Investment Outlook FY 2012

NBP Fullerton Asset Management Limited
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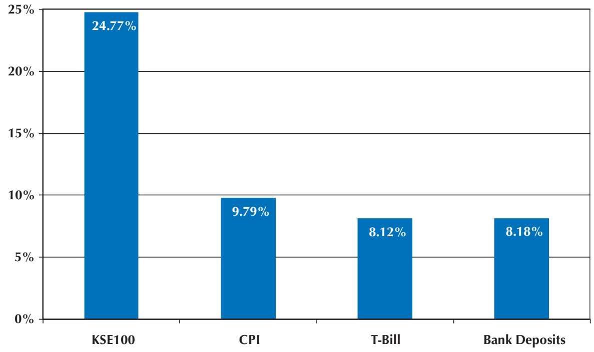
The recently announced Federal Budget for FY12 seems overambitious targeting 23% growth in tax revenues. Pakistan is stuck in stagflation over the last few years. This reflects a stagnant economy (growing at a meager 2-3% per annum) and double-digit inflation. Dismal law and order situation, chronic power shortages, high defence expenditures, and low development spending are expected to continue in the coming years. A good agriculture crop ensuing from favorable weather conditions can add a percentage point or so, to the economic growth rate. Lower tax collections and sticky current expenditures will continue to force the government to borrow heavily. In FY 2011 total government borrowing has exceeded Rs 1 trillion, which translates into borrowing of about Rs 3 billion per day. High government borrowing poses a major upside risk to inflation, interest rates, and currency, and downside risk to the economic growth.

Both the quantum and exorbitant interest rates at which the government is borrowing are causes of concern. Average bank deposit rate is 6% p.a.; whereas government borrowing via National Savings Schemes is at around 13% p.a., on average. This is an anomaly as this goes against the basic principles of investments. Government is AAA rated and borrows at much higher rates than banks, which are AA rated, on average. In India, the average bank deposit rate is 7.5% p.a. whereas the average rate on government savings schemes is marginally higher at 8% p.a. In Pakistan, the government is borrowing at twice the bank deposit rate. As a result government debt servicing now constitutes 73.5% of total tax revenues. Also, government borrowing at such high rates has crowded out the private sector, which cannot afford to borrow at rates higher than the government, and still be profitable in this stagflation environment.

Fixed Income investors are advised to invest in short-term bank deposits and government instruments to protect their investments against rising interest rates and inflation. Currency investors are advised to closely watch the current account. FY 2011 has been a good year on the external accounts front thanks to record workers' remittances of about US$ 11 billion and rise in exports mainly due to higher commodity prices, especially cotton. As long as the current account deficit is under US$ 500 million a month, the risk to the exchange rate will be low. However, higher current account deficit can result in significant devaluation of the rupee versus other currencies.

FY 2011 has been a good year for the Pakistani stock market. The KSE-100 Index rose by 28.53% during the year, whereas NAFA Stock Fund rose by 28.37% (Net of Management Fee & all other expenses) during the same period. FY 2012 is also expected to be a good year for the Pakistani stock market. Corporate earnings are expected to rise by 20% in FY 2012, and the stock market is expected to rise in line with corporate earnings. The forward price-to-earnings ratio of 7.5 times is substantially lower than other countries in the region, which reflects the higher country risk. The Chart below shows that over the last 10 years the Pakistani stock market has performed better than Treasury Bills, bank deposits and inflation. We expect the stock market to outperform inflation and fixed income options over the long-run. Investors are advised to invest in defensive, high dividend yielding stocks, preferably via mutual funds to benefit from diversification and professional expertise.



In FY 2011, NAFA Multi-Asset Fund and NAFA Islamic Multi-Asset Fund were ranked the best performing funds in their categories providing return of 25.30% and 28.44% respectively to unit holders. Moreover, since its inception on August 21, 2010, NAFA Asset Allocation Fund was the second best performing fund among its peers, posting return of 19.45%. We will strive to keep up this performance in FY 2012 as well.