National Fullerton Asset Management Limited

Investment Outlook

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Liquidity is back in the Economy

The liquidity crunch during the second half of 2008, which was one of the worst that we have experienced in Pakistan, is now history. This is good news for different asset classes such as the TFCs, stock market and real estate. We have already seen a gradual recovery in the values of these asset classes and this trend is expected to intensify further over the next 6 months.

The improvement of liquidity in the system is a result of various factors. First, Pakistan's trade deficit has dropped from US$ 2.3 billion in October 2008 to US$ 411 million in January 2009. This means less rupees are being converted into dollars and leaving the system. Second, foreign remittances have increased considerably, with official remittances at US$ 637 million in January, 2009. These higher remittances are driven by global recession, which has persuaded Pakistanis to transfer their funds back home in search of safety. Third, higher foreign exchange reserves and a stable foreign exchange rate is encouraging Pakistanis to invest at home. Fourth, a significant decline in inflation and expectations of further decline over the next few months is giving confidence to investors. Lastly, Foreign Direct Investment in the first seven months of this year at US$ 2.59 billion is slightly higher as compared to the corresponding period last year, despite the global recession. The liquidity is further expected to improve as an additional US$ 3 billion is expected from international financial institutions and the United States (on account of arrears) till June-end.

The impact of this improved liquidity is that interest rates have dropped substantially and bonds / TFCs prices have risen sharply over the last couple of months. This trend is expected to continue in the coming months as well. Several economic houses are projecting inflation (CPI) to drop by 500 basis points, and the discount rate by 300-400 basis points from now till July, 2009.

NAFA cash / income funds have substantial holdings in TFCs. The value of these TFCs dropped significantly in the fourth quarter of CY 2008 due to the liquidity crunch. Consequently, SECP issued a Circular in November 2008 instructing all AMCs to discount the value of TFCs in their funds. This resulted in a drop in the value of income funds in the market. Over the last couple of months, there has been continuous improvement in the value of these TFCs, and as a result, the return on NAFA cash / income funds is improving. NAFA Cash Fund (NCF) dropped by about 7.3% in value in November, 2008. However, since then the return on NCF has improved and has touched 18.5% (annualized) in February, 2009. NCF has a cushion / upside potential of around 8%-9%. This is in addition to the regular income in NCF, which is around 14% annualized at present (net of all expenses). It is expected that as liquidity further improves in the system, and the value of TFCs held in the funds improve, investors will recoup some or all of their November losses in the coming months.

NAFA Cash Fund – TFC Portfolio

Rating	% Net Asset Value (NAV) of the Fund
AA+ to AA-	50.6%
A+ to A-	15.8%
BBB+ to BB-	4.4%
D	1.1%
Aggregate	**71.9%**

Cushion / Upside Potential in NAFA Cash Fund

	Rupees (Millions)	% of NAV
Difference between Market Price and Par Value of TFCs	545.0	6.6%
Provisioning made according to SECP Circular 1	82.0	1.0%
Excess Provisioning made	137.2	1.7%
Total	**764.2**	**9.3%**

* Total Fund Size is Rs 8.27 Billion