

December 18, 2009

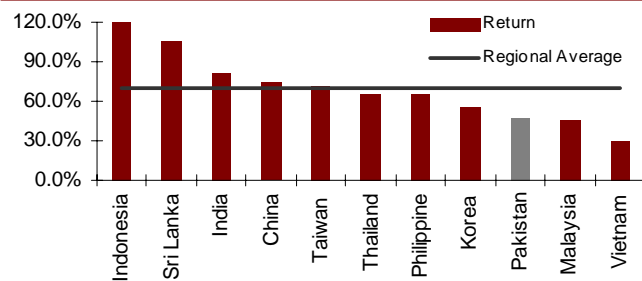
Pakistan Market**Pakistan lags behind regional markets****MORNING BRIEFING**

KSE100 Index: Closing 9227.18 ↓ (-26.48)

Healthy foreign inflows and reversing macro imbalances have helped Pakistan's equity market to post a return of 57% (48% in US\$ terms) to date in 2009, its best performance since 2005. While the market has risen by 57% overall, the upsurge was confined to two short bursts Mar-Apr and Jul-Sep 2009. The flurry in activity during Mar-Apr was mainly led by domestic participants in the backdrop of an improved political & economic situation, while the surge during Jul-Sep was primarily a result of foreign inflows of US\$236mn as Pakistan benefited from its re-entrance into MSCI's index and reversing macro vulnerabilities. Despite a 48%YTD US\$ return, Pakistan market lagged behind the regional peers which posted an average annual return of 70%.

48% return in 2009, average regional return 70%

After a free fall in the beginning of the year and hitting a trough of 4,815 points, Pakistan's market rebounded sharply to post a 57% return (48% in US\$ terms) to date, touching a peak level of 9,846 points in Oct 09. The average regional performance (incl. Pakistan) during the period was however, higher at 70%, particularly led by handsome gains in Indonesia (120%), Sri Lanka (106%), India (82%) and China (75%). While the Sri Lankan market rallied on successful completion of the security operation against the Tamil Tigers, performance in China, India and Indonesia was led by economic resilience and better growth outlook.

Graph: Pakistan & Regional markets YTD performance

Source: Bloomberg *As of Dec 17, 2009

Pakistan's market rallied in two sprints

The local equity markets had experienced a flurry of activity, in response to the political temperature cooling down, when the SC judges were reinstated by the Prime Minister on Mar 16, 2009. The market's cheeriness on this development was evident from the massive rallying of 33% within a span of 6 weeks, mainly driven by revived local interest; foreigners though, remained net sellers of US\$58mn in this period. Volumes too picked up substantially, averaging 294mn shares during the period, versus 140mn previously.

Pakistan's re-entry in MSCI's radar (included in MSCI FM index effective May 31, 2009), reignited investor interest with the index posting a return of 31% between July-Sep, on the back of US\$236mn worth of foreign portfolio inflows. Since mid Oct however, the market has remained volatile (return of -6%) with low volumes traded, driven by concerns over 1) the Kerry Lugar Bill, 2) the NRO, 3) the deteriorating security situation and 4) delays in the release of IMF's tranche.

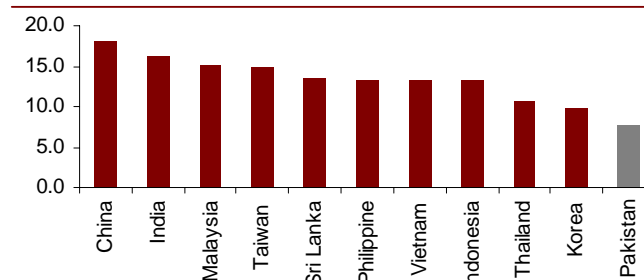
Pakistan trading at 40% PE discount to the region

Despite performing admirably in 2009, Pakistan trades at an attractive one year forward PE of 7.8x and a discount of 40% to the average of regional Asian emerging and frontier markets defined by MSCI. The prevailing discount is higher than the historical average of 34% and is likely to revert to historical levels as major risks have been subsiding 1) the Kerry Lugar Bill has been approved by the government 2) uncertainty over the NRO is now over 3) the army is slowly accomplishing its objectives in the tribal areas and 4) the IMF tranche is likely to be approved in the Dec 23rd board meeting. Given these developments, which will likely cause the PE discount to fall to 34%, the market will be set to cross the 10,500 mark.

Outlook

With the expectation of monetary easing, public/private inflows, resolution of inter-corporate debt and banking system liquidity, we remain bullish on Oil, Fertilizer, Power and

Telecom sectors. Our top picks include PPL, POL, HUBCO, ENGRO, PSO and PTC.

Graph: Pakistan and Regional markets PE(x)

Source: JS Research, Thomson Reuters

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Also in focus**C/A deficit shrinks to US\$1.36bn in 5MFY10**

Pakistan's current account deficit for 5MFY10 came in at US\$1.36bn compared to a deficit of US\$7.32bn in the corresponding period last year, down 81%YoY. Reduction in imports and high remittances are the major reasons behind the deficit ease off. In November, the current account deficit narrowed to US\$275mn from US\$552mn in October. Given the deficit for the 5MFY10, there is a downside risk to our full year current account deficit forecast of US\$8.3bn.

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