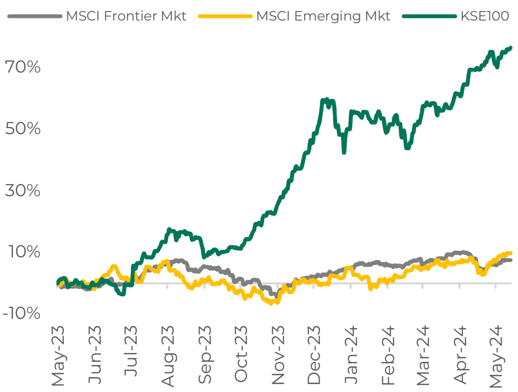
KTrade Talks:

With Ruchir Desai Co Fund Manager AFC Asia Frontier Fund; Webinar Series

Foreign institutional investor views are optimistic but call for consistency in successfully completing an economic cycle to support the market re-rating process and generate higher portfolio inflows. We hosted Ruchir Desai Co-Fund Manager of the AFC Asia Frontier Fund based in HK in our KTrade Talks Webinar Series last week. The AFC Asia Frontier Fund managed by Asia Frontier Capital has been ahead of the curve increasing Pakistan allocation to 9.6% as of Apr'24 from 5.5% last year. This follows Pakistan securing a short term IMF program averting default which de-rated valuations to multi-year lows.

KSE100 vs MSCI EM & MSCI FM Performance



Source: Bloomberg, PSX, KTrade Research

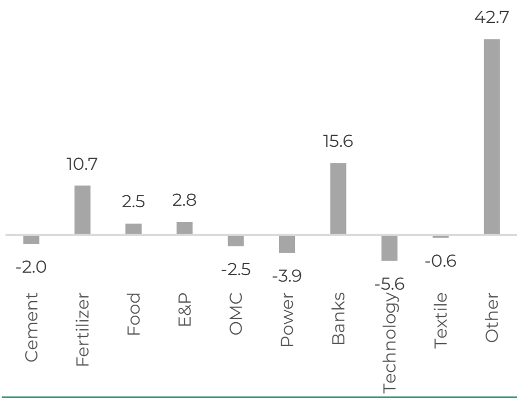
Frontier Market Landscape

The frontier market landscape when Pakistan was previously a frontier market (2009-2016) has changed. US markets have outperformed most international asset classes and geopolitical tensions exposed frontier market buffers to weather macro-economic headwinds. At the same time aggressive rate hikes and continuing hawkish monetary policy stance by the US Federal Reserve led to allocations moving away from frontier markets.

Region Overview

US inflation has peaked and a reversal in monetary stance will anchor asset allocation back to emerging and frontier markets especially as these economies are recovering from post Covid shocks. At the same time Vietnam has been under discussion for a potential upgrade to Emerging Market from Frontier. However, foreign ownership limits and prefunding of trade conditions are likely to delay an upgrade from MSCI – the largest among benchmark indices. FTSE Russell upgrade may happen sooner but will have a limited impact on a reweighting for Pakistan given lower level of assets tracking the benchmark.

Foreign Portfolio Breakup CYTD – USD 60mn



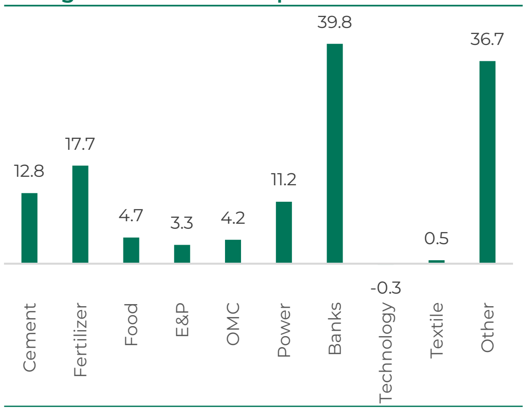
Source: NCCPL; KTrade Research

Way Forward for Pakistan – Consistency is Key

Within frontier markets Vietnam has capitalized in regionally positioning itself a manufacturing hub following US trade restrictions with China via the Entity list. This follows a strategy implementation over decades led by consistent policies replicating the China road map 25 years ago under Vietnam's one-party political landscape. The evolution of Vietnam's manufacturing position reflects a focused process moving through the value added chain. This has allowed foreign investment in Vietnam to take a 10-15 year view where unlike Pakistan foreign investment is generally short term due to instability consequently leading to economic stress. For Pakistan, in Ruchir's view the next 3-5 year process should be to complete an economic cycle where Pakistan would be better served by consistent policies that deliver a stable GDP growth of 4% over next 4-5yrs versus an unnecessary acceleration in GDP beyond 6% subsequently becoming unsustainable and leading to boom bust cycles.

Ruchir reiterated Pakistan's geo-strategic advantage within a region that is growing at a relatively robust pace across Central Asia to the Middle East. This could support the potential to develop pockets of expertise and allow for a gradual move across the value chain over the long term.

Foreign Portfolio Breakup FYTD – USD 131mn



Source: NCCPL; KTrade Research

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Undemanding Multiples

Completion of an economic cycle is also likely to restore foreign investor confidence that could underpin a phased wise re-rating in Pakistan market multiples to 5.5x - 6x earnings over the next 12-18 months and mean convergence to 8x within 36-48 months. Pakistan courting Saudi investment though positive requires stability and consistent policies to generate a structural impact for Pakistan in Ruchir's view.

Pakistan Economic Ecosystem

Regarding Pakistan's policy rate setting Ruchir has taken a 12 month view versus general street views on a month by month basis. While potential IMF prescriptions and budgetary measures could push out rate cuts Ruchir expects the easing cycle to start during 4QCY24 with aggressive cuts through CY25 recommending a higher allocation to cyclicals. PkR parity outlook is within long term average with a 4%-5% depreciation annually.

Improvement in high frequency data points including the inflation reading on a downward trajectory and even at this point has created space for a dovish stance on the monetary front. When the direction is set, the banking sector is likely to benefit from gains arising on their investment book. Following suite, cyclical sectors (Cements, Autos and Steel) along with a few Mid-Cap companies with high inclination towards financing are anticipated to benefit anchoring allocations at the AFC Frontier Fund.

Sector View

Pakistan banks play an integral role in supporting the government through the bond market. The largest borrower from the sector is the government given the tight fiscal space. Local debt restructuring according to Ruchir will be extremely difficult to manage as it will have an adverse impact on the banking sector and believes Pakistan has averted this crisis.

Ruchir also reiterated that the cyclical sectors such as Cements and Autos are likely to experience tailwinds as the dovish stance sets in. In addition to this the undemanding valuation across sectors and of the market itself remain extremely attractive.

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Rating Definitions:

•Outperform >18.5% potential upside

•Neutral: 12.5% to 18.5% potential upside

•Underperform <12.5% potential upside