrow. We see economic growth trajectory to remain on course as the investment activity in power & infrastructure in the context of CPEC and private sector expansion would not be derailed by the recent political developments. Similarly, we expect the ruling party will resume its focus on the economy and the development initiatives announced in the federal budget ahead of general elections scheduled in 2018. Improving energy availability, healthy profit margins, robust demand, and benign financial cost would support corporate profitability.

All said, we reiterate our positive outlook on the stock market for long term investors with our view premised on attractive valuations, improving economic growth prospects, benign near-term inflation & interest rate outlook, abundant local liquidity, and healthy double digit corporate earnings growth. We expect foreign inflows to resume in due course as the recent sharp correction of around 13% from its high hit on May 24, 2017 has widened valuation gap vis-à-vis regional markets. We advise investors to focus on the long-term investment objective and gradually accumulate position instead of waiting for the return of perfect investment condition.

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