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PAKISTAN Strategy

REP-019

MARKET VISTA

KSE-100 Index: Foreign Outflow to continue

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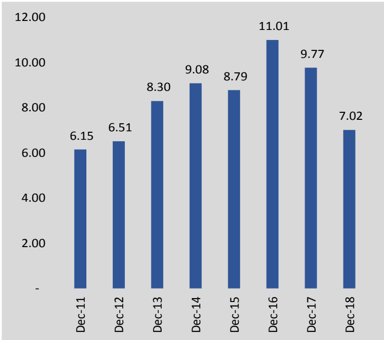
- **Pakistan Equity Market has witnessed foreign net selling of US$300.4mn in CY18TD, cumulatively US$1.4bn since CY15. While idiosyncratic country risks did influence market sentiments, EM market sell-off acted as the final nail in the coffin.**
- **Emerging Markets (EM) are trading at a CY18F P/E of 11.6x, lowest since 2013 and at a discount of 35% to Developed Markets (DM) vs. 23% avg. since 1995. Yet, betting on EM stocks at this juncture would be gutsy in our view, considering the contrast between EM macros and fundamental trends coupled with investor attractive developments in the US.**
- **US growth prospects are influenced from protectionist measures the Trump administration has taken. Part of such measures is the re-negotiation on NAFTA agreement which can spur industrial growth and employability in the US in our view. Additionally, factors such as unwinding of Quantitative easing program (diversion of fund to debt market) and incentive for Trump administration to settle trade related issues before mid-term elections, make US market attractive.**
- **Pakistan macros have not remained immune to EM trends - currency devaluation and interest rate hikes - which should affect growth prospects. While KSE-100 has remained flat CYTD, possibility for further correction exists based on domestic policy turbulence and imported bearish pressure from EM markets. We recommend investors to accumulate on a corrective rally as bottom-up valuation remains strong. Our top picks are MCB, HUBC, ASTL, OGDC, INDU, PPL.**

Revision in NAFTA agreement 'likely': Trump Administration and Mexico have reached accord to revise key portions of the NAFTA (a trilateral agreement between Mexico, Canada, and the US with the purpose to reduce trade barriers), putting pressure on Canada to accept consensus terms. The revised portions are likely to encourage manufacturers to invest more in US and shift production from low-wage Mexico. The points of contention with Canada are; i) U.S. wants Canada to reduce tariffs on dairy products, and ii) changes to NAFTA's dispute settlement process known as chapter 19. We expect progress between US and Canada deal before the final deadline (end of Sep'18) as end of NAFTA means an economic downturn in Canada where the deal could provide political advantage to Trump in mid-term elections. To highlight, US accounts for 73.7% of Canada's exports where 20% of exports are related to auto sector and Trump mulls to hit 25% import duty on such imports.

EM markets to remain under pressure: MSCI EM index has fallen into bear market territory, losing 20% of its value from Jan 26'18 peak. Vanguard FTSE Emerging Markets ETF also followed suit, shedding 11.5%YTD. In sharp contrast, US indices stand close to all-time highs. We believe, despite the undemanding valuations (EM discount to DM: 35% vs. 23% since 1995), EM outlook remains murky in the short-term. Factors supporting our view are; i) uncertainty over the possibility of a broad-based trade war and China's response, ii) fund flow from equities to DM debt when Fed pushes through Quantitative tightening which can accelerate EM currency declines and policy rate hikes, and iii) specific EM country difficulties. On the other hand, US indices are expected to continue their bull run as Trump Administration has meaningful incentives to find deals and end trade disputes (such as NAFTA) before the November midterm elections.

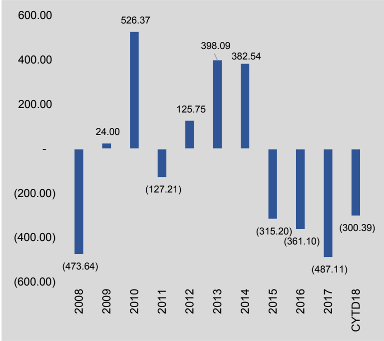
Locals to ride in foreign shoes: Foreigners, despite reducing equity exposure by US$1.4bn since 2015, still own 8.1% of the market capitalization vs. 8.4% in 2015, indicating that the locals have followed foreigners in aligning their portfolio. We expect foreign outflow to continue at least in the short term where domestic liquidity squeezes from diversion of funds to money market instruments in a rising interest rate environment potentially accelerates the sell-off. As such Pakistan market has remained flat CY18TD, after having a bull run for 6 years, we still believe further correction cannot be ruled out. Additionally, investor sentiments could weigh-in uncertainty in domestic policies for addressing country's economic woes. That said, valuation remains attractive with CY19F P/E of 7.0x, lowest in 5 years where we advise investors to gradually accumulate in at lower levels as bottom-up valuation remains strong. Just to recall, emerging-market stocks reached a low in dollar terms a few weeks after the Russian default but doubled in 18 months.

Market trading at 5y low PE



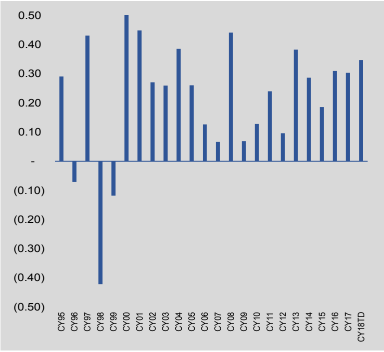
Source: Bloomberg & AKD Research

Foreign Outflow in past 4 years



Source: NCCPL & AKD Research

EM market Discount expanding



Source: Bloomberg & AKD Research

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Neutral	> 10% to < 16% expected total return
Sell	< 10% expected total return (Rf: 10%)

Old Rating Definitions (Discontinued)

Buy	> 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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