

The pakistani stock market and its analysis



In this report we will be giving an overview of the Pakistani Stock Market with specific emphasis on the Karachi Stock Exchange (KSE). The history of the Stock Market will be provided, along with an analysis on the major spikes in the market and the reasons for these spikes. The major sectors contributing to the Stock Exchange Market are also highlighted in this report. Moreover, the Stock Markets role in the growth of the economy along with market indicators will also be discussed. The Last objective that we will be covering in our report would be to identify the factors which affect the performance of the Stock Market. The time frame that this report will cover will be between January 2001 and December 2009.

Overview

The Pakistan stock market has three major listings:

Regular Days Timings:

Pre- market sessions from 09: 15am to 09: 30am and normal trading sessions from 09: 30am to 03: 30pm.

The Karachi Stock Exchange (KSE)

The Lahore Stock Exchange (LSE)

The Islamabad Stock Exchange. (ISE)

The ISE was incorporated as a guarantee limited Company on 25th October, 1989 and became fully operational on August 10, 1992. In 1997 ISE it introduced an automated trading system (ISECTS) and later changed it to “

ULTRA TRADING” system in 2002. Presently ISE’s turnover has reached 1 million shares per day and has 118 members.[1]

Another stock exchange in the Pakistan stock market is the LSE, which is the first automated stock exchange of Pakistan, is also the second largest stock exchange of Pakistan. It was established in October 1970 and currently has 519 listed companies from 37 sectors of the economy. The total market capitalization is approximately Rs 2746. 325 billion.[2]

The last stock exchange in Pakistan is the KSE, which is the largest stock exchange in Pakistan and was established on September 18 1947 and was incorporated on March 10, 1949 in order to maintain the interaction between the lenders of capital such as savers and investors and borrowers of capital such as government and companies. As individuals had excess amount of cash and were looking at options to gain more money and while companies were seeking for investors who would invest in there firm to increase capital. Karachi Stock exchange provided them with a platform to allow the business to take place between them with benefits being enjoyed by both the parties. The stock exchange started with 5 companies with a paid-up capital of 37 million. Trading use to took place through the open out cry system on pits on the trading floors. The first index introduced by Karachi Stock Exchange was the KSE 50 index. In 1991 foreign investors were given the opportunity of operating in the secondary capital market and also due to the privatization policy in Pakistan the development of the Karachi Stock Exchange accelerated. The KSE 50 index was removed as it was not truly representing the stock markets performance as a result in 1991 the capital weighted KSE 100 index was launched. It started trading through the computerized trading

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system Karachi Automated Trading System (KATS) since 1997. In 2005 online trading was also introduced making it more easy to use for investors. Membership of KSE is fixed and limited to 200 members, which can include individual, corporate and foreign entities. Prospective members have to buy membership from existing members and the price is negotiable between the buyers and sellers[3].

The most dominant sectors in the Pakistani market are the Oil and Gas exploration and distribution companies such as OGDC, POL, PPL, and PSO. Fertilizer manufacturing firms are also important companies in the market. These would include ENGRO and FFCG. Moreover, other sectors which make up a major chunk of the stock market are telecommunications (PTCL), power generation (HUBCO) and commercial banking sector (NBP, Standard Chartered and MCB)[4].

KSE has a total listing of 650 companies as of 2010, with a total market capitalization of Rs 2, 890 billion at the end of March 2010. At the moment the stock exchange trades on 4 indices of which two are world known indices which are KSE 100, KSE All Share Index and the other two are KMI 30 and KSE 30. KSE, being the leading stock exchange in Pakistan trades ordinary shares, preference shares, redeemable certificates and term-finance certificates such as corporate bonds, and since 2003, futures trading in some active stocks also started.

KSE also wants to have wide based investor participation. This would help in dealing with them more easily and would increase the efficiency of the stock exchange. It wants to become a Hub for capital funds this would be done by

increasing the float of existing trade companies. It also wants to introduce cross-border listing of companies and the trading of indices would also take place through cross-border listing.

Market Indicators:

There are three indicators that show how well the economy is doing presently or is going to do in the future. Investors use these indicators to make their investment decisions. These three indicators are:

Leading Indicators: These indicate future events and the Stock Market is a part of this. They are assumptions into the future. The Stock Market is a leading indicator because the stock market usually begins to fall before the economy starts to fall, and the Stock Market becomes better before the economy comes out of a recession. These indicators are very important for investors because they predict what the economy is going to be like in the future and thus influence investment decisions. However they are only short term predictors of the economy.

Lagging Indicators: This indicator is one that follows an event. The most important lagging indicator is unemployment. It has the ability to see if a pattern is occurring or about to occur. If the unemployment rate is increasing steadily, then this indicates that the economy is doing poorly.

Coincident Indicators: This indicator occurs at approximately the same time as the conditions they denote. They change at the same time as the economy or the stock market. Personal income is a coincident indicator; high personal incomes indicate a strong economy. GDP is also a coincident indicator.

Affects of KSE on the economy:

One of the main goals of KSE is to reflect Pakistan's economic health by providing an efficient, fair and transparent Securities Market. Therefore KSE plays a leading role in the growth and development of Pakistan. The GDP and the components which contribute to calculating the GDP show that when they are of positive value, the GDP will be good. These components will only be positive when the people are consuming and/or saving, when there are investment opportunities etc. all this reflects the KSE's functionality. If KSE is functioning in a good condition, stock trading is been done in numbers, then consumption and investment in Pakistan is increasing.

Thus, we can say that it is the KSE that enhances and pushes up the activities of Pakistan's economy. It is through KSE that many major companies have succeeded in traveling the long journey to success. Through this Market (KSE) businesses issue stock to raise money in order to finance expansions and also, when there is a need of additional capital in order to operate successfully. The common term for such financing is Equity Financing.

How does this all affect the economy then?

It is through these stock issues by businesses and companies that give investors an opportunity to invest in a moderate risk instrument. When companies will issue stock in order to expand its operation and investors will buy stock; it will automatically give a boom to the economy through creating employment opportunities in a country through which production and consumption in the economy increases. The unemployment rate for Pakistan,

which is steadily declining. One factor contributing to this decline is the Stock Exchange.[5]

The money which could have been lying idle in the saving accounts or in idle deposits with the bank is now being invested to promote business activity. It is also benefiting several economic factors such as commerce, industry and agriculture. People who used to save money because of lack of investment opportunity now are investing that money in stock markets.

KSE being the highest tax payer in Pakistan contributes a large sum of money in the economy where the listed companies also contribute 10 percent of total revenue collected by the Government. Even the KSE brokers contribute about 50 percent of their profits by paying taxes on them. Lastly the investors who also pay 10 percent of their dividends as taxes. All this money goes to the government who further invests it in the economy.

KSE also provides opportunities for investments to the small investors. Those investors, who either love to be an owner of the company or stay home or earn profits, get benefited by investing in Stocks. Any one whether big or small stock investor can invest in KSE. In short KSE provides the small investors to own stock of the same firms as large investors.

In terms of share prices and their demand and supply all stock markets are fluctuating markets. Share prices tend to rise or remain stable when the economy is either growing or is stable. And when an economy is going through hard times like depression, recession or financial crisis the stock market tends to crash down. Through fluctuation of KSE stock prices we can

say that the market plays a vital role in the growth and downfall of Pakistan's economy.

With the emergence of KSE, it has attracted many foreign investors who have been investing large amounts of money in Pakistan's stock markets and especially Karachi Stock Exchange (KSE). This has given a boom to the economy in the early days when foreign investment was started in Pakistan.

Beside the factors mentioned above there are other factors that affects the KSE and eventually the economy.

A very small number of the population of Pakistan is actual participant of KSE. Trading is done by a few major investors who are the market makers. They tend to manipulate the market for their own good more then actually making it for others. This creates volatility in the market causing it to crash down at times.

Other related factor is the small number of investors who invest usually by following the price trend which is decided by the market forces i. e. the supply and demand. The demand and supply eventually reflects the trading of stocks which reflects the economy of Pakistan.

Recent events and incidents concerning internal security situation and political uncertainty have hurt the trading of stocks and KSE. Indirectly the economy also suffered because of this.

As Pakistan is largely dependant on global economies, it suffers when countries like US and EU are going through recession phase. Stock market loses its trading activity which was being done by foreign countries. When <https://assignbuster.com/the-pakistani-stock-market-and-its-analysis/>

there's less foreign investment, KSE Index tends to fall. If this goes on for long then the economy gets affected negatively.

Lately many investors have shown interest in Mutual funds which is why it has become an important player in Karachi Stock Exchange. Though it's true that mutual funds are the least risky investment, but when the market crashes down due to some reason, the ones who invested in mutual funds face losses. This is because when some variables like recession, political or economic situation of the country, war, inflation etc. affect the market, they also affect the entire range of stocks. The type which is traded in stock market is closed-end Mutual Funds, price of which is determined by the demand and supply of the shares. This is the reason why the investors suffer losses when market crashes down.

Analysis:

In 2001, the KSE index had grown to 1770 points after its introduction with a base of 1000 points in 1991.[6]On September 11, 2001 when two planes crashed into the world trade center in New York, there was a slight effect on the Pakistani market, even though it was not very pronounced the stock market still remained closed for 3 days and opened with the introduction of new circuit breakers to check volatility. The index fell from 1255.99 points to 1208.3 points, and continued falling for a few days as an aftermath of the event. In October 2001, KSE reported a 33% increase in its index for the month owing to a resolve in the Crescent Investment bank overexposure and also positive financial indicators for Pakistan such as a debt write off and a reduction in interest rates. The market again fell from May 18 to 20, 2002 when there was a tension in the Pakistan-India border, resulting in a loss of

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252 points in the index. Moreover the short comings of the COT system which promoted overtrading by investors as well as sudden withdrawal of funds from COT financiers contributed to the sudden loss in the index.

In 2002, KSE experienced phenomenal growth in the market (an increase of 92%) because of the effective macro economic policies that the government implemented. KSE got the title of “ The best performing market amongst the leading stock markets of the world” as Pakistan and Srilanka were the only two countries in Asia to not report a loss in that year. The bullish economy was present because of a number of reasons which include an increase in interest of foreign investors in the market.

The start of 2003 however was bearish because of the Iraq crisis which brought uncertainty in the market. Moreover high leverage and over bought positions in the carry over market by speculators increased uncertainty. Because of speculation, those who had bought the stocks through borrowings, started “ panic selling” them to make a large profit and which resulted in a sharp fall in the KSE index. However when the uncertainty of the Iraq war crisis reduced, the market recovered significantly along with anticipations of favorable future relations with India. Moreover, the announcement of the budget and the successful visit of the Pakistani president to the USA boosted investors’ confidence, and 2003 ended with the KSE all time high index of 3402 points.

The 2003 boom continued till the mid of 2004 and resulted in an index of 5620.7 on 16th April 2004. Moreover a record turnover of a billion shares was also seen on this day. During the year KSE continued to perform well

and has succeeded in doing so because of various reasons such as the continuation of sound macro economic policies by the government.

By 2005, due to a period of robust growth the index had skyrocketed to 9,989 points. After hitting a peak at an approx of 10303 points, in March 2005, we see the Karachi 100 index of the Karachi stock exchange falling back into instability till the end of May 2005 (30/may/2005 @ 6707.56 which was the 2005 market crash). On 8th October 2005, Northern parts of Pakistan were hit by an earthquake which devastated the country and led to the stock market declining sharply. However some sectors actually increased trading such as cement, food, and banking sectors because investors believed in a positive future outlook.

We analyzed that there were two kinds of responses that investors give out whenever the economy of Pakistan hits a political or law and order crisis either there is a marked indifference or there is a marked difference. According to Bloomberg's researchers, the KSE is affected positively when the investors, both local and foreign take an action when they believe that the country holds promise. The index takes a negative turn when investors pull out from the market, or when there is more supply and less demand, as the economy or one major player as a whole takes a downturn.

In 2006, rising gold prices made the investors transfer their money from stock to gold which was just one of the factors why the KSE reached from 12000 points only to sink to 9600 points. Foreign buying interest had been very active on the KSE in 2006 and continued in 2007.

The KSE underwent through a fall in 2008 mostly because of the global financial crisis and partly due to the domestic situation in the country. The index plunged in 31 December 2008 to 5685.01 from the record of 15,676.34 on April 18, 2008. The once thriving KSE-100 index of over 15676 points now went at a record low around 9,187 on 21 November 2008 where the KSE put a floor price for stocks to keep it from plunging down. The index froze to 9187.1 points till 14 December 2008. After resuming trading however the index only managed to further slope down from 15 December 2008 onwards. It only stopped going down after it hit a new low at 4815.34 points on 27 January 2009 and from then gradually started to recover throughout the entire 2009.

As said, the fall of stock market fall of 2008 contributed to a few things. First the domestic troubles caused by regime change lack of political stability in Pakistan, convinced a lot of people that Pakistan was not much of a land of opportunity. Then with the global crisis, Pakistan too was affected.

The credit default swap rose causing Standard & Poor's and Moody's to lower its ratings to a negative for Pakistan and putting altogether more pressure on the Pakistani Currency. And with foreign reserves falling by more than 60 percent, investors both local and foreign thus started to believe that the country which was under so much debt will soon if not immediately will start to default. The country's CPI too spiked high, and though the State Bank of Pakistan tried its best to enforce a tighter monetary policy, it still failed. Eventually all these factors caused increasing inflation and current account deficit. High inflation and high interest rates for the major players meant cutting down cost, most companies then suspended their growth plans till <https://assignbuster.com/the-pakistani-stock-market-and-its-analysis/>

the economy stabilized. But this also meant unemployment. For investors, spending cost increased and saving and investment cost decreased. Foreign investors seemed alarmed and took Pakistan's weak economy not very attractive.[7]

Factors Affecting KSE:

Karachi Stock Exchange (KSE) is affected by number of factors directly or indirectly. Some of the major factors are:

Interest Rates

Inflation

Monetary policy

Foreign Direct Investments

Law and order

Interest Rates

The cost of borrowing money, and they have a huge impact on KSE especially short-term interest rate; the Stock Exchange is basically a place where an individual can invest his/her money to gain profit by taking a risk. On the other hand depositing in bank also has its advantages, such as getting a fixed return on the money that is deposited through the interest rates, and has its negatives such as low interest rates. An investor wants a high interest rate on his deposits for the money that he deposited initially as compared to a low return through a low interest rate. Thus when the interest rates decrease, investors find investing in stock exchange more attractive

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than keeping their money as deposits in bank and earning very a very low return on the amount they deposited. However when interest rates increase; potential investors would find depositing their money in banks more beneficial, and not invest in the KSE, thus creating fluctuations in the market equilibrium constantly. Moreover, to find out the value of future dividends, investors must discount them and find out their present value and what they are worth at this point in time. A high interest rate would make the future dividend values less valuable in today's Rupees; and would decrease the value of the stock.

Inflation Rate

Inflation is one of the biggest threats to the economy, and is increasing steadily in Pakistan, being 9% in 2005, 7.9% in 2006 and reaching as high as 25% in 2008 after the increase in global petrol prices. When inflation occurs individuals are more concerned with spending rather than saving, and thus would not use the money to invest in KSE. Net earnings of the company determine the price on the stock market. When it is speculated that the company will have high earnings then the stock prices of the company would increase. When it is estimated that the company is not going to perform up to par, then its stock prices fall. The prices of the stocks are directly proportional to the earnings of the company. Thus an increase in inflation will cause the revenue of the country to fall, and thus affect the stock prices negatively. A decrease in inflation would cause the opposite shift.

Monetary policy:

The monetary policy of a country is used to achieve the objectives of the government by adjusting the amount of money being circulated in the economy through OMO's, the discount rate, or through the reserve requirement. Unanticipated changes in the monetary policy increases the risk premium on stocks for a certain period. This either increases the riskiness of stocks; it reduces the willingness of investors to hold risky stocks, or both. When the monetary policy is tightened (the money supply is reduced in the economy) it causes investors to see stocks as being more risky and thus they demand a greater return on their investment for investing in the stock market, and eventually it drives down stock prices. A tight monetary policy reduces the financial buffers of an investor and increases the exposure of investors to future shocks in the market. The affect of monetary policy only affects the stock market to a certain extent.

Foreign Direct Investments

Stock market liberalization is when the country's government decides to allow foreigners to purchase stocks on that country's stock exchange. In Pakistan, the stock market was liberalized in February 1991, which attracted foreign investors, and foreign direct investment and indirect investment started which had a positive impact on the stock market as well as the Pakistani economy. When more investors entered, the risk premium on stocks fell, and because of the increase in the demand competition of the stock market, stock prices rose. As the foreign currency inflows increased, there was an increase in supply which caused the Pakistani rupee to appreciate. This increased the prices of the shares and improved the foreign exchange reserves. Stock liberalization reduces the cost of equity capital of

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the country because it divides the risk between domestic and foreign investors. There is no restriction on foreign ownership of stocks except in life insurance companies. The net portfolio investment starting July 2009 stood at \$431.93 million in Pakistan. Moreover, the amount of overseas investment in the local stock market increased to 9% in 2009.

Law and order and Natural disasters:

Karachi Stock Exchange is affected to a level by the law and order situation in the country, and the affect depends upon the severity of the crises.

Investors invest in KSE thus a huge factor of risk is present, when you see the current situation of Pakistan, especially Karachi, where there is huge chaos when we talk about Law and order.

Bomb blasts in Pakistan have a very minimal amount or no amount of affect on KSE due to the reason that this is now a routine of Karachi and Pakistan. If we see last 5 bomb blasts, it does not have any affect on KSE.[8]However as we can see Natural disasters do have a huge affect on KSE. According to the report regarding the earthquake in 200 the trading was bearish. This is because company's were investing more on revamping the earthquake victims rather than growing, many employees of various companies had family members, or their own homes affected and destroyed in this disaster; thus shortage of labor reduces the production of company. If the production of company is slow then it becomes dull for investor to buy shares of that company, and thus the trading on the stock market declined. Moreover, the import of earthquake relief items such as tents and plastic sheets caused an

increase in the trade deficit of Pakistan. All these factors made investors less willing to invest in the stock market.

Appendix

Table 1:

Table 2:

Table 3:

Date of the bomb blast

KSE 100 Index

Before

On the day

After

28th December 2009

9, 422. 23

Closed (due to various holidays)

9, 507. 95

5th February 2010

9, 769. 73

Closed (due to public holiday)

9, 809. 98

30th April 2010

10, 454. 63

10, 428. 12

10, 389. 46

10th June 2010

9, 678. 38

9, 379. 78

9, 471. 12

7th October 2010

10, 029. 36

10, 191. 68

10, 260. 48

Table 4:

Table 5:

Table 6:

Table 7:

Table 8: