Investment Outlook

National Fullerton Asset Management Limited

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Summer Brings Rising Uncertainty

Pakistan offers mixed prospects while we enter the summer of 2009. On the economic front, almost all statistics show improving trends. Budget deficit, trade deficit, current account deficit, inflation, interest rates, foreign exchange reserves, liquidity status, etc., show that the bleeding we experienced in the first half of FY 2009 (Jul-Dec., 2008) has stopped, and we have entered a phase of consolidation. The next phase that the country is expected to enter in FY 2009-10 is that of "growth". Economic growth has suffered a lot in FY 2008-9, which is evident from two factors. Private sector borrowing had declined to Rs.92.5 billion in the first 8 months of FY 2008-9 relative to Rs.320 billion in the first 8 months of FY 2007-8. The overall economic growth rate is expected to be around 2.5% in FY 2008-9 versus 5.95% in FY 2007-8.

In FY 2009-10 the overall economic growth rate is projected to improve to around 4%. Two factors are expected to support this improvement. First, inflation (Sensitive Price Index) has declined substantially from around 32% in August 2008 to around 20% at present. This is projected to decline further to 12% in June 2009. In FY 2010, inflation is expected to be in single digits. This will enable the State Bank of Pakistan to further ease the monetary policy, thus providing stimulus for growth. KIBOR is expected to be under 10% in FY 2009-10, which will enable businesses to expand again. Second, the Government of Pakistan is expecting substantial foreign assistance from "Friends of Pakistan" and donor agencies, adding up to several billion dollars in the near future. This will enable the government to substantially increase development spending and possibly also reduce oil prices. This will not only help economic growth, but will also increase the liquidity in the system, some of which will spill over to the stock, TFC and real estate markets. Thus the recovery in asset prices, which started in January 2009, is expected to continue in FY 2009-10.

There is, however, a risk looming over this expected recovery. And that is the law and order situation in the country. There is a possibility of a major military operation in Swat and FATA regions sometime this summer. This expected operation may last a couple of months. The repercussions of such an operation may be felt in the streets and capital markets of the country. It is expected that the military operation will be followed by the strengthening of the civil administration, the police, the traditional tribal system and the judiciary in these areas. A large chunk of foreign assistance will be injected in these regions to create jobs and improve human and physical infrastructure. There is a strong possibility that such an operation, backed by a large majority of the Pakistani population including the residents of these regions, and supported by ample foreign economic assistance, will be successful in improving the law and order situation of the country.

The stock market volatility may rise in anticipation of a military operation and / or at the time of launch of such an operation. However, this will be a temporary phenomenon, and the market is expected to recover on first signs of success of the operation. NAFA has reduced equity exposure in its Stock and Multi Asset Funds, and is watching the situation closely to further reduce the equity exposure if such a scenario develops. However, this will be a temporary change of strategy linked to an expected event of military operation in the Swat and FATA regions. We still believe that the stock market is at very attractive levels at present, and feel that it will close CY 2009 at a higher level than where it is at present.

NAFA Stock Fund has already risen by 54% from its bottom level achieved only about 3 months ago, whereas NAFA Multi Asset Fund has risen by 39% from its bottom level. We advise our investors in funds with an equity exposure to remain invested for a longer period of time to recover losses that they might have experienced in 2008 due to a huge fall in the stock market. NAFA funds are bouncing back and we expect this trend to continue in 2009 and beyond, although in between there will be times where the stock market will experience increased volatility and corrections.