The Bear Phase Prevails

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The Colombo stock market celebrated its one hundredth year of share trading this year. It has come a long way since its early days although progress has been somewhat slow during the last two years. The market initially commenced to provide a trading opportunity for investors to trade in plantation company shares, but no real growth was witnessed until 1989, al- though the number of companies listed continued to increase gradually except in the 1950's and 1970's. In 1989, the stock market was opened to foreign investors and this was the beginning of the boom in the market. In recent times, the market witnessed two bull runs, the first from March 91 to February '92 with the opening of the market to foreigners and, the second from July '93 to March 94. During the last bull run, the Sri Lankan market was reported to be one of the best performing markets in the world. But, unfortunately with the emerging markets going out of favour the Sri Lankan market went into a hear phase in October 1994 and has not recovcred since.

The current market capitalization is Rs. 106.14b and the bulk of it is represented by the banking and finance sector which accounts for 32.75%. The important sectors are the manufacturing (16.3%) and diversified holdings sectors (13.4%). The most sought after stocks in the banking sector are the two development banks; the Development Finance Corporation of Ceylon and the National Development Bank and the two commercial banks, namely Hatton National Bank and Sampath Bank. In the diversified holdings sector, the conglomerates Aitken Spence & Co. Ltd., John Keells Holdings Ltd., and Hayleys Ltd., attract significant local and foreign institutional investor interest. Aitken Spence and John Keells have substantial exposure to the tourism sector and have thus been affected by the downturn in tourist arrivals. In the manufacturing sec- tor, stocks of the ceramics companies attracted significant interest. Ceramic companies in Sri Lanka have doubled their capacities in the last two years and have very attractive growth potential as they possess many competitive advantages over their foreign competitors. Richard Pieris Ltd., a diversified manufacturing sector company, has also attracted substantial investor interest.

During the current year, the market has been extremely dull with levels being some of the lowest recorded for the last three years. The main reasons being, the lack of interest by foreign investors due to both domestic and international factors. On the domestic front, the unsettled security situation in the country, unruly activities by various trade unions, and the delay in implementing the much needed infrastructure development programs have been of concern. On the international front, the continued strengthening of the mature markets as the United States and Japan and the unsettled conditions in India due to an indecisive election have kept investors away from the Indian Sub-continent. Foreigners have always been the driving force of the Sri Lankan market, as most domestic investors adopt a policy of entering the market only for short-term gains. Therefore, only when an upturn in the market is witnessed do we observe heightened retail investor activity. Also, as the market is going through a long bear run since October 1994, most local and foreign investors are heavily invested in the market and in the current context are reluctant to increase their exposure. But, as prices have been low for the past two years, most investors are not willing to sell at current prices. Another factor for the lack of interest in the market is that corporate results have also not been encouraging, with most companies recording declining earnings for the current financial year.

On the international front, the Indian elections have resulted in a centre-left government, which must depend on the Congress party to be in office. It is clear that they will continue with the previous government's reform policies, but the stability of the government is in question. Therefore portfolio investors may initially adopt a conservative approach towards India. This may in the medium-term result in no significant inflow of funds to Sri Lanka. But with the United States economy expected to slow down and its stock market reaching a peak, it is expected that more funds will move into Asia.

On the local front, economic activity is expected to recommence in the north. If the reconstruction of Jaffna in particular begins, it would be a massive boom to the whole economy. Further, although trade unions continue to oppose privatisation, the government is expected to go ahead with its ambitious privatisation programme. Already Shell International has bought controlling interest in Colombo Gas Company Ltd., and Caltex has done so with Lanka Lubricants Ltd. Presently Air Lanka Ltd., the national carrier, Independent Television Network a government-owned TV channel with an islandwide coverage and Sri Lanka Telecom are to be privatized within the next one and a half years. Thereafter, the government intends to privatize the two state-owned commercial banks that control 50% of the banking industry and the two state-owned insurance companies that also control 50% of the insurance market. These privatisations will have the advantage of increasing the liquidity market, and offering quality companies with strong earnings potential to institutional investors. In addition, privatisation will ensure improvements in the management and technical skills of the employees and provide a better service to the customers. These privatizations will also attract large multinationals who would be interested in making a controlling stake in the said companies.

The economy grew at 5.5% GDP in 1995, and this achievement is considered commendable, considering the problems the country is faced with. The massive defence expenditure that was incurred due to the escalation of the conflict is cause for concern but the resilience of the economy is admirable. Even though the country has been affected by drought, a GDP growth of 4.5% in 1996 and over 5.5% in 1997 is projected. The outlook of the market for the next two quarters would be a stagnant index but thereafter, with the military and economic situation anticipated to be positive, the All Share Index is expected to appreciate by at least 30%. This forecast is based on the assumption that the improved military, economic and political environment will result in strong performance by many corporates. Particularly, stocks in the banking and finance sector and the diversified conglomerates are expected to be the largest beneficiaries when the economy takes off. The banking and finance sector will benefit from increased loan growth, fee income and capital market activity. The improvement of the military environment will result in a revival of the tourist industry and the diversified conglomerates particularly Aitken Spence and John Keells will benefit immensely with their profits expected to grow by over 50%. The ceramic industry which has immense growth potential will benefit from an expansion of the domestic market and improve export sales. This will result in over 50% growth in profits for most listed companies in this sector.