Faysal AssetManagement

PSX purview amidst Political noise (JIT decision) and updates in capital markets ("artificial" currency movement etc.)

June 30, 2017

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Last week the rupee tumbled, and yet the currency market did not panic. The stock market has shed 5,768 points since May 31, with billions of rupees evaporated, but the losses have been endured quietly.

Are Political factors exploiting market movements…? Addressing genuine concerns…!

The business community tracked JIT developments closely but despite this possible threat to the stability of the political system it does not appear to be particularly nervous.

Can this cool be interpreted as the growing maturity of the private sector of Pakistan? Have they accepted political uncertainties as a certainty and adjusted accordingly?

Why does the PML-N leadership that revived the GDP growth rate not enjoy the active support of the business community? Is the class too preoccupied with some other set of problems to care about the JIT or its outcome?

The position adopted by traders and manufacturers varied, with the former more vocal in defense of the sitting government.

Under the current government the tilt in the policy framework has become more pronounced, with manufacturers and exporters not being extended the support they require to compete locally and globally.

The falling exports and squeezing margins did not allow them to invest in expansion and modernization, while traders multiplied their fortunes on consumption-led growth.

The community had already factored in the volatility of the markets in the wake of political uncertainty in an election year. Besides, despite noisy debate, they did not expect a major disruption in the system at this point, whatever the outcome of the JIT.

Most leaders were not in favor of extra-constitutional solutions. Though we get better access to the corridors of power under a Martial Law, and economic management improves, military rule always ends violently, wiping out much of the gains. All said and done direct rule is unsustainable in this country, with interests in the cement and power sectors.

Over time, people have gotten used to political polemics. Close to the election political debate dominates public discourse everywhere. Many of the members in the fast-moving consumer goods, auto, cement, and fertilizer and power sectors are doing well but can do better if long-standing issues of tax anomalies and tax refunds could be addressed promptly.

As much the PML-N leadership liked to hinge Pakistan’s future to its own, the private sector was not convinced. They hoped that the case and the JIT will increase respect for the rule of law by power-wielders. In the case of Nawaz’s removal from office the PML-N should re-elect another parliamentary leader and complete its term.

Some circles are utterly disappointed with the Sharif brothers and blamed Finance Minister Ishaq Dar who allowed the textile base of the country to erode at a big cost to the economy.

Textile industrialists were fighting a battle for survival with ongoing protests by textile mill owners in Punjab.

The textile sector has been warning the government about slippage in exports but the relevant people have been too busy to pay attention. Now the trade deficit of $33bn is compromising external sustainability. Even today if the government moves to address long-standing issues related to a higher cost of production compared to our competitors, the textile industry of Pakistan has the potential to scale-up exports by billions of dollars on its own by commissioning idle capacity.

For the business community the JIT was a side topic. Some expect too strong a reaction from corporate Pakistan even if the JIT decides against the premier. Despite unending theatrics in the political arena and TV studios the fact is that donors trust Pakistan better today than ever before. New loans are contracted at favorable terms and cheaper interest rates.

Hopes have been raised that the Pakistan Stock Exchange will be able to attract a wider segment of investors following the Chinese acquisition of 30% stakes in the bourse and listing of PSX shares for trading. Big tycoons like Arif Habib want Chinese Consortium to be allowed to trade in the secondary market and raise its shareholding in the PSX to 51%. Chinese can currently invest in listed shares and not the PSX shares. This anomaly should go in order to provide the Chinese with a level playing field.

Seven applications of companies in different fields of business and industry including life insurance, food, pharmaceutical, technology, distillery, and brokerage houses are being processed by the PSX.

Estimates are that about a dozen companies could be listed in the course of the next one year.

Besides, companies such as steel mills and cement producers are also issuing right shares to raise funds — for both expansion and working capital — in cases where bank borrowing is expensive or difficult.

Currently the number of shareholders in the listed companies is stated to be very low, just over one million and only 0.25m on Central Depository Company (CDC) records.

A number of factors are stated to have contributed to this state of affairs: a lack of public awareness about the intricacies of stock trading and a negative perception that bourses are not an avenue for investment but a place for gambling, a wide held view as apparent from market volatility and speculative activity.

So, how can the market escape volatility when the country's politics is so volatile?

Certainly, the economy is not immune to the government's inconsistent policies. All this have an impact on the financial health of the listed companies.

Other reasons for low investor participation are stated to be limited outreach of securities houses and a low rate of domestic savings.

It is felt that brokerage services should be extended to more cities where potential investors remain untapped. Even in Karachi, which is supposed to be the country's financial hub, there is a vast scope to increase business.

Ten financial institutions, including CDC, operating in the capital market are stated to have joined hands to expand outreach and extend the one-window operation to attract potential investors. One may, however, express some reservation about them setting up office in a place like Abbotabad.

Perhaps more problematic in attracting potential retail investors is the issue of liquidity and paltry free float of shares.

Often it is difficult for an investor to exit the market without incurring a loss owing to the prevailing market price of shares held by them, complains an investor.

Very few individuals have the skill to independently navigate the market and for them the best choice is to invest in mutual funds.

But the size of the combined mutual funds portfolio is reckoned to be smaller than the volume of investments made by the upper bracket of high-net-worth individuals or funds belonging to big business houses.

Critics say the stock market is narrow, shallow and lacks the required depth. That, they say, explains much of the market volatility. The number of listed companies is 561 while hardly 50 are active.

Some of the best performing companies buy back their shares because of nominal float of their stocks and the uneconomical cost of remaining listed.

For one reason or the other, the number of listed companies has remained stagnant for a long time.

In the United States, the situation is similar. JPMorgan just announced re-purchase of $19.4bn worth of shares over the next year with the intention of increasing quarterly dividends from 50 cents to 56 cents.

The Bank of America will buy back $12bn in shares to raise its dividends by a stipulated 60pc to 12 cents.

The present course of development of bourses tends to deviate from their original objective to widen corporate, industrial and business ownership.

Nor do market players in Pakistan seem to be very keen, as evident from the lack of a structured approach, to attract more retail investors.

In India, banks used their countrywide network to increase the number of investors in the bourse by providing ‘end to end’ and ‘stop to stop’ services for stock trading.

The sudden melodrama of Rupee fall adding fuel to fire…

The sudden and surprising decline of the rupee against the dollar by a hefty 3.1%, in the opening hours of interbank trade last Wednesday, left both the money and the stock markets in disarray.

That day, the dollar rose to PKR 108.50, before settling at PKR 108.25 by close, which was billed as the largest single drop in the rupee’s value in nine years.

The Ministry of Finance distanced itself from the drama enacted solely by the State Bank of Pakistan (SBP). A furious finance minister summoned a meeting of top bankers of leading banks a day later.

But what came of it was a mild statement of a ‘communication gap’ between the SBP and the Ministry of Finance, which was — we were told by Finance Minister Ishaq Dar — at the heart of the rise and fall of the dollar against the rupee.

In this day and age, a ‘communication gap’ between responsible people in two cities of the same country, on such an incredibly important issue, is hard to digest.

The Finance Minister stressed that the dollar-rupee parity would be determined by ‘market forces’, but in the same breath pledged that the rupee would be maintained somewhere between PKR 107 and PKR 105. Whither the SBP autonomy?

Stock strategists say that foreigners have been waiting for the currency to find its true value before entering the market.

The Pakistan Stock Exchange (PSX), which boasted of having given investors a CY16 return of 46% —the highest in Asia and fifth highest in the world — a year ago, has been humbled with a minor 2.6% return in the January-June half of 2017.

Barring the United Arab Emirates, China, Qatar and Russia, the PSX index has underperformed most of the regional bourses.

Most market participants complain that foreign investors have been the spoilers of the market.

With 30% of the free-float, they still remain a force to be reckoned with.

During the January-June period, foreign investors remained net sellers and offloaded stocks worth $333 million — over eight times the $41m sell-off during the same period last year.

But the unkindest cut of all was the net selling of $81m by foreigners on May 31, on the eve of Pakistan’s re-entry into the MSCI Emerging Market, in place of the consensus forecast of a huge inflow of $450m.

The fall of the stock market since has been unstoppable and we hear daily stories of investors who have been ruined.

One big reason for foreign funds’ reluctance to enter the PSX has for long been touted by market pundits, analysts and brokers as the foreigners’ belief that the rupee is over-valued.

Stock strategists at brokerage houses that cater to foreign clients say that foreigners have been waiting for the rupee to find its true value, before entering the market, lest the rupee depreciates after they buy stocks and they incur heavy losses.

Lesser dollars would buy more shares after devaluation, so why not wait.

Last Thursday, foreigners made an entry into the market to mop up stocks worth $7m, apparently on the faith of the 3.1% rupee devaluation.

A reversal the next day would find them trapped. Foreign investors, frustrated due to the uncertainty, might now put their investment plans in PSX on the hold for a long time.

Soon after the first news of a devaluation of the rupee last Wednesday, stock brokerages started to release reports on its effect on share prices.

Analysts feel that a gradual/controlled devaluation would be positive for the market, as foreign buyers who have been delaying purchases fearing exchange losses would start to flock in.

Furthermore, in terms of market as a whole, 32% of market capitalization would be positively impacted, 30% would be slightly positively impacted and 16% of capitalization would be neutral.

While it would be slightly negative for 16% of the market and only 6% would face a material negative impact.

During the day (last Wednesday), Investors were busy repositioning their portfolios evident by the sector specific movements.

The losers were the Engineering (-4.3%), Refinery (-3.9%), Cable and Electrical (-3.8%), Auto Assemblers (-3.3%), Cement (-1.6%) and Pharma (-1.4%) sectors, which was likely on the belief that the rupee depreciation may spike raw material costs.

Key Drivers

Thus, Pakistani market's risks have revolved around politics, security and the currency.

While the security situation has considerably improved over the last few years, politics and the rupee are both giving cause for worry.

Accordingly, focus is now set on the submission of findings by JIT to the Supreme Court on Today (July 10), which should facilitate the direction of the ongoing political racket.

Any opportunity of dissipating political clouds could provide a new support to the market. PSX 100 is currently trading at a cheaper price to earnings ratio of 9.2x (2017) compared to Asia Pacific regional average of 13.2x while offering twice as better dividend yield of 5.3% versus 2.6% offered by the region.