2015 remained unexciting, CY16 to be a different story

KSE100 yields 2% in CY15; better days ahead…

- Owing to higher uncertainty arising from plunging commodity prices, hike in Fed rate for the first time in 7yrs, and currency devaluation led by China predominantly affected the performance of financial markets globally in CY15 where MSCI Emerging Index and Frontier Index lost 16.3% and 18.3%, respectively. KSE-100, however, managed to outperform the former two indices by 18.7% and 20.7%, posting a return of 2.4%.
- During CY15, KSE100 index performance was primarily supported by the initiation of the first phase of US$46bn worth China Pakistan Economic Corridor (CPEC). However, in addition to the aforementioned global factors, obstacles in the local market ranging from political noise, tightening scrutiny by the regulatory bodies to the liquidation of a foreign fund constrained the performance.
- In CY15, major constituents of the local broader market i.e. the Oil & Gas and Commercial Banks exhibited lackluster performance losing 32% and 15% on the back of declining int'l oil prices (11yrs low) and SBP's monetary easing stance.
- Whereas, Autos (↑13%), Engineering Sector (↑25%), Pharmaceuticals (↑18%) and Construction (↑8%) performed well backed by higher infrastructural development activities and policy incentives.
- CY15 remained a challenging year for the commodities and currencies, where majors like Oil, Coal and Gold lost 30.9% (WTI Crude), 24.3% and 9.7%, respectively. Following regional currency depreciation frenzy, PkR devalued by 4.5% against the US$.
- Local fixed income securities outperformed rest of the asset classes, where average returns ranged between 5%-10% arising from decline in market yields.
- Going forward, we expect a turnaround in the asset class returns in CY16. Equities are expected to perform in the backdrop of 1) continuation of infrastructural development activities majorly associated with projects under CPEC, 2) possible inclusion of Pakistan into the MSCI emerging space from Frontier. Resultantly, we foresee infrastructure theme to gain investors interest and prefer Cement, Engineering & Allied Products and Autos. Since we don't expect further decline in interest rates, in addition to the local financing required for the initiation of CPEC project, we expect the Banking sector to get participants attention back.
- However the risk to our thesis can arise from both global and local grounds. Depressed global outlook anticipated on the back of decline in major commodity driven economies and any further currency devaluations could further exacerbate the global financial markets affecting Pakistan. The local threats, which include failure of the materialization of CPEC projects due to possible political instability and worsening law and order situation, could dampen the market performance.

Foreigners' participation

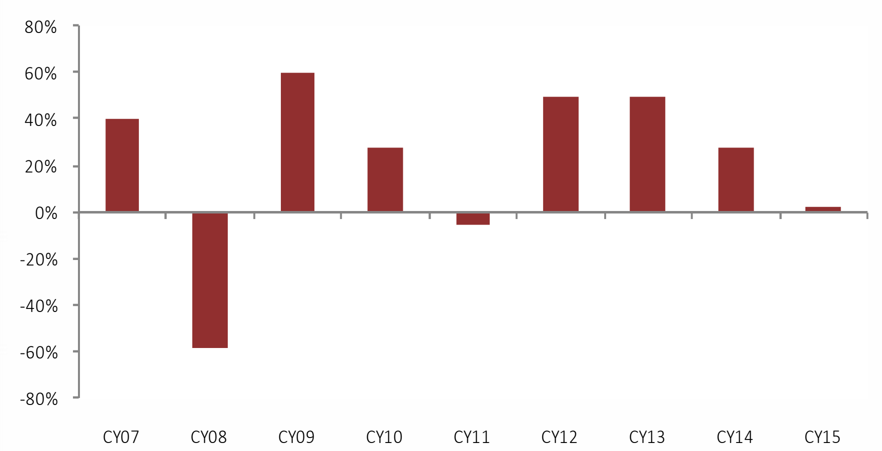
- Net Sellers, not really: Pakistan equities depicted a correlation to emerging economies in terms of foreign flows and resultantly witnessed a net foreign outflow of US$316.62mn in CY15, compared to US$382.54mn inflow from last year. Contrary to the NCCPL FIPI data, we strongly believe that the net flow is tilted inwards during CY15 as foreigners have pumped approximately ~US$800mn in HBL Privatization, which was not routed through FIPI. Hence, after incorporating the privatization proceeds, net inflows clocked in above ~US$480mn.
- IPOs and SPOs: The year included seven Initial Public Offerings (IPO) and two Secondary Public Offerings (SPOs), which on a cumulative basis raised ~PkR14.4bn and ~PkR14.5bn from the market, respectively.
- CPEC - game changer: China and Pakistan inked a 15yr long China and Pakistan Economic Corridor worth US$46bn, which is expected to be completed over three phases. First phase of the particular corridor has already been initiated.
- Euro-Asian giant steps in: Russia signed an inter-governmental agreement for the construction of an 1100km long gas pipe-line with an estimated cost of ~US$2.0bn.
- LNG: CY15 also witnessed the efforts to restore LNG supply from Qatar, Russia and Australia and gas pipeline through Turkmenistan.
- Restoring confidence: Successes in the on-going Zarb-e-Azab operation have enhanced the law and order situation in the country which is expected to further cement investors' confidence.

Proposed Portfolio

Sectors	Index Weights	Proposed Weights	Preferred Stocks	Our Say
Banks	25.3%	15.0%	HBL, UBL, AKBL & MCB	Interest Rate "Status Quo" stance expectation till June'16 to lift the earnings profile.
Insurance	2.9%	2.5%	AICL & IGIIL	Room for growth backed by new projects under CPEC and improved law and order situation, in addition to well diversified portfolio.
Textile	2.8%	1.5%	NML & KTML	Weaker Chinese demand and India's production to keep supply demand glut in place. Any possible withdraw of GSP+ would be a sentiment dampener.
Sugar	0.5%	0.5%	HABSM	Cyclical uptick might drive the price performance in the latter half of the year.
Cements	10.1%	20.0%	MLCF, LUCK, DGKC, PIOC & CHCC	Higher demand outlook with failing coal prices to keep fundamentals strong.
IPPs	9.6%	10.0%	HUBC, KAPCO, NCPL & NPL	Sector provides stable dividend yield with hedge against currency devaluation.
OMCs	3.1%	5.0%	PSO & HASCOL	Improved margins amid expectation of stablity in oil prices to range between ($32-$45 per bbl) for FY16.
E&P	10.0%	12.0%	PPL, OGDC & MARI	Revisions in policy agreements for new and existing fields, makes space for greater exploration efforts and pricing incentives.
Steel	0.3%	6.0%	ASTL, MUGHAL & CSAP	Higher demand arising from various on-going public and private construction projects.
Auto Assemblers	2.4%	4.0%	PSMC, INDU & MTL	Finalization of Auto Policy creating room for existing players to bring new models should generate investor's interest. Additionally, any subsidy to agriculture could create further demand.
Auto Parts & Accessories	0.5%	2.0%	GTYR & THALL,	Increase in demand expected from higher car sales.
Fertilizers	14.8%	9.0%	FFBL, FFC & ENGRO	We prefer FFBL & ENGRO for diversification and FFC for dividend yield.
Misc / Others	1.5%	1.0%	TREET	We prefer TREET based on its expansionary plans into Battery, Healthcare and Education business.
Cable & Electrical Goods	0.6%	1.0%	PAEL	Tax benefits on manufacturing of transformers.
Refineries	0.7%	1.0%	NRL & ATRL	Higher demand of asphalt expected from the road and motorway development projects.
Paper & Board	1.0%	1.0%	PKGS	Improved demand from consumerable segment.
Food & Personal Care	4.6%	3.0%	EFOODS	Higher volumetric sales outlook, coupled with weak farm-gate milk prices expected to boost earnings.
Cash		5.5%		

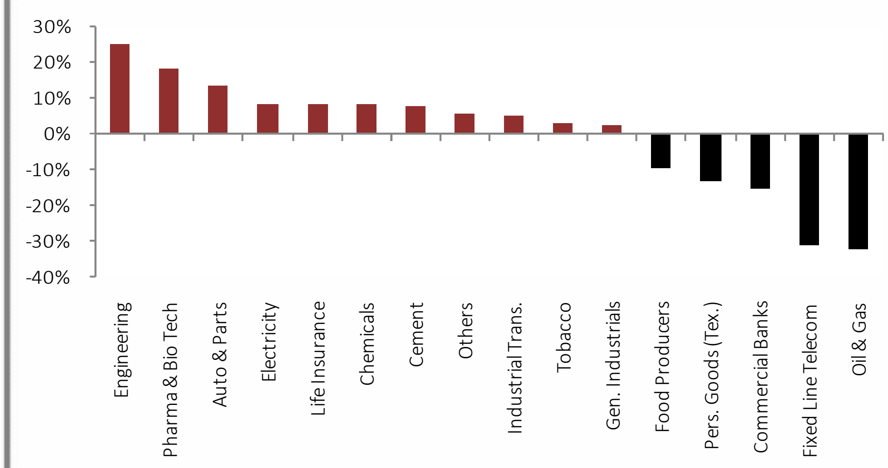
Appendix I

KSE100 Index Returns (%)



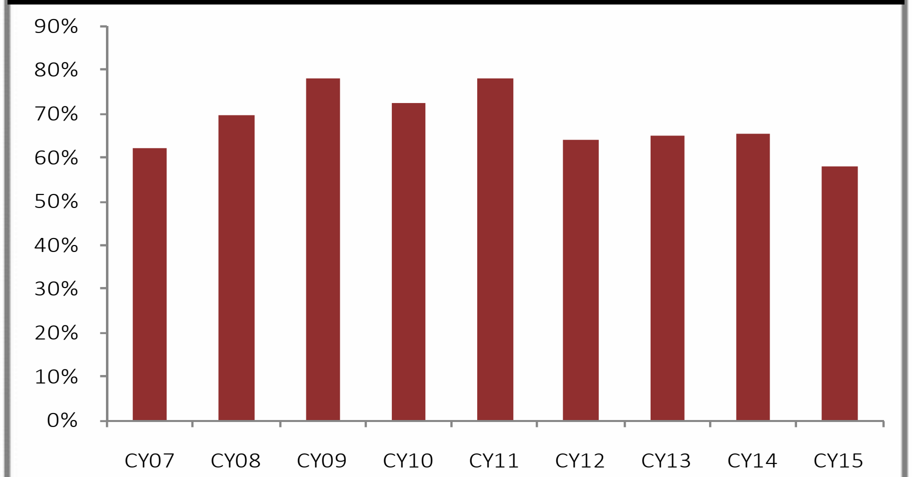
Source: KSE & IFSL Research

KSE Sector wise Returns (%)



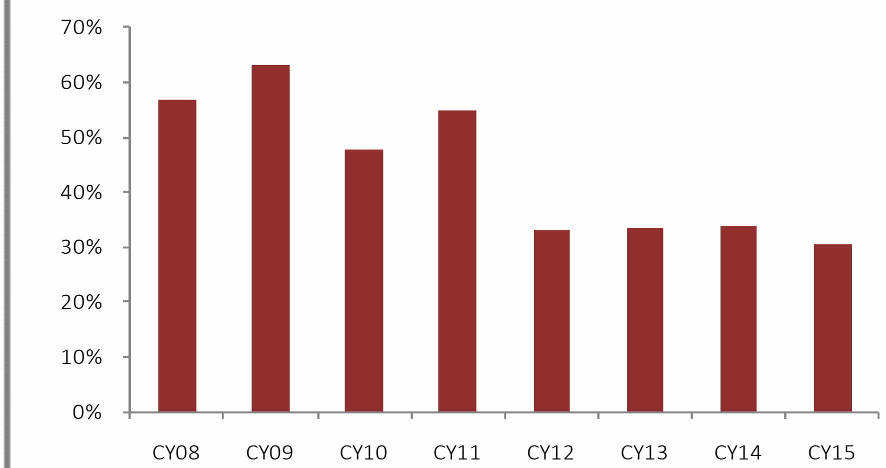
Source: IFSL Research

KSE100 Volume Contribution to All Share Index (%)



Source: IFSL Research

KSE30 Volume Contribution to All Share Index (%)



Source: IFSL Research

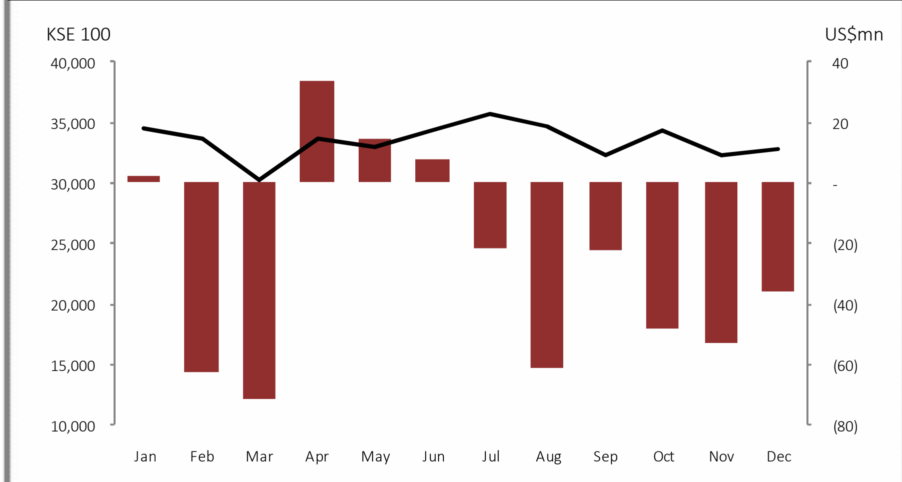
Appendix II

Year	Symbol	Company	Listing / Subscription Date	Total Offer (PkR mn)	Over / (Under) Subcription
Initial Public Offerings					
2015	SINDM	Sindh Modaraba	23/Jan/15	135	-84%
2015	SYS	Systems Limited	03/Feb/15	520	207%
2015	SPEL	Synthetic Products Enterprises Limited	10/Feb/15	581	59%
2015	MUGHAL	Mughal Iron and Steel Industries Limited	15/Apr/15	930	236%
2015	DCR	Dolmen City "REIT"	26/Jun/15	6,115	30%
2015	ASC	Al Shaheer Corporation Limited	24/Aug/15	2,375	148%
2015	ASTL	Amreli Steels Limited	01/Dec/15	3,787	136%
2014	EFERT	Engro Fertilizers Limited	17/Jan/14	2,119	279%
2014	AVN	Avanceon Limited	11/Feb/14	352	6%
2014	HASCOL	Hascol Petroleum Limited	14/May/14	1,413	11%
2014	EPQL	Engro Powergen Qadirpur Limited	27/Oct/14	1,215	125%
2014	SPWL	Saif Power Limited	15/Dec/14	1,449	190%
Secondary Public Offerings					
2015	KEL	K-electric	01/Feb/15	6,580	-44%
2015	EFERT	Engro Fertilizers Limited	01/Apr/15	7,919	179%
Privatization					
2015	HBL	Habib Bank Limited - 2nd Issue	10/Apr/15	102,365	58%
2014	UBL	United Bank Limited	11/Jun/14	38,224	93%
2014	PPL	Pakistan Petoleum Limited	27/Jun/14	15,342	42%
2014	ABL	Allied Bank Limited	11/Dec/14	14,440	41%

Source: KSE & IFSL Research

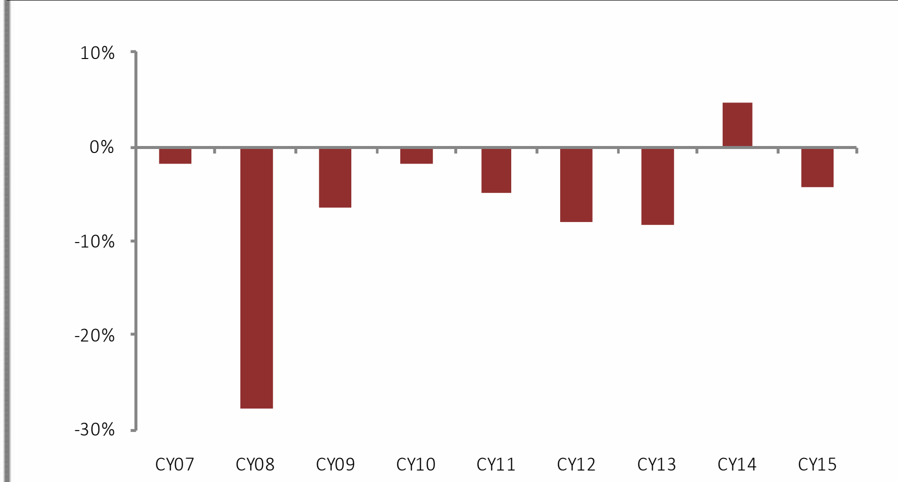
Appendix III

FIPI Net flows vs. KSE100 Performance



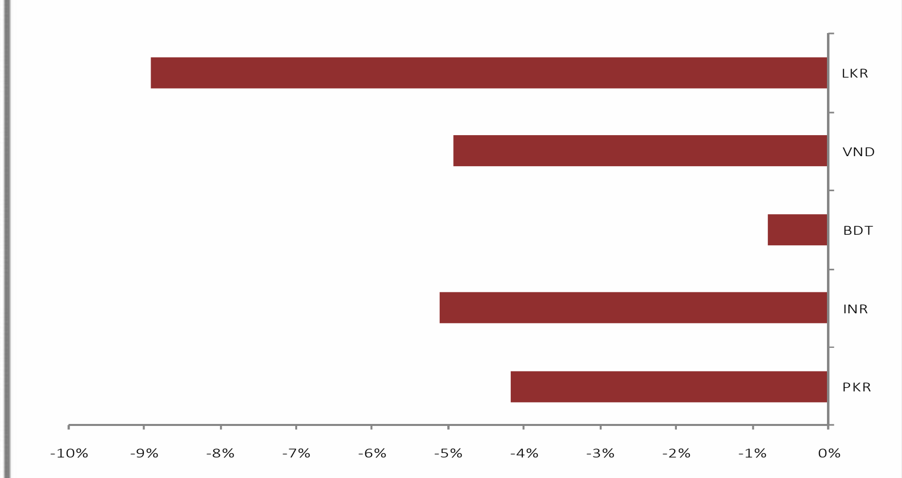
Source: NCCPL, KSE & IFSL Research

PkR vs. US$



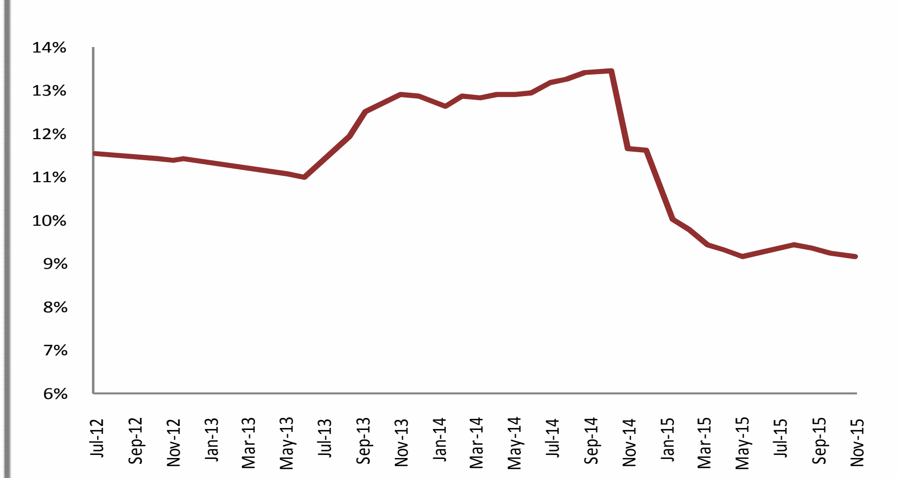
Source: Bloomberg

Regional Currency Performance vs. US$



Source: Bloomberg

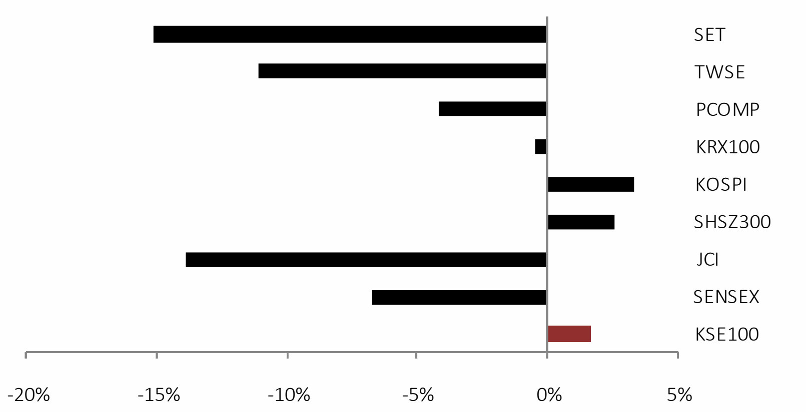
Historical Discount Rate



Source: SBP & IFSL Research

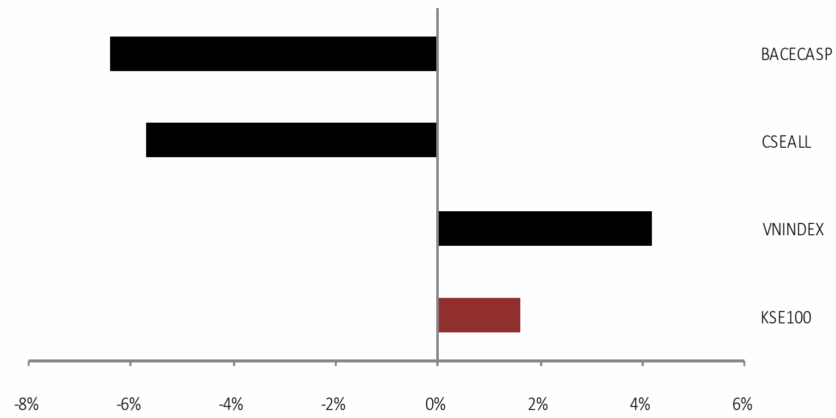
Appendix IV

Emerging Markets Performance vs. KSE-100 (%)



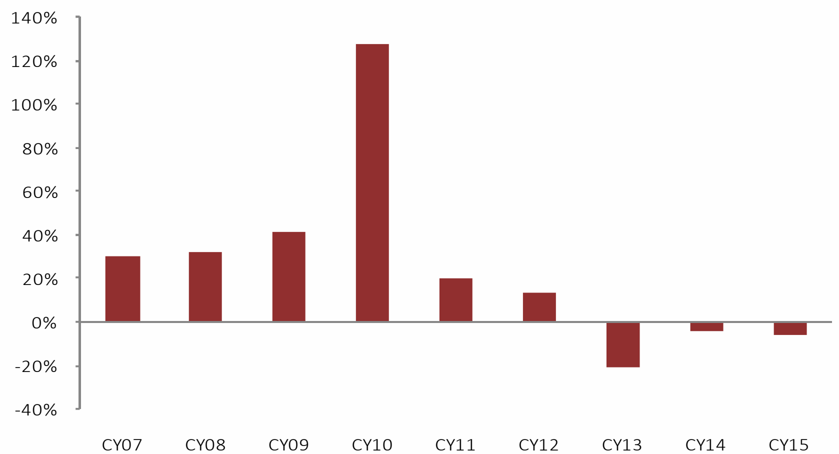
Source: Bloomberg

Frontier Markets Performance vs KSE 100 (%)



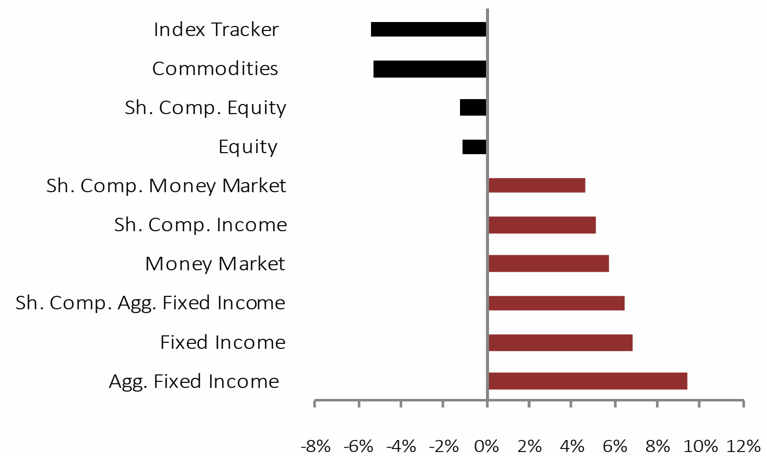
Source: Bloomberg

Annual Gold Return (%)



Source: Bloomberg & IFSL Research

Asset Class Performance (%)



Source: MUFAP & IFSL Research

Appendix V

Economic Indicators	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Real GDP Growth %	5.00%	0.36%	2.60%	3.60%	3.80%	3.70%	4.10%	4.24%
Agriculture Growth %	1.80%	3.50%	0.20%	2.00%	3.60%	2.90%	2.10%	2.89%
Manufacturing Growth %	6.10%	-4.20%	1.40%	2.50%	2.10%	0.60%	4.50%	3.60%
Services Growth %	4.90%	1.30%	3.20%	3.90%	4.40%	4.90%	4.30%	5.00%
Current Account Deficit (% of GDP)	8.20%	5.50%	2.20%	-0.10%	2.10%	1.10%	1.30%	1.00%
Trade Deficit (% of GDP)	10.00%	8.10%	6.70%	5.00%	7.20%	6.23%	6.09%	6.36%
Inward Remittances (US$bn)	6.50	7.80	8.90	11.20	13.20	13.90	15.80	18.72
Inward Remittances (% of GDP)	4.30%	5.00%	5.10%	5.30%	6.00%	5.60%	5.80%	18.20%
FDI (% of GDP)	3.60%	2.40%	1.20%	0.80%	0.40%	0.60%	0.60%	-0.16%
Exchange Rate (US$PKR)	68.40	81.40	85.40	86.00	94.60	98.90	98.80	101.78
External Debt (% of GDP)	27.40%	31.50%	30.90%	28.10%	25.40%	26.60%	22.70%	24.00%
Credit Rating	CCC/B3	CCC+/B2-	B-/B3	B-/B3	B-/B3	B-/B	B-/B	B-/B+
Tax to GDP (%)	10.60%	9.50%	10.10%	9.50%	10.00%	9.60%	9.50%	11.00%
Federal Budget Deficit (% of GDP)	7.3%	5.2%	6.2%	6.5%	6.8%	8.2%	8.1%	5.3%
Avreage CPI Inflation (%)	12.00%	21.00%	11.70%	14.10%	11.10%	7.40%	8.60%	4.53%
Average DR (%)	12.00%	14.00%	12.50%	14.00%	12.30%	9.00%	10.00%	8.89%
Foreign Reserves (US$ bn)	11.40	11.80	16.80	18.24	15.28	11.01	14.14	18.69

Source: IFSL Research

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