



National Fullerton
Asset Management Limited

Investment Outlook

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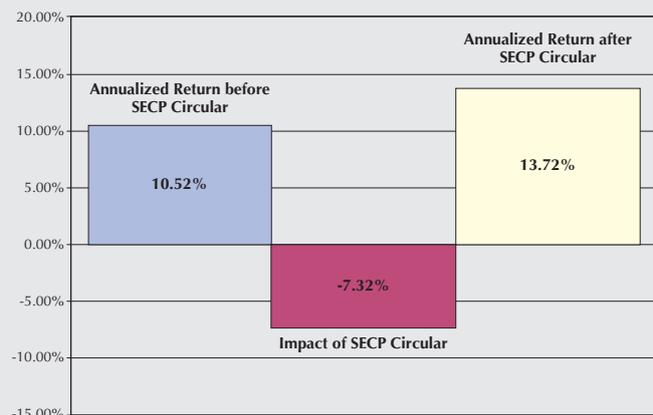
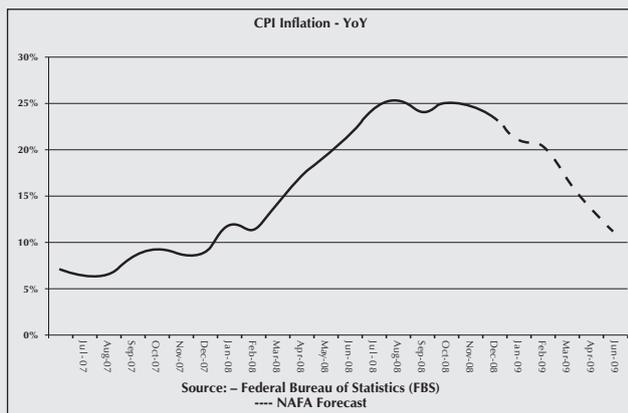
Economic Performance and Asset Valuations

Pakistan's economy is showing clear signs of improvement. Pakistan received around US\$ 700 million in Foreign Direct Investment in December 2008, and a similar amount in worker remittances. The current account deficit reduced to under US\$ 500 million in December versus over US\$ 2 billion in October. Government fiscal deficit has remained on target in 1HFY09 at around 2% of GDP. Inflation (Consumer Price Index) has declined from 25% in August 2008 to 23% by end-December 2008 on a year-on-year basis, and is expected to further decline to 12% by June-end, 2009 (See the chart below).

The global economy, especially the Western economies, are in their worst crises in decades and most global experts feel that the worst is yet to come. These economies have leveraged themselves to unsustainable levels, and it will now take years to reverse the excesses of the last two decades. The total public and private sector debt of the United States is over 350% of its GDP, which makes the United States one of the most highly leveraged countries in the world. The global economic slowdown has been a blessing in disguise for Pakistan. If the global economy was still robust and oil was still trading at over US\$ 100 per barrel, Pakistan would have been in deep trouble by now. Pakistani exports have been hit slightly by the global recession. However, due to a substantial decline in the import bill stemming from reduction in prices of crude oil, palm oil, steel and other commodities, Pakistan has been a net gainer from the global situation.

Why has the slow but steady improvement in Pakistan's economic situation not translated into improving asset valuations - stock market, TFCs or real estate? There are several reasons for this. First, there is an overhang of supply that has to clear before we move into a net positive investment mode. Global economic situation and resultant panic selling of all assets by foreign investors is keeping the Pakistani stock market depressed. Second, some of the major local brokerage houses who have suffered huge losses over the last six months, have been forced to sell their shares. Third, some banks which were forced to acquire shares due to defaults on CFS and / or margin financing have been off-loading these shares in the market. Fourth, lack of confidence, and "once bitten twice shy" mentality is keeping even genuine investors away from the market despite very attractive valuations. In my view, there is still about Rs. 20 billion of supply of shares in the market. With the Rs. 20 billion NIT State Enterprise Fund and gradual return of genuine investors in the market, this excess supply is expected to be cleared in the next few weeks. The Circular debt, which is still keeping liquidity tight in the market, is expected to be substantially paid off over the next 3-months. This is due to expected government budgetary support from the donor agencies such as The World Bank and Asian Development Bank. The resultant improvement in liquidity is expected to boost asset values.

In some cases, distress selling has already come to an end. Those double AA rated TFCs, which were trading at 25% discount to their face values 3-months ago, are today trading at 15% discount to their face values. It is expected that by June these TFCs may start trading at their par value. Thus, the losses that cash / income fund investors experienced in November as a result of the SECP Circular, are expected to be reversed in 2009. This makes cash / income funds a very attractive investment for investors with a one-year investment horizon. Below, please see the performance of our largest fund – NAFA Cash Fund before and after the SECP Circular.



I still expect a substantial recovery in asset values in 2009. In 1998-99, the stock market recovered by 48% in 12-months after dropping by 53% in 3-months. However, the recovery was very volatile with several good and bad months. I expect that 2009 recovery will also not be smooth, but similar to the 1998-99 recovery. Those who will be patient, and will not get disheartened by the ups and downs of the stock market, will reap the rewards.