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

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Investing in a Low Interest Rate Environment

It is becoming challenging for investors to earn a decent regular income from the available fixed income avenues in the prevailing low interest rate environment. Comforted by the considerable improvement in macroeconomic indicators, SBP, in its latest monetary policy review meeting in May, has further slashed the discount rate by 100bps to a 42-year low of 7.0%. Accordingly, money market yields have sharply declined with 1-year T-bill currently yielding just 6.8% per annum. Similarly, yields on 3 and 5-year PIBs have come off to 7.5% and 8.1%, respectively. Banks have also reduced profit on saving accounts & term deposits to 4.5-6% per annum. Similarly, NSS has also lowered rates on different products. Case in point is that returns on aforesaid investment avenues will barely keep pace with inflation which is expected to hover around 6-7% over the next 12 months.

Real estate investment is an option which offers attractive returns to investors. However, real estate investments are illiquid and expose investors to high price volatility and concentration risk. Also, taxes to transfer real estate have gone up substantially in the recent past. Further, these investments require large sums that most of the investors may not have. Advent of REITs in future would address some of the above concerns/constraints.

An alternative attractive investment option is the stock market which has yet to capture improving macroeconomic fundamentals. Ignoring all positive signals, the stock market continues to remain in the doldrums during the last few months. Resultantly, in our view, the valuations are extremely attractive as the KSE-100 index is trading at a forward Price-to-Earning of 9x, and offering a handsome dividend yield of about 6% to investors. We see a strong case of multiple (Price-to-Earning) rerating for equities driven by a combination of improved macroeconomic fundamentals, easy monetary conditions, and attractive valuations. Also, we expect corporate earnings to continue to grow at about 14% p.a. in the coming four quarters. Astute investors can take advantage of the aforesaid anomaly to earn a healthy return.

Key indicators have significantly improved but market remains in the doldrums

	May-15	Jan-15
KSE-100	33,057	34,444
Market PE	9.0x	9.5x
Inflation	3.4%	3.9%
SBP discount rate	7.0%	8.5%
Foreign Exchange SBP Reserves (USDbn)	12.3	10.4
Import cover(weeks)	15x	11x
Moody's outlook	Positive	Stable
Current account deficit-YTD (USDbn)	-1.4 *	-2.3
BOP surplus-YTD(USDmn)	2,118 *	358
1 Year T-bill yield	6.8%	8.4%
Pakistan 10Y CDS	416bp	462bp

Source: KSE, PBS, SBP, Bloomberg, NAFA
* up to month of April 2015

However, stock market investing is a science as well as an art that requires financial research and analytical skills. Further, this investment class exposes investors to a considerable short-term volatility. To allay these obstacles, investors can consider different types of equity mutual fund i.e. balanced, asset allocation, capital protected and pure equity funds, as per their risk tolerance and return requirement driven by their investment horizon, liquidity requirements and risk preferences. Asset allocation, balanced and capital protected strategies allow investors to have partial exposure to the stock market with a much lower level of volatility. While pure equity funds deliver superior returns over the long term, but they are subject to higher volatility. Generally, equity mutual funds have superior performance track record with majority of the funds outperforming their respective benchmarks over a medium to long-term period.

Its merit mentions that all our equity related funds are comprehensively outperforming their benchmark. For instance, our flagship equity related fund, NAFA Stock Fund has delivered 346% return during the last 5-years versus 254% by the benchmark KSE-100 index. An investor who invested Rs.100,000/- in our NSF 5 years ago has seen his investment value grow to about Rs.446,000/- at present.

Performance of NAFA's Key equity related Funds

NAFAFunds	Cumulative Returns	
	5 Years	1 Year
NAFA Stock Fund	346%	32%
NAFA Multi Asset Fund	203%	26%
NAFA Islamic Asset Allocation Fund	227%	32%

Considering the low interest rate environment that is expected to continue for some time, we advise investors who have a medium to long term investment horizon to consider investing in equities.