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

Investment Outlook 2011

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CY2011 will be another difficult year for Pakistan. The structural issues facing Pakistan need to be addressed to give a positive signal to local and foreign investors. Some of the key structural issues facing the country are as follows:

- Some segments of the economy remain outside the tax ambit such as agriculture, services and real estate. Thus tax collection is under 10% of GDP, one of the lowest in the world.
- Domestic Debt servicing is eating up about 44% of government tax revenues.
- Defense spending is about 33% of government tax revenues, which is among the highest in the world.
- Development spending including education, health care, population planning, flood protection and infrastructure etc. is substantially lower relative to other emerging markets.
- Government-owned organizations are incurring losses of about Rs 300 billion per annum.
- Excessive government borrowing in the last three years has crowded out the private sector, which is the more efficient sector. Private sector borrowing has come down from Rs 366 billion during FY2007 to Rs 71 billion during FY 2011 (July- December 2010). Whereas government borrowing during the same time period has risen from Rs 164 billion to Rs 450 billion.
- The size of the Federal and provincial governments has bloated over the years.
- Successive governments have failed to provide an enabling environment to the private sector and non-profit organizations to provide public services.
- No focused effort has been made by successive governments to develop alternative sources of energy, such as coal, hydel, wind, etc.

The above mentioned structural issues cannot be resolved overnight. However, if a serious and concentrated effort is made to start addressing these issues, the investors will take it as a positive signal and start investing again. In 2010, Foreign Portfolio Investment in the Pakistani stock market stood at around US$ 500 million. In the same year about US$ 30 billion has been invested by foreign investors in the Indian stock market. India's economy is 10 times larger than that of Pakistan. On this basis, if US$ 30 billion is invested in the Indian stock market, then about US$ 3 billion should have been invested in the Pakistani stock market instead of US$ 500 million. Concrete progress towards redressal of the above mentioned structural issues can help increase foreign investment in Pakistan several fold, improving job creation and government tax collection.

In 2011, government borrowing is expected to remain excessive, thus inflation and interest rates are expected to rise further. The Pakistani stock market is trading at a forward price-to-earnings ratio (PER) of around 8.5 times, which makes it one of the least expensive markets in the world. However, considering our economic, political and law & order situation, we believe that the stock market is fairly priced. Corporate earnings are expected to rise by 15%-20% in 2011, and the stock market is expected to rise in line with corporate earnings. The main driver of the stock market in 2011 will continue to be Foreign Portfolio Investment.

In CY2010 NAFA Stock Fund was the 4th best performing fund in the market among 18 stock funds, whereas NAFA Multi Asset and NAFA Islamic Multi Asset Funds were ranked 1st in their respective categories. The Table below shows the performance of NAFA's funds with an equity exposure versus their benchmarks and peer groups. In the 3rd Quarter of 2009 NAFA appointed Sajjad Anwar, CFA as Head of Equities and Tanvir Abid, CFA as Head of Research. This team has followed a disciplined investment strategy that has yielded these results, and we hope that this good performance will continue in 2011 and beyond.

Performance in CY2010 (January- December)

	Return	Benchmark Return	Peer Group Average
NAFA Stock Fund	21.15%	17.65%	15.78%
NAFA Multi Asset Fund	20.80%	15.45%	10.04%
NAFA Islamic Multi Asset Fund	27.50%	21.82%	18.78%
NAFA Capital Protected Strategy	13.87%	7.60%	N.A.

Source: Mutual Funds Association of Pakistan