# 7 Picks from Pakistan's Star Fund Manager

## Alfalah Investment's Maheen Rahman, Pakistan's sole female fund manager, is bullish on oil and bank stocks.

By: Daniel Shane
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Pakistan has been one of the top performing stock markets over the past year, soaring by a whopping 55% in U.S. dollar terms. Only the likes of Argentina and Peru can boast juicer returns.

Maheen Rahman, head of Karachi-based fund manager Alfalah Investments, doesn't see the rally fizzling out just yet, either. Rahman's opinion is worth listening to: not only is she Pakistan's sole female portfolio manager, her fund has been the top performer since its inception in 2009.

Pakistan will join the esteemed ranks of MSCI's Emerging Markets index later this year, luring in billions of dollars of passive funds. Pakistan still looks cheap in comparison, too: The benchmark Karachi Stock Exchange 100 index trades at 13 times earnings, compared to 15 on average for emerging markets. That's a valuation gap of about 15%, while on average Pakistani shares yield nearly 5%.

The money manager, whose resume includes stints at Merrill Lynch and ABN Amro in Singapore, tells *Barron's Asia* by phone that the rally has been powered by "a complete turn in sentiment." Apart from the MSCI upgrade, Chinese investment has poured in as part of the Middle Kingdom's 'New Silk Road' ambitions, fueling spending on badly needed infrastructure like power plants. Terrorist attacks have fallen in frequency over the past couple of years amid an army crackdown. Spooked foreign executives have since begun returning. That's helped propel shares higher in industries spanning from cement to auto-makers.

But it's events outside of Islamabad's control that could fuel the next stage in the rally. "Oil prices for Pakistan are very critical," explains Rahman, whose firm manages about $500 million. The country imports about 90% of its petroleum products and so its current account deficit widens when crude prices rise. It also means Pakistan tends to import a lot of inflation. Rahman recalls 2008, when oil prices topped around $140 a barrel, causing the current account deficit to shoot up and the local rupee to plunge 20% versus the U.S. dollar. Inflation jumped by a similar amount, prompting the central bank to hike interest rates to around 15%. GDP growth that year slumped to 1.7%. "We're simply not insulated against higher oil prices," she says. Oil has traded at over $50 throughout 2017, and Rahman says that is "like somebody handing us a gift basket," as at around this price the Pakistani rupee avoids jitters and the economy can still grow. Interest rates and inflation have been stable for the last few months, prompting more long-term decision making on investments by corporates. Companies are now making plans on where to place capital over the next five years, rather than just the next six months, Rahman says. She sees oil trading between $50 and $70 for the next five years. "Within that band Pakistan is in an incredibly comfortable situation," she reckons.

It's no surprise then Rahman recommends holding energy stocks. Oil companies in Pakistan generally do well when oil is in that sweet spot. If it's too cheap, they can't make any money. If it's too pricey, the economy suffers. One of Alfalah's top holdings is Oil & Gas Development Company (OGDC.PK), an upstream producer majority owned by the Pakistani government. Despite its shares rising 50% over the last 12 months the stock has underperformed the local index. OGDC looks cheap at less than nine times forward earnings, Rahman believes, and as it's the KSE 100's biggest component it can "take the entire index with it" if it starts outperforming. Another stock, Pakistan Oilfields (POL.PK), is more of a pure oil play, she says, and is more sensitive to shifts in the crude price. Its shares have beat the index by 40% over the last year, but have skidded 9% since the start of the year. The third big upstream producer, Pakistan Petroleum (PPL.PK), is more of a natural gas play, Rahman says. Because of local regulations, gas prices in Pakistan tend to lag behind movements in oil prices, she adds. The stock has also underperformed the benchmark. Rahman recommends holding all three stocks. "These companies still look very underpriced," she believes.

Rahman also sees good opportunities in the downstream parts of the oil industry, such as local petroleum distributors. She says these stocks can catch a tailwind from more spending on infrastructure like roads and new logistics supply chains that are being built. "It's a direct relation to how many more cars and buses you have the on the roads," she says. One pick here is Pakistan State Oil (PSO. PK), which runs 3,500 service stations across the country. The stock is up by more than 40% over the past year and trades at a thrifty eight times next 12 months' earnings.

The next leg of the market rally could also come from Pakistan's blue chip banks. Of the country's population of almost 200 million, it's thought that less than a fifth of Pakistanis hold bank accounts. The number of people who use more exotic products - like mutual funds - is thought to be a couple of hundred thousand. That's a big opportunity for lenders to expand their base of low cost deposits – a cheap source of funds.

The banks also have a big role to play in financing about $160 billion in infrastructure projects. Rahman says interest rates have bottomed out at 5.75%. That means the spread banks earn between what they charge borrowers and pay depositors, or net interest margin, has stopped narrowing, and should start widening. Her top pick here is Habib Bank (HBL.PK), Pakistan's biggest lender. Again, the shares have underperformed the index. "It's very primed in terms of its balance sheet strength and its ability to lend to consumers as well as Chinese and government infrastructure projects," Rahman believes, pointing out its stable net interest margin and low non-performing loans ratio. She thinks rivals United Bank (UBL.PK) and MCB Bank (MCB.PK) are also undervalued by the market. "What investors are looking for is just confidence in an end to the dip in earnings we've seen," she says. "That's why I think there's still a bit of juice left in the overall index level."

Rahman is the sole female fund manager in traditionally conservative Pakistan. Female participation in the South Asian country's workforce is one of the lowest in the world, although it's doubled in the last 20 years or so. Money management has something of an 'Old Boys Club' reputation: Only one in five fund managers worldwide are women. "It's not just a Pakistan problem - it's a global problem," she agrees. Just like the markets, attitudes to professional women in her home country seem to be on the up. "It's a question of motivation and ambition," Rahman believes. "If there are women out there, there's nothing to stop them from getting there."