

What drives the growth of the market?

Role of Earnings and other Macro factors



Md. Moniruzzaman, CFA
Vice President, BMBA
Managing Director, IDLC Investments Limited

September, 12, 2020

Market Growth Drivers

Stock market returns comes from mainly two sources

```
graph TD; A[Stock market returns comes from mainly two sources] --> B[Earnings growth]; A --> C[Valuation multiple (e.g. P/E)]; B --> D[Presence of good governance companies]; B --> E[Supporting macro environment];
```

Earnings growth

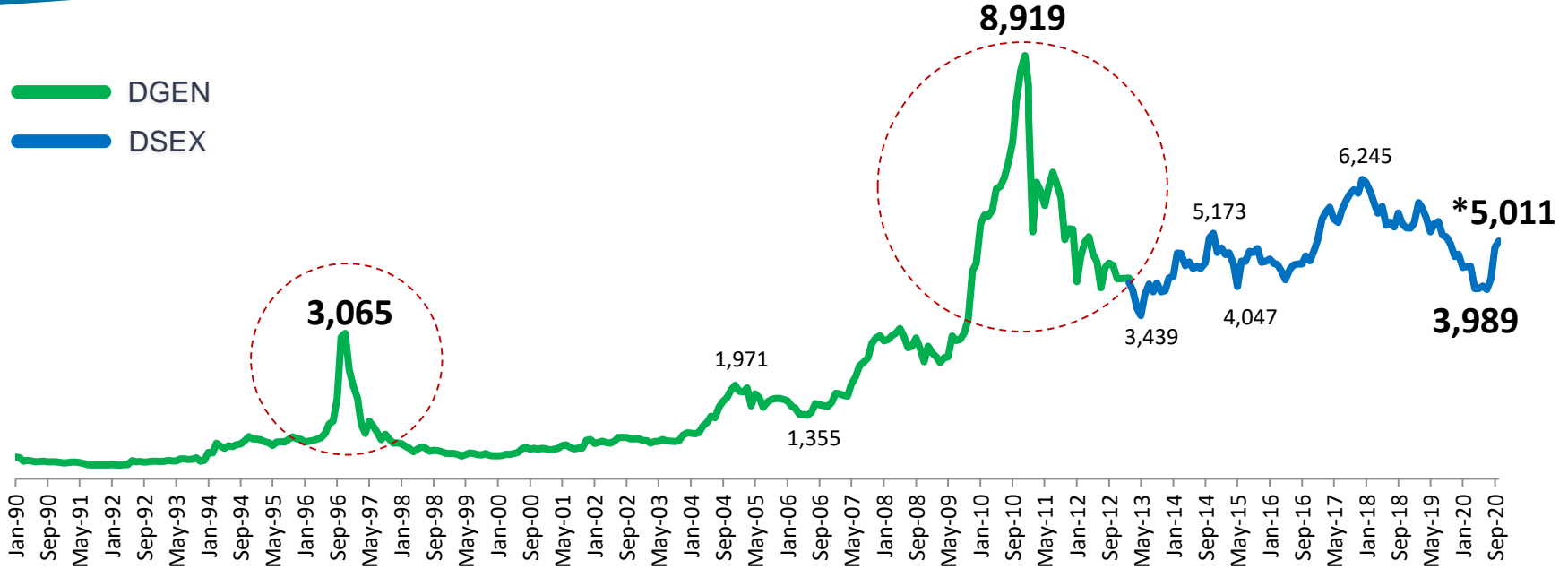
Valuation multiple (e.g. P/E)

Presence of good governance companies

Supporting macro environment

The Journey of last 30 Years

Market Index (Jan 90 – Sep 20)



What goes **UP** must come **DOWN**

We are not alone in the world of Irrational Exuberance

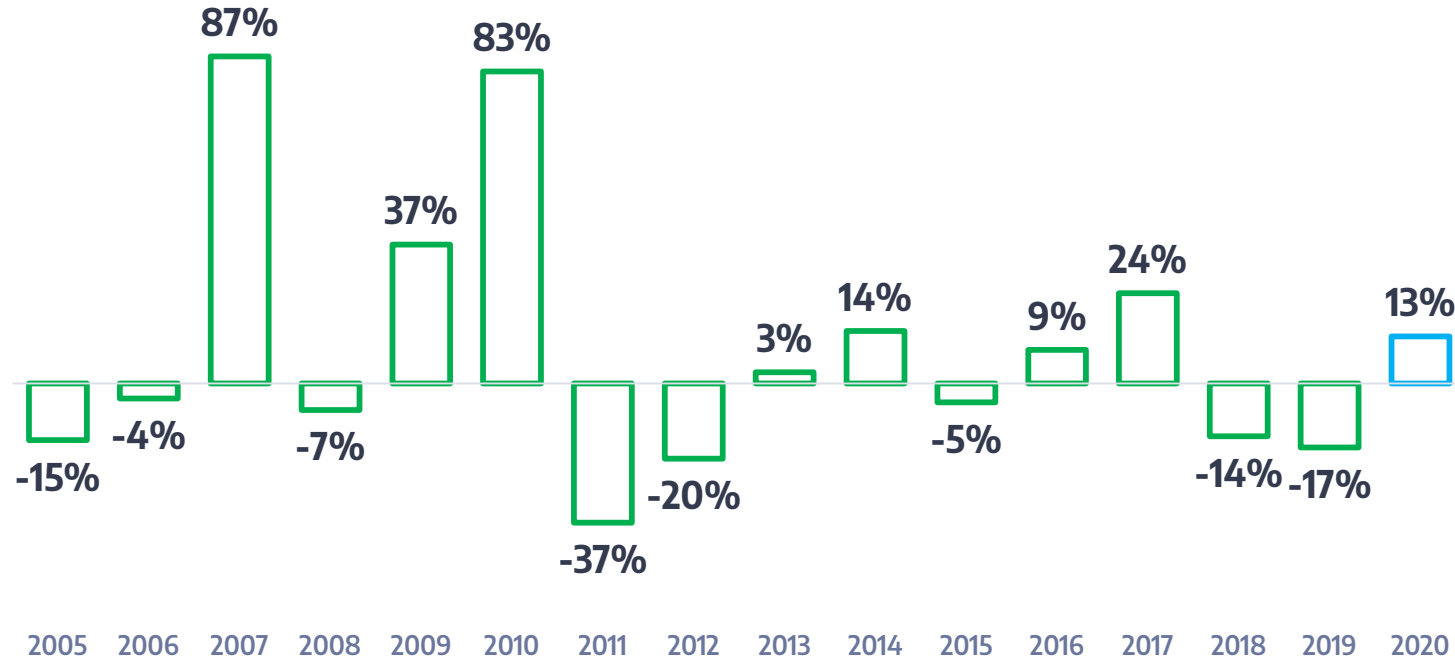


Source: Bloomberg data, Stifel estimates.



Stifel Research

Market Return has been highly volatile in last 15 years



Peter Lynch's Formulas for Valuing a Stock's Growth

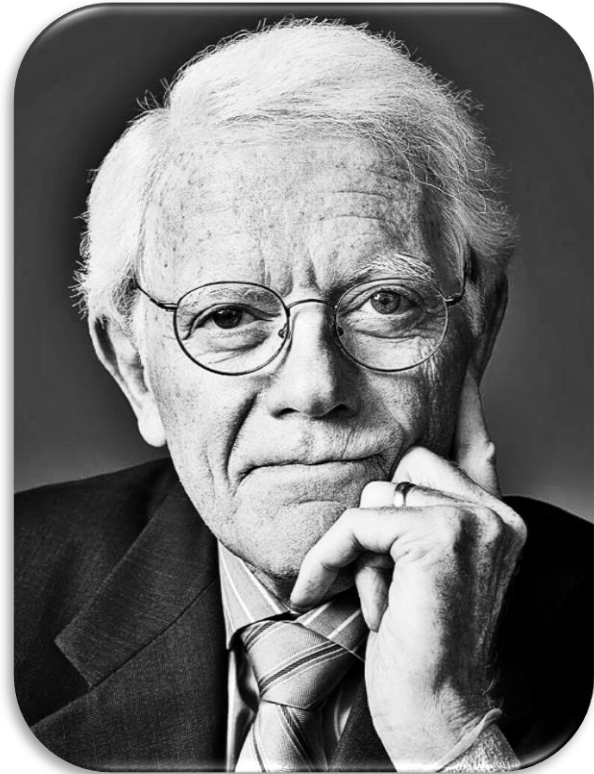
“The P/E ratio of any company that's fairly priced will equal its growth rate.

”

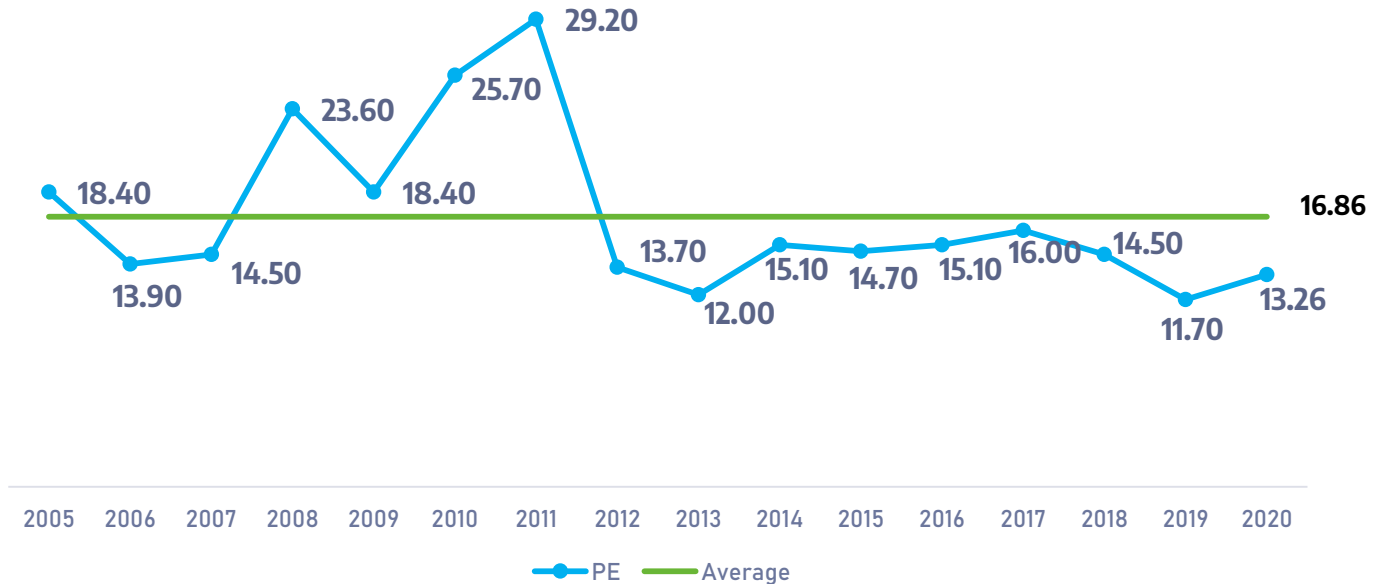
~

“If the P/E of Coca-Cola is 15, you'd expect the company to be growing at about 15 percent a year.

”



Historical Market P/E (2005 – 2020)



2010 PE of 29x is an overshoot
The fundamentals of the companies did not justify this

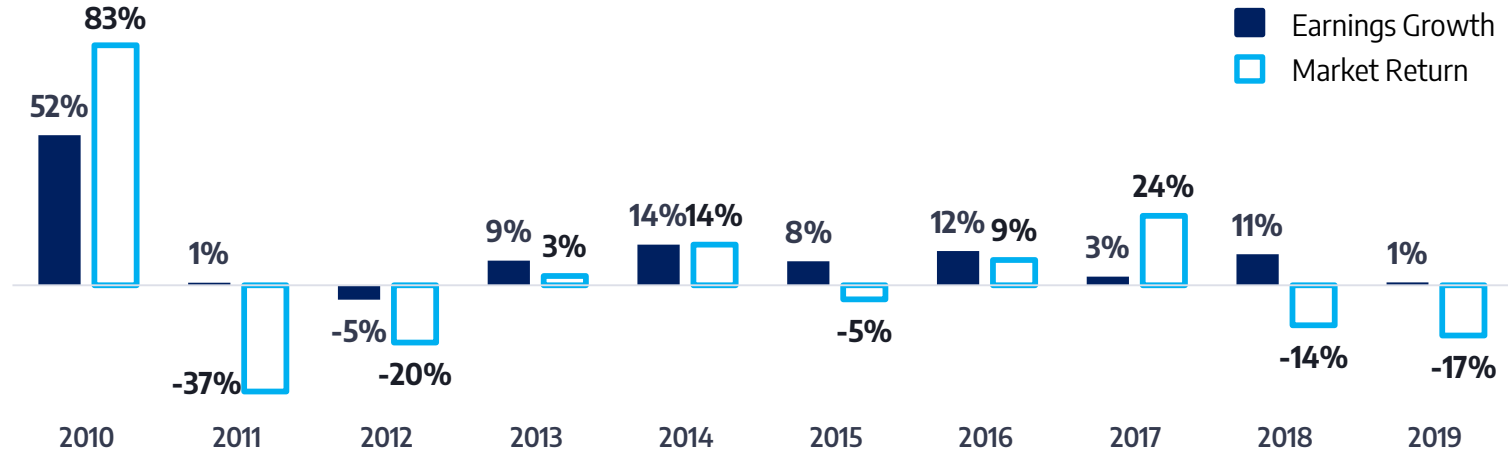
Sectoral P/E Ratios: 2010 vs. 2020

P/E Ratio	Dec-10	7-Sep-20
Bank	25.24	8.04
Financial Institutions	47.27	16.41
Engineering	50.10	17.89
Food and Allied	27.30	16.64
Fuel and Power	21.57	13.02
Jute	55.66	54.43
Textile	52.44	15.91
Pharmaceuticals	34.12	16.90
Paper and Printing	126.93	34.98
Service and Real Estate	43.93	17.17
Cement	33.44	25.32
IT	64.91	20.42
Tannery	20.66	11.61
Ceramic	106.86	49.01
Insurance	64.64	14.69
Telecommunication	20.35	12.53
Travel and Leisure	65.45	26.21
Miscellaneous	19.54	41.77
Market	29.16	13.26

**Some scrips might be trading
at higher P/Es than they
deserve**

Does fundamental work?

Market Return and Earnings Growth are related



Market return overshoots earnings growth in bull market, e.g. 2010, 2017

That over enthusiasm gets corrected in subsequent two years.

For no-growth or little-growth in earnings, people exits from the market.

2010 Earnings Growth

Sector	2009	2010	Change
Bank	40,609	63,442	56%
Cement	2,499	240	-90%
Ceramic	501	891	78%
Engineering	2,147	5,557	159%
Financial Institutions	6,786	13,840	104%
Food and Allied	2,351	3,345	42%
Fuel and Power	11,995	15,683	31%
General Insurance	1,998	3,032	52%
IT	101	138	37%
Miscellaneous	3,962	7,761	96%
Pharmaceuticals and Chemical	5,303	6,661	26%
Service and Real Estate	404	1,373	240%
Tannery	811	914	13%
Telecommunication	15,084	10,705	-29%
Textile	1,257	3,181	153%
Travel and Leisure	550	1,484	170%
Total	96,358	138,247	43%

**Even 2010 had to produce
massive 43% earnings growth**

How Growth Impacts Price in Valuation Model

Gordon Growth Model Formula

$$\text{Value of Stock} = \frac{D_1}{(k - g)},$$

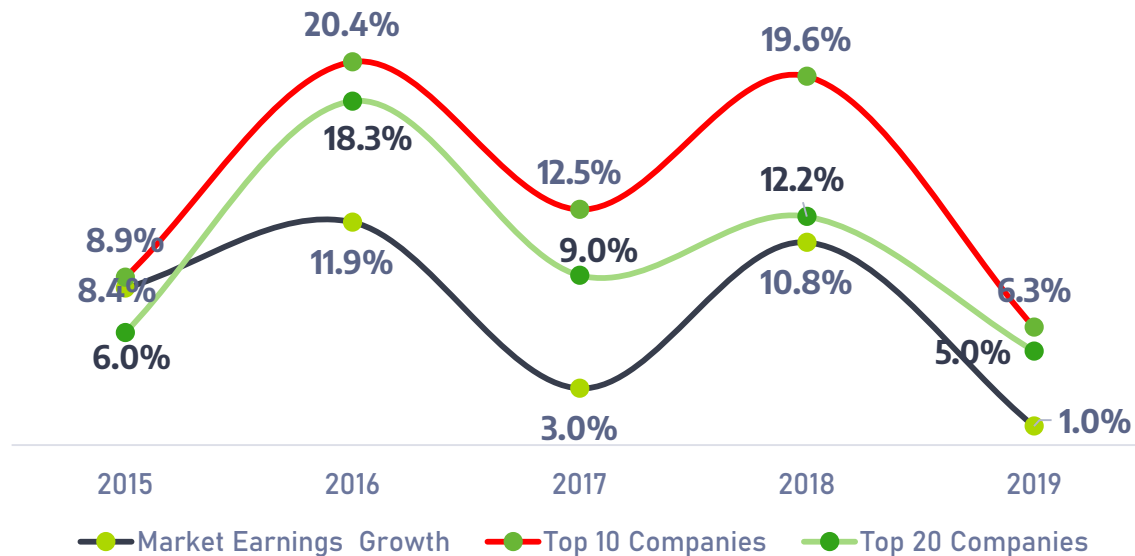
D_1 = Dividend
 k = Required Return
 g = Growth

	Price	Dividend	k	g
Stock 1	750	15	12%	10%
Stock 2	214	Same	Same	5%

What impacts earnings growth?



Good Governance is the Cornerstone of Growth



Earnings growth of top 10 and 20 market cap companies has historically been higher than that of the total market

Companies with good governance and competent management

Return of Blue Chips

AVERAGE ANNUAL RETURN (CAGR) AS OF DECEMBER 31, 2019				
Stocks	Last 5 yrs	Last 7 yrs	Last 10 yrs	Last 16 yrs
Square Pharma	3.70%	15.50%	14.70%	22.70%
Renata	18.20%	25.10%	19.50%	38.30%
Beximco Pharma	5.80%	7.70%	0.10%	13.30%
Marico Bangladesh	13.10%	35.60%	22.00%	*
Reckitt Benckiser	28.50%	27.80%	11.10%	27.50%
Grameenphone	1.60%	13.90%	11.10%	*
Berger Paints BD	16.40%	29.10%	18.80%	*
Brac Bank	29.70%	25.70%	16.70%	*
BATBC	3.80%	21.60%	24.20%	27.10%
IDLC Finance	3.30%	6.50%	4.70%	*
Olympic Industries	0.00%	24.70%	26.30%	*
*No data available or yet to calculate		Primary data: Dhaka Stock Exchange		

DSE Index	-1.8%	1.1%	0.0%	10.2% (20 yr)
-----------	-------	------	------	------------------

Performance Comparison

A Well Governed Tobacco Co. Vs. not so well Governed Financial Institution

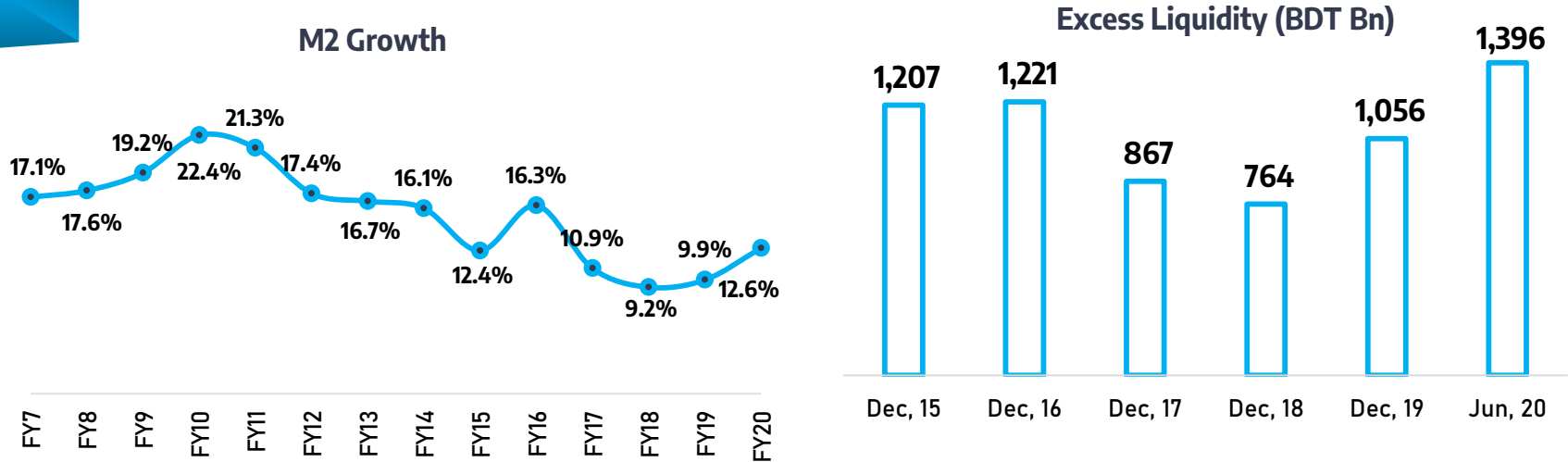


Source: Stock Bangladesh

Conducive Macro Factors



Market liquidity improving after 3 years



After 3 years of liquidity crunch, money market liquidity is improving.

Bangladesh Bank (BB) came up with policy supports (CRR and SLR cut, low Repo rate etc) and expansionary monetary policy to improve liquidity.

Excess Liquidity (higher than required SLR investment) also hit BDT 1.4tn in June 2020.

Export picking up as global lockdown eases

Export during 2020 (USD Bn)



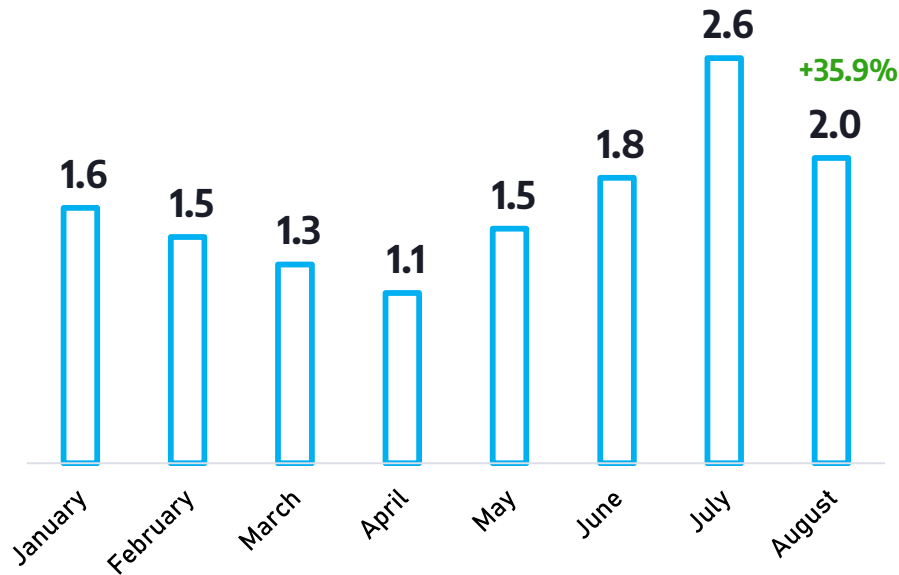
Pandemic drove -17.1% growth in FY20

RMG export posted 44.6% growth after seven months of negative trend in August 2020.

Positive impact in Listed Company Earnings and Overall Wealth Effect

Robust remittance growth continues

Remittance during 2020 (USD Bn)

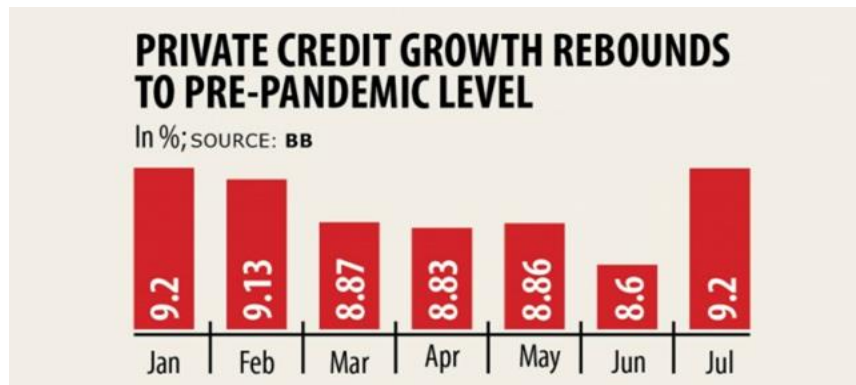


11% growth in remittance during FY20 amid the pandemic

Another 36% growth in August after July's record USD 2.6bn

Big boost for Consumption

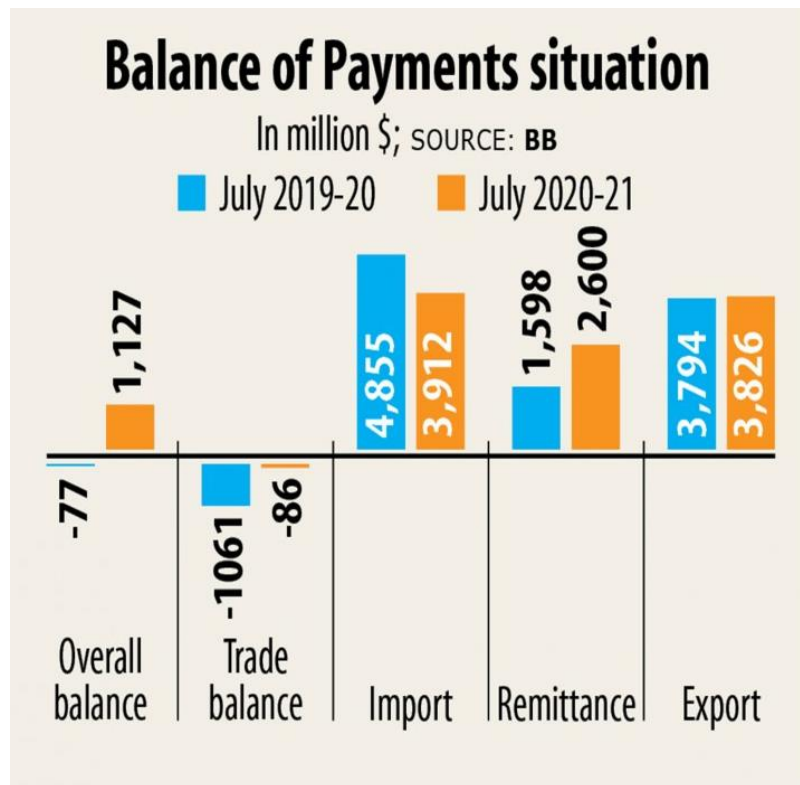
Private sector credit showing signs of positivity



**Stimulus packages:
Disbursement picks up as
business normalises**

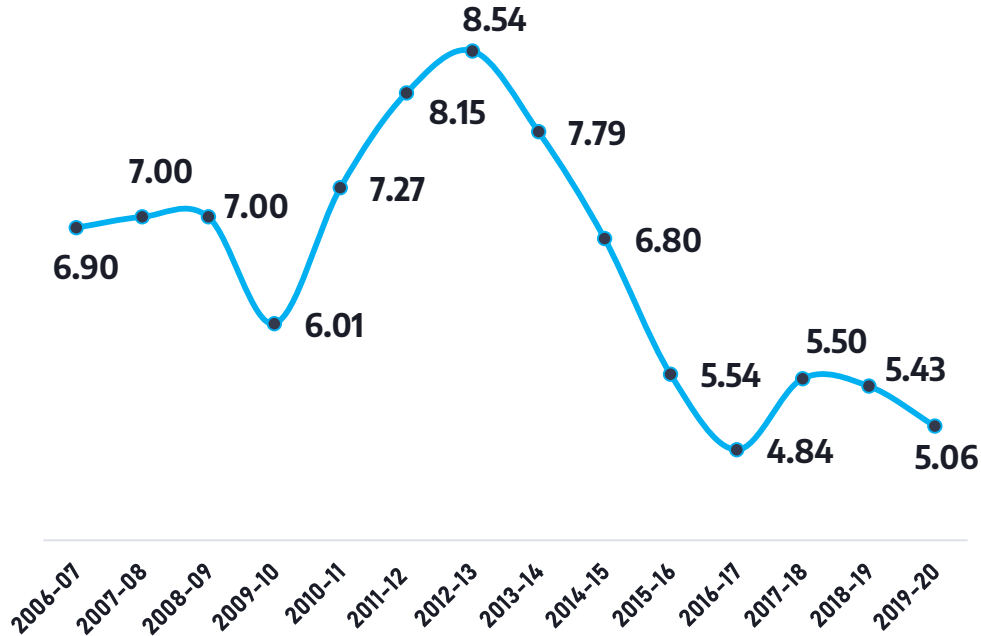
8 September, 2020

Balance of Payment is improving



11 September, 2020

Weighted average deposit rates of Banks (%)



Globally, any asset price bubble is created by easy money

Outside World Events

If Frontier Market Index performs well, investors put their funds there. Every market gets a pie of it

If US market performs too well, investors take the fund out of Frontier markets and put in US

If global interest rate declines, fund flows from bond to equity

Concluding Remarks



Earnings and price both fell significantly from 2010 level



2010

**BDT
4.0bn**

Earnings fell
97%

2019

**BDT
0.1 bn** ↓

**BDT
64.4bn**

Market cap
decreased
88%

**BDT
8.0 bn** ↓



2010

**BDT
6.9bn**

Earnings fell
40%

2019

**BDT
4.1 bn** ↓

2020

**BDT
92.7bn**

Market cap
decreased
76%

**BDT
22.2 bn** ↓

Earnings and price both increased from 2010 level



2010

**BDT
10.7bn**

Earnings
increased
222%

2019

**BDT
34.5bn** ↑

**BDT
307.3bn**

Market cap
increased
48%

**BDT
454.1bn** ↑



2010

**BDT
2.9bn**

Earnings
increased
221%

2019

**BDT
9.2bn** ↑

**BDT
45.0bn**

Market cap
increased
330%

**BDT
193.6bn** ↑

Top gainer since introducing floor price

Stock	Floor Price	Price (9th Sept)	Return From Floor
ZEALBANGLA	31.6	163.9	418%
GQBALLPEN	66.1	223.4	237%
EASTERNINS	29.8	100.7	237%
PARAMOUNT	36.3	112.6	210%
APOLOISPAT	2.8	8.3	196%
SHYAMPSUG	23.8	69.7	192%
DACCADYE	2.9	7.8	168%
BXSYNTH	3.2	8.4	162%
SAVAREFR	98.1	237.7	142%
BDFINANCE	7.9	18.5	134%
KEYACOSMET	2.5	5.8	132%
FINEFOODS	41.9	92.7	121%
BIFC	2.6	5.7	119%
PIONEERINS	29.4	61.9	110%
FASFIN	4	8.4	110%
GENNEXT	2.2	4.6	109%
ZAHINTEX	3.6	7.5	108%
PEOPLESINS	15.1	31.3	107%
BEXIMCO	13	26.6	104%
BXPHARMA	60.7	122.1	101%
SPCERAMICS	8	16	100%
TUNGHAI	1.9	3.8	100%

What we need

We do not need so many non-performing stocks, but a few **dependable scrips**.

We need less number of speculators, and **more of value investors and contrarians**.

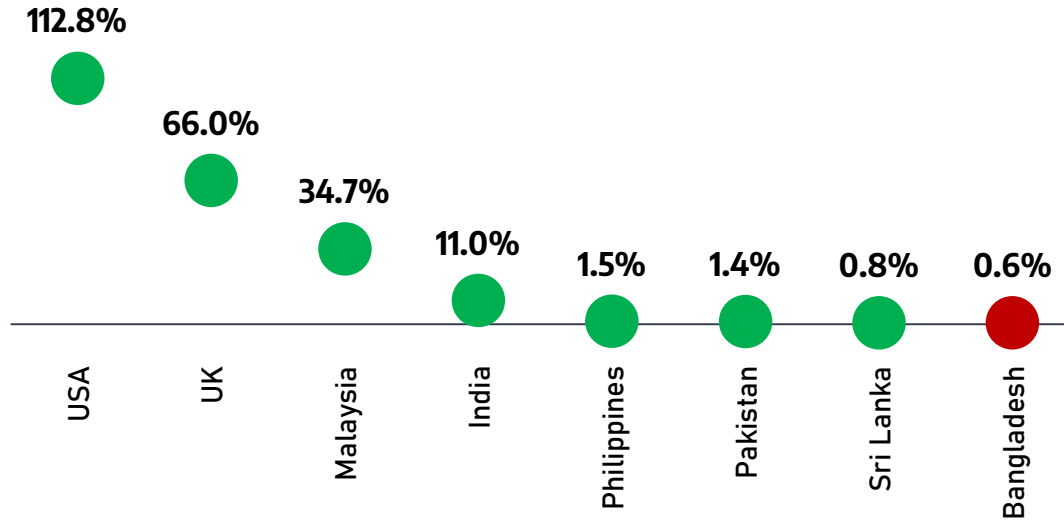
We need **Fund Management Process** in the regulated entities, not buying 100-200 scrips blindly.

We need retails to be channeled through **mutual funds and discretionary accounts** of merchant banks.

Use of **margin loans** to be restrained.

Global Mutual Fund Industry

AUM as % of GDP as of 2018



Source: World Bank, SEBI Handbook of Statistics, IDLC

In developed countries mutual fund is one of the most popular investment vehicles.

In USA, the size of the industry is bigger than the economy itself.

Bangladesh is lagging well behind its neighboring country India in terms of the size of mutual fund industry relative to the economy.



Thank You