NBP Fullerton Asset Management Limited
(Formerly National Fullerton Asset Management Limited)

Managing Stock Market Risk

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Most investors remain confused about the stock market puzzle – to invest or not to invest. After the 60% decline in the Pakistan stock market in 2008, most investors promised to themselves that they will never again invest in the stock market. Most are still keeping their promise. And they have watched from the sidelines the stock market rise by about 60% in 2009 and another 28% in 2010. What should they do now? The answer lies in the basics of stock market investing: invest only that amount in the stock market that you do not need for at least 5 years. This way even if the stock market declines you have sufficient time for it to recover. And there is one other important lesson: do not take naked / 100% exposure of the stock market. Pakistani stock market is amongst the most volatile markets in the world with a standard deviation of about 25%. Two ways to take a managed exposure of the stock market are through an Asset Allocation Fund or a Capital Protected Fund / Strategy.

In an Asset Allocation Fund, NBFC Regulations allow the Fund Manager a range of 0%-100% exposure in any asset class, whether it is money market, debt or equity. Thus, if a Fund Manager expects the stock market to be bullish he or she can invest 100% of the Fund's assets in the stock market. But if the Fund Manager expects the stock market to experience a bear run, he or she can sell 100% of the Fund's equity portfolio, and switch to the safer money market or income options. NAFA launched NAFA Asset Allocation Fund (NAAF) in August 2010. Figure 1 shows the performance comparison of NAAF with bank deposits and the stock market. The Fund has experienced a much higher return than bank deposits and a lower return than the stock market.

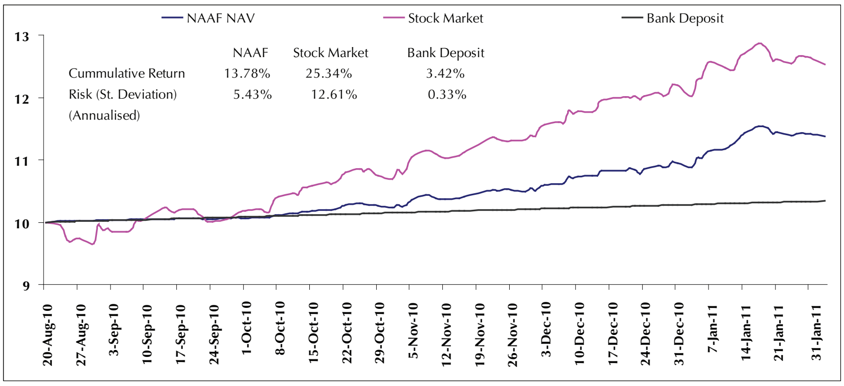

Figure 1
Performance of NAAF vs Stock Market & Bank Deposits

Also, its risk (volatility) is much lower than the stock market - 5% volatility versus 13% for the stock market. Thus, the downside risk of the investor is much lower relative to the stock market. An investor can possibly live with this relatively lower level of risk and can still beat bank deposit rates and inflation. We urge our investors to consider this Fund for their personal assets and/or provident / pension funds.

Another safer option to invest in the stock market is to do it via capital protected strategy. When one buys a house or a car one generally also buys an insurance policy to protect the value of the asset. So when one invests in the stock market, why not also buy an insurance policy on the investment to have a peace of mind. This is what a capital protected strategy / fund does. The cost of this insurance is that your return / profit may be lower than the stock market, but possibly higher than bank deposits, over the medium-to-long term. NAFA started offering capital protected option to its investors about a year ago. Figure 2 shows the return on the Strategy for our investors for 2010 versus bank deposits and the stock market. Again, although the return is lower than the stock market, it is better than bank deposits. More importantly, the investor has the comfort that his principal is protected, and the volatility of the Strategy is much lower than the stock market - 2% volatility versus 15% for the stock market. Presently NAFA is managing assets of several provident / pension funds under the capital protected strategy, with returns averaging about 14% per annum for investments over 6-months old.

Presently, the stock market seems slightly overpriced due to a 23% rise in a short span of four months. A correction seems overdue. However, despite the economic, political and security challenges facing the country, corporate earnings are expected to grow at 20% per year in the coming years. Also, if we exclude OGDC and MCB, the stock market is trading at price-to-earnings multiple of 6.7 times on FY12 earnings. An attractively priced stock market, good expected corporate earnings growth and continued interest from foreign investors will help the stock market double over the next 4-5 years (expected annual rate of return of 18% per annum). A managed exposure to the stock market via an Asset Allocation Fund or Capital Protected Strategy can enable investors to benefit from this expected rise.

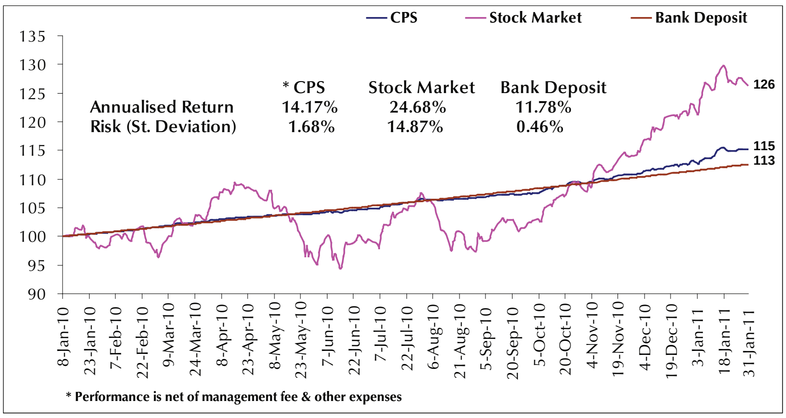

Figure 2
Performance of CPS Portfolio Managed by NAFA vs Stock Market & Bank Deposits