NBP Fullerton Asset Management Ltd.
A Subsidiary of National Bank of Pakistan

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How to Profit from the Stock Market upside, while protecting the Downside?

Investment in Money Market and Fixed Income products (bank deposits, T-Bills, TFCs etc.) presently offer around 10% p.a. return, which does not even compensate for inflation, thus eroding the real value of investment over time. On the other hand, the Pakistani stock market has historically (last 13 years) provided an attractive return of about 24%p.a. However, this performance was accompanied by several ups and downs. During this period there were three years where the stock market investors sustained losses. An ideal situation for investors will be to get the upside of the stock market, while avoiding the downside risk. Capital Protected Strategy offers such an opportunity, providing protection to the investor in the down markets, while rewarding investors with attractive returns in the up markets. When we buy a car or a house we buy insurance to protect ourselves against any eventuality. Capital Protected Strategy is similar to an insurance policy – protecting the investor from the loss of capital, while helping the capital grow by investing in the stock market.

Under Capital Protected Strategy, a certain portion of the portfolio is invested in the low-risk assets (T-bills, bank deposit, money market mutual funds). The remaining portion (cushion) is gradually invested in the risky assets (shares, equity related funds). Due to the changing performance of the assets, especially the risky asset, the portfolio is dynamically allocated between the low-risk & the high-risk assets based on the Strategy. The risky asset is sold as it falls in value and bought as it rises in value. The risk tolerance of the portfolio becomes zero when the net asset value per unit of the portfolio equals the pre-defined floor.

Based on our back-testing, during the period from January 2001 to December 2013, Capital Protected Strategy offered a 14.5% annualized return against the stock market return of 24.2% per annum. In addition to the capital protection, the risk of the investment as measured by the standard deviation of the return is calculated at 7.9%, which is much lower than the 27.6% volatility of the stock market during the same period. As the Chart depicts, an investment of Rs. 100 via Capital Protected Strategy in January 2001 would have grown to Rs. 578 in nominal terms in December 2013. This is a better performance than offered by banks, T-bills and National Savings Schemes during the same period.

Figure-1:
Performance of key asset classes from Jan2001 to Dec2013

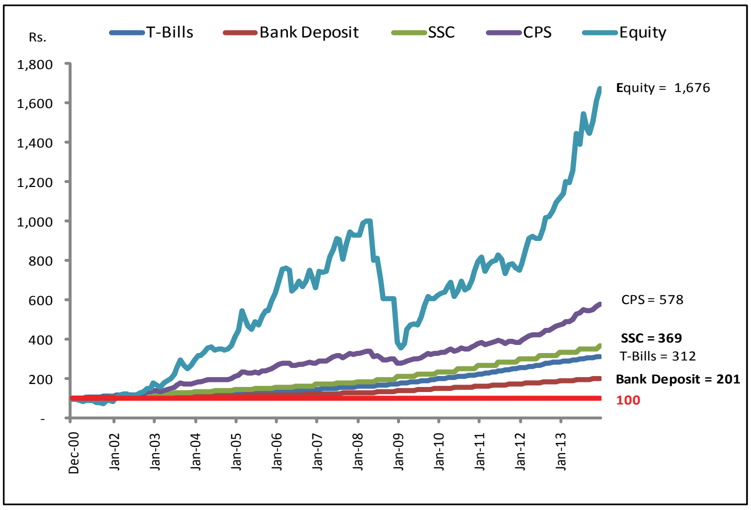

Figure-2: Performance of key asset classes from Jan2001 to Dec2013

Asset class	T-bill	Bank Deposits	Special Savings Certificates	Capital Protected Strategy	Stock Market
Nominal return	9.2%	5.5%	10.6%	14.5%	24.2%
Inflation	9.0%	9.0%	9.0%	9.0%	9.0%
Real return	0.2%	-3.2%	1.5%	5.0%	14.0%
Standard Deviation (Risk)		0.2%	6.8%	7.9%	27.6%

** All figures are annualized*

NAFA is launching NAFA Islamic Principal Protected Fund (NIPPF-I) with an objective to gain the upside of the stock market, while protecting the downside risk. The Fund will be managed under the Constant Proportion Portfolio Insurance (CPPI) methodology. NAFA is presently managing around 50 mandates of corporates, trusts, employee funds and high net worth individuals under the Capital Protected Strategy. The Fund is open for subscription between 24th January and 5th March 2014. We expect that investing in the stock market via capital protection strategy will become a preferable and popular option for employees' funds and individuals in Pakistan in the coming years.