

December 23, 2009

Pakistan Market**2009: Macro, politics & the market****MORNING BRIEFING**

KSE100 Index: Closing 9332.47 ↑ (+98.87)

Post the commodity shock, Pakistan has undergone massive structural adjustments mainly led by IMF's guidelines. Though the fruits of reforms are evident from the recent macro data as well as the 'Stable' outlook given by the sovereign rating agencies, the deteriorating law & order situation and ongoing global recessionary woes have prolonged the prospects of recovery, in our view. The expected liquidity stimulus was delayed due to the non-fulfillment of Friends of Pakistan's commitments, US's late approval of the Kerry-Lugar bill and a lag in the release of the Coalition Support Fund. This in turn affected domestic liquidity and kept short-term rates at higher levels, despite SBP reducing the policy rate by 250bps in 2009. Even then, we term year 2009, as a year of achievement, as Pakistan's establishment has taken bold macro economic initiatives to eliminate long-standing structural flaws by doing away with fuel & electricity tariff subsidies, introducing banking and tax sector reforms and more. Interestingly, the reforms carried out in 2009, have strengthened Pakistan's economic governance when compared to global economic power houses like China and India, as both continue to subsidize power & fuel in their respective countries. The International Finance Cooperation assigned Pakistan the 85th rank vis a vis China's 89th and India's 133rd among countries in terms of 'ease of doing business' in 2010.

Politics: Volatile but on the right path

Year 2009 has brought a number of political issues in the lime light and can be termed as one of the most eventful years in the recent past. The year's accomplishments include; the Chief Justice being reinstated in March, Balochistan's package being announced in order to rid off regional disparity, the long-standing National Finance Commission (NFC) awards issue being resolved with political consensus, the Gilgit Baltistan district receiving more autonomy, and the controversial NRO being declared invalid by the Supreme Court. Additionally, the armed forces conducted successful

operations against militants to uproot terrorism from the country. The Parliament also played a very active role as all heated issues, ranging from the Balochistan package, the NRO and the Kerry-Lugar Bill, were debated upon. The most revolutionary aspect of this year, was that the Rule of law and Freedom of Speech have and will continue to strengthen in the country, thereby helping build efficient institutions, contain corruption and achieve national long-term development goals.

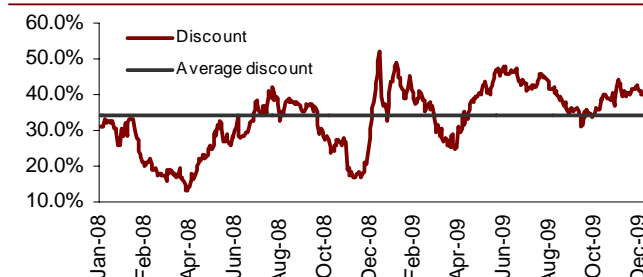
Markets: A mixed reaction

After a dismal performance last year, the market rebounded sharply in 2009, the debt market provided a 20.1% return on the back of monetary easing of 250bps by the SBP, while the equity market surged 59%. After a free fall in the beginning of the year and hitting a trough of 4,815 points, Pakistan's market recovered significantly to post a 59% return (49% 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 (117%), Sri Lanka (116%), India (80%) and China (68%).

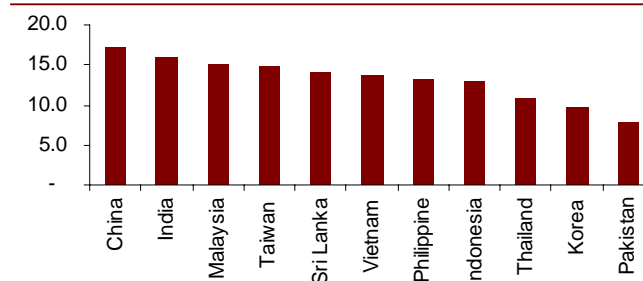
Index to rise above 10,500 on historical discount

Pakistan currently trades at an attractive one year forward PE of 7.8x and at a discount of 40% to the average PE of 13.2x of regional Asian emerging and frontier markets defined by the MSCI. The prevailing discount is higher than the 5 year historical average of 34% and is likely to revert to historical levels amid improved risk profile, which would propel the market to cross the 10,500 mark. We remain bullish on the Oil, Fertilizer, Power and Telecom sectors with PPL, PSO, ENGRO, POL, HUBCO, PTC and DGKC our preferred plays for 2010.

For more details please refer to our detailed report titled "2009: Macro, politics & the market" to be released shortly.

Graph: Pakistan's PE discount relative to the Region

Source: JS Research, Thomson Reuters

Graph: Pakistan and Regional markets PE(x)

Source: JS Research, Thomson Reuters

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