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

Investment Options and their Characteristics

Dr. Amjad Waheed, CFA
Chief Executive Officer

A large segment of our population invests in bank deposits and National Savings Schemes (NSS). Presently bank deposits in the country are around Rs 5.7 trillion and investment in NSS stands at Rs 1.63 trillion. In contrast, a very small percentage of the population invests in the stock market. Investing in the stock market is equivalent to investing in a business because shares simply represent ownership of a business. Presently, there are only around 285,000 investors in the stock market with a free float of Rs 759 billion.

The objective of investing in any asset class is that it should increase the purchasing power. Over the last 15 years, average annual inflation was 8.7%. The average bank deposit rate in the country has been around 6.4% p.a. However, high net worth individuals and corporates have the bargaining power to negotiate better rates with banks on their deposits, which is slightly below the prevailing KIBOR / discount rate. These investors have earned an average return of around 9% per annum from banks. The return on Defense Savings Certificates has averaged 12.6% per annum over the last 15 years; however, there are heavy penalties if the investor decides to withdraw before maturity.

The Pakistani stock market has demonstrated an average return of 15% per annum over the last 15 years. Of these 15 years, the stock market offered a positive return for 10 years and a negative return for 5 years. The best year for the stock market was FY2002-03, when it rose by about 92%. The worst year was FY1997-98, when the stock market declined by about 44% following the nuclear tests by Pakistan. If someone had invested Rs 100 in a bank 15 years ago, this amount would have grown to Rs 332 today. Same Rs 100 invested in Defense Savings Certificate would have grown to Rs 591 at present, and the same Rs 100 invested in the stock market would have grown to Rs 758 at present. Thus, the stock market has offered higher return versus other investment avenues over the long term (see Chart 1). However, the stock market can be very risky for short term investors. Therefore, it is recommended that only investors with long-term investment horizon should invest in the stock market.

The Pakistani stock market has the risk (volatility) of around 27%, which is much higher as compared with other stock markets. This is due to the high political and economic risks facing the country. The very high volatility of the Pakistani stock market is one of the key reasons that most investors avoid investing in the stock market. One way to reduce this risk is investing via an asset allocation or balanced mutual funds. One such example is NAFA Asset Allocation Fund (NAAF), which has generated better return than the stock market, with a risk (volatility) of about one-third that of the stock market (see Chart 2). This performance has been achieved by superior market timing and better security selection. Such funds are expected to become popular among investors in due course of time.

To summarize, in order to earn a positive inflation-adjusted return, individual investors and employees' funds should invest in equities. However, they should invest gradually, say some amount every month, rather than in one go. Also, they should only invest a portion of their total assets in equities. The best way to invest is via mutual funds or using investment advisory services. Here the fund manager can alter the asset allocation among various asset classes such as stocks, TFCs, Treasury bills, etc., based on his or her view on each asset class in light of the economic and political situation of the country.

Chart 1

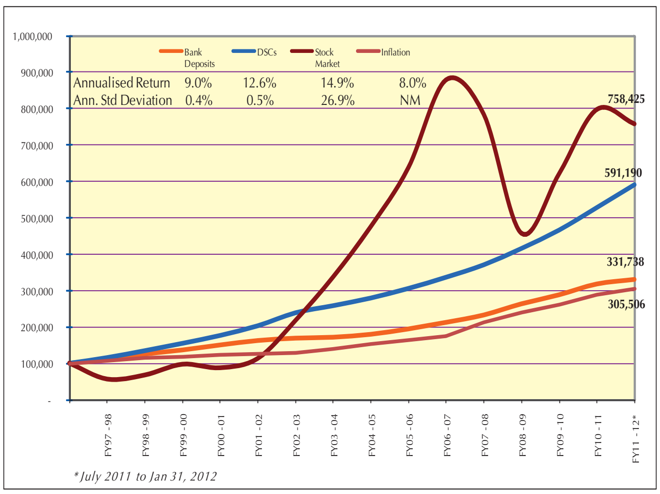

Chart 2