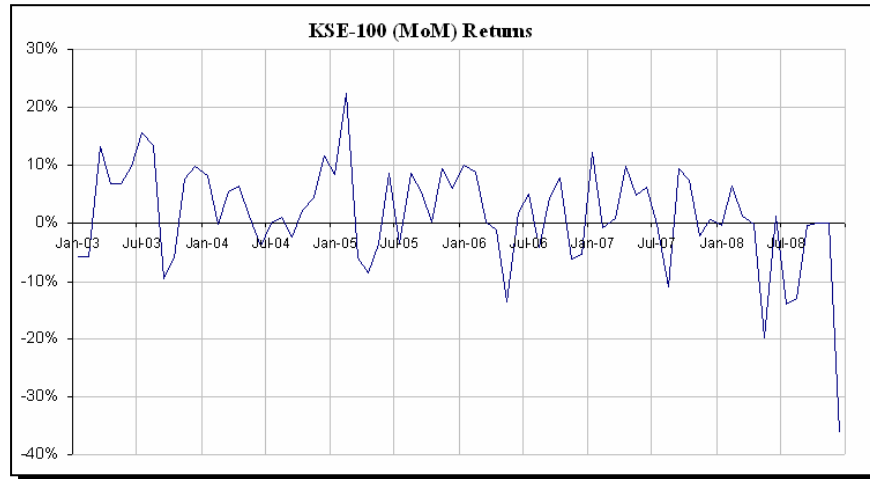


A Rearview Account...

Fund performance is interplay between management strategy and market dynamics. Our capital markets have been characterized by significant volatility. Even though year-on-year index returns depict upward rally, with 66% return for 2003, 39% for 2004, 54% for 2005, 5% for 2006 and finally 40% in 2007, a breakdown into monthly returns shows that the index did not follow a straight upward trajectory. The average monthly returns graphed below, reflect the volatility over this period.



Subsequent to the peak in April 2008, the index has experienced a sharp downward slide, with market capitalization having been eroded by almost 58% in CY08, while the KSE-100 index touched 2003 levels in January 2009.

The mutual fund industry, which had long been dominated by National Investment (Unit) Trust and Investment Corporation of Pakistan, flourished over the last three years, with a rapid increase witnessed in the number of industry participants. Our mutual fund industry is however still in nascency, with practices and systems still evolving.

The industry size had almost doubled from Rs. 160b in June 2006 to Rs. 302b by the end of June 2007. The pace of growth in 2008 was much slower, with the industry's assets under management reported at about Rs. 336b as of June 30, 2008¹. The number of funds increased over this period from 46 in June 2006 to 90 by the end of June 2008.

Table 1: Industry Statistics		(Rs. M)		
	June 2006	June 2007	June 2008	
Total Assets under Mgt.	159,910	302,483	335,528	
Bank Deposits	2,786,731	3,460,811	3,832,454	
AUM % Bank Deposits	5.7%	8.7%	8.7%	

The unprecedented collapse of equity markets and liquidity constraints in the financial sector has shaken the confidence of investors while also bringing to surface the wherewithal of some outfits. The size of mutual fund industry has almost halved during the period July – December 2008, reducing to under 5% of domestic deposits.

¹ Source: www.mufap.com.pk

Tables 2 & 3 present the growth trends, broken up into different categories:

Table 2: Open-End Funds (Rs. M)				
	Jun. '06	Jun. '07	Jun. '08	Dec. '08
Asset Allocation	7,074	5,456	7,433	4,416
Balanced	5,138	6,3758	12,215	6,722
Bond	1,025	1,386	365	374
Capital Protected	-	2,617	6,489	6,060
Equity	75,064	117,919	111,206	11,770*
Fund of Funds	192	145	1,241	866
Income	19,258	71,086	91,265	51,628*
Index Tracker	998	1,393	534	251
Money Market	8,320	44,823	57,460	32,662
Total	117,069	251,199	288,208	111,443

Note: Table also includes Islamic funds.

**Net Assets not reported by National Investment (Unit) Trust*

As can be ascertained from tables 2 & 3, in recent years, fund managers introduced open-end funds of varying types. The proliferation of income / money market funds led the growth in the mutual fund industry. Though a number of equity funds have also been launched lately, these remained small in size. At the outset, most of the larger asset management companies attracted investment from financial institutions, corporate or retirement / pension funds. The penetration within retail segments largely remains limited, with total number of investors estimated at around 129,000 at the end of June 2008 for open-end funds.

Table 3: Closed-End Funds (Rs. M)				
	Jun. '06	Jun. '07	Jun. '08	Dec. '08
Balanced	3,921	5,885	6,049	3,424
Capital Protected	-	108	1,397	1,216
Equity	38,291	43,617	37,396	17,063
Fund of Funds	629	646	592	241
Income	-	1,027	1,115	1,063
Total	42,841	51,284	46,549	22,768

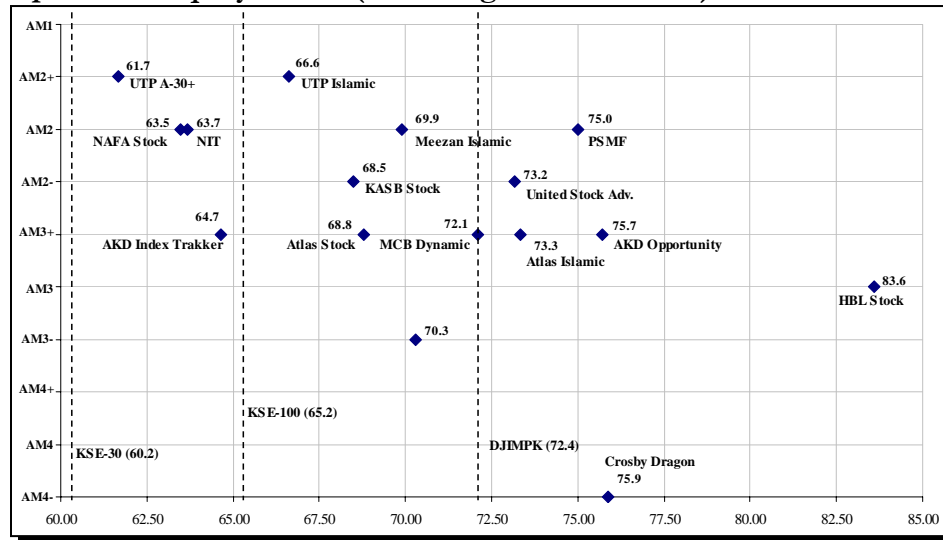
Note: Table also includes Islamic funds.

The discussion that follows focuses on performance analysis of funds in the equity, balanced and asset allocation categories. In addition to this, we have also examined the growth pattern of some of the largest income/money market funds and issues faced by them.

EQUITY FUNDS

At the end of 2008, there were 16 open-end equity funds, including index tracker and Islamic funds, which had been in existence for at least one full year. The graph below shows the ending value of Rs. 100 invested at the beginning of the investment horizon. Also for comparative purposes, KSE-100 Index, KSE-30 Index and DJIMPK have also been presented. Even though Islamic and conventional funds have been presented in the same graph, these are recognized as separate asset classes, with investor behavior found to be particularly distinct in case of Islamic funds and growth observed even during the year 2008.

Open-End Equity Funds (Including Islamic Funds)



In order to decipher the performance differences across various open-end stock funds, we have examined in detail some selected funds. Amongst the universe presented above, HBL Stock Fund (HSF) stood out as the best performing fund. While the largest equity exposures in HSF are similar to other funds encompassing scrips from the Commercial Banking, Oil & Gas as well as Fertilizer sectors, however, the extent of erosion has been the lowest as the fund manager progressively reduced exposure in equities and instead added some long term bonds to the portfolio holdings. Also included amongst the top performers are AKD Opportunity Fund, Pakistan Stock Market Fund and United Stock Advantage Fund (USAF).

NAFA Stock Fund (NSF) experienced the highest amount of capital erosion (36.5%). The portfolio featured several stocks from the technology and communication sector exhibiting relatively low trading volumes over FY2008. Technology and Communication has been classified by some fund managers as amongst the worst performing sectors for the year ended June 30, 2008.

Overall, the universe of stocks offering potential for dividend or capital gains yield has remained limited. Moreover, fund managers are inhibited by the number of stocks that are either well researched in-house or by external parties such as brokerage houses. Equity funds have therefore exhibited considerable concentration as fund managers showed a strong preference for companies from the oil & gas, fertilizer and commercial banking sectors. Scrips such as Fauji Fertilizer Bin Qasim Limited, Fauji Fertilizer Company Limited, Oil & Gas Development Corporation Limited (OGDCL) and Engro Chemicals Limited are common to all funds, although varying in the proportion of net assets allocated. Data for the past one and a half years show that these scrips are amongst the volume leaders on the Karachi Stock Exchange. Some of these scrips such as OGDCL common to equity portfolios across the board have significant weightage in the KSE-100 index as well, a popular benchmark for equity fund managers. With the exception of NAFA Stock Fund and Islamic stock funds that benchmark their returns vis-à-vis KSE-30 index and DJIMPK respectively; all funds under review have used KSE-100 index as a benchmark.

The most concentrated portfolio belongs to UTP Islamic Stock Fund, with just seven scrips accounting for more than 70% of the portfolio allocation. The most well diversified portfolio belonged to USAF, with top seven scrips accounting for just below 30% of net assets. Generally speaking, funds with portfolio allocations diversified across different sectors and scrips have posted stronger returns over the period under review.

Table 4: Open-End Equity Funds (Including Islamic Funds)							
	AMC Ratings	1 Year	<i>Rank</i>	2 Years	<i>Rank</i>	3 Years	<i>Rank</i>
AKD Index Trakker Fund	*AM3+	42.1	14				
AKD Opportunity Fund	*AM3+	51.5	6	70.8	4		
AMZ Plus Stock Fund	*AM3-	54.7	3	71.2	3		
Atlas Islamic Fund	AM3+	51.8	5	55.2	11		
Atlas Stock Market Fund	AM3+	44.2	11	56.2	10	60.9	5
Crosby Dragon Fund	*AM4-	55.5	2	113.1	1	97.6	1
HBL Stock Fund	*AM3	64.4	1				
KASB Stock Market Fund	*AM2-	43.8	13				
MCB Dynamic Stock Fund	AM3+	49.4	7				
Meezan Islamic Fund	*AM2	47.0	8	62.9	8	64.2	3
NAFA Stock Fund	*AM2	39.9	15	63.0	6		
National Inv. Unit Trust	*AM2	44.0	12	65.0	5	63.8	4
Pakistan Stock Market Fund	AM2	53.5	4	73.8	2	70.5	2
United Stock Adv. Fund	*AM2-	45.9	10	62.9	7		
UTP A-30+ Fund	AM2+	34.6	16	46.1	12		
UTP Islamic Fund	AM2+	46.6	9	56.3	9	57.2	6
KSE-100 Index		41.1		57.5		60.5	
KSE-30 Index		33.0		44.0			
DJIMPK Index		46.9		57.1		53.3	

* AMC Ratings by JCRVIS Credit Rating Co. Ltd. All AMC Ratings are as of Jan. 15, 2009

Some may argue, and rightly so, that equity market returns must be tracked over longer time horizons. For this purpose, we extended our investment horizon to 3 years. Very few fund managers have been able to post consistent results through the market cycle. The rankings of some funds have dropped sharply while some fund managers, such as AKD Investment Management Limited, Arif Habib Investment Management Limited and UBL Fund Managers Limited have been able to largely maintain their relative positioning over the three-year period. Even amongst these fund managers, some have not been able to exhibit as strong performance in other categories, the returns for which follow later in the document.

Table 4 can be explained with the help of an example. An investor purchasing units worth Rs. 100 of say Pakistan Stock Market Fund in January 2008 would have an ending investment value of Rs. 53.5 as of January 15, 2009. The same initial investment in January 2007 would have an ending value of Rs. 73.8. Over a three year period, the fund manager would have returned the investor Rs. 70.5, after adjusting for management fees. Returns are adjusted for dividends, if any. Note however, that these values are not adjusted for sales load, so the actual money that an investor would take home after 3 years would be even lesser. Nevertheless, the investor would have been better off by taking exposure in PSM rather than investing into the index.

Table 5: Closed-End Equity Funds (Including Islamic Funds)

	AMC Ratings	1 Year	<i>Rank</i>	2 Years	<i>Rank</i>	3 Years	<i>Rank</i>
Al Meezan Mutual Fund	*AM2	65.5	2	105.9	1	107.5	1
Asian Stocks Fund	NA	47.4	12	62.3	12	49.9	10
First Capital Mutual Fund	AM4+	49.4	11	64.8	11	62.9	6
Golden Arrow Stocks Fund	*AM3+	59.9	3	77.2	4	60.1	8
JS Growth Fund	AM2+	54.5	9	67.9	9		
Pakistan Premier Fund	AM2	57.5	6	76.0	6	71.8	4
Pakistan S.A. Fund	AM2	59.2	5	84.9	3	80.5	3
PICIC Energy Fund	*AM3-	56.6	7	66.1	10		
PICIC Growth Fund	*AM3-	55.9	8	68.2	8	54.6	9
PICIC Investment Fund	*AM3-	59.7	4	74.4	7	71.3	5
Safeway Mutual Fund	NA	50.4	10	76.7	5	60.2	7
UTP Large Cap. Fund	AM2+	68.1	1	90.7	2	96.5	2
KSE-100 Index		41.1		57.5		60.5	
KSE-30 Index		33.0		44.0			
DJIMPK Index		46.9		57.1		53.3	

* AMC Ratings by JCRVIS Credit Rating Co. Ltd. All AMC Ratings are as of Jan. 15, 2009

Within the closed-end equity funds category, the last fund was launched in December 2002. All these funds were issued for perpetuity though NBFCs Regulations, 2008 require asset management companies to seek approval of the certificate holders / shareholders upon expiry of every five years from November 21, 2007, or the date of launch of the fund whichever is later, to convert into an Open End Scheme or revoke the Closed End Scheme or wind up the Investment Company. Closed-end funds do not face any redemption pressures and thereby enjoy greater flexibility in making investment decisions. The returns posted by closed-end equity funds are relatively better than the open-end equity funds, though the return differential is not significant over the 2 and 3 years periods. In 2008, the return gap between open-end and closed-end equity funds widened to over 7 per cent.

ASSET ALLOCATION FUNDS

Asset Allocation Funds provide investors with a variable mix of the three main asset classes - stocks, bonds and cash equivalents, with the proportional composition varying in response to changes in the economy and investment markets. The following graph illustrates the performance of asset allocation funds over 2008:

Open-End Asset Allocation Funds (Including Islamic Funds)

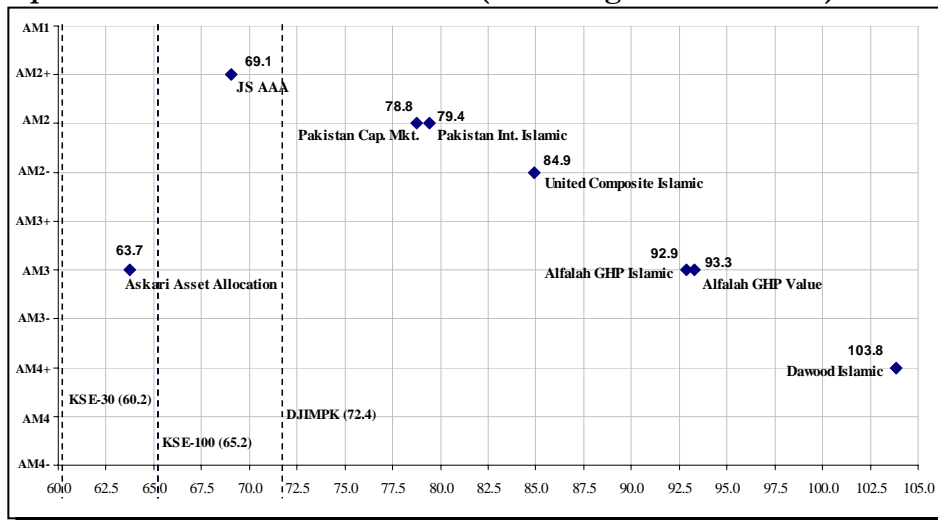


Table 6: Open-End Asset Allocation Funds

Equities % Net Assets	June 2008	June 2007
JS Aggressive Asset Allocation Fund	97	28
Askari Asset Allocation Fund	94	-
Pakistan Capital Market Fund	65	83
Pakistan Int'l Element Islamic Fund	59	65
United Composite Islamic Fund	43	52
Alfalah GHP Islamic Fund	28	-
Alfalah GHP Value Fund	24	51
Dawood Islamic Fund	15	-

The funds that experienced the highest amount of capital erosion were most heavily invested in equities. Table 6 presents the proportion of net assets invested in equities, at year-end FY07 & FY08.

It is interesting to note that managers of some asset allocation funds had adopted a very bullish outlook amidst a bearish market. While the equity markets had started falling since May 2008, some fund managers chose to either remain heavily invested in equities or some even increased equity exposures.

Equities % Net Assets	Jun-07	Sept-07	Dec-07	Mar-08	Jun-08	Sept-08
AAAF	46.2	21.0	83.1	82.0	95.8	58.7
JS AAA	28.7	34.1	79.6	72.1	97.1	97.1

Table 7: Open-End Asset Allocation Funds (Including Islamic Funds)

	AMC Ratings	1 Year	Rank	2 Years	Rank	3 Years	Rank
Dawood Islamic Fund	AM4+	93.2	1				
Alfalah GHP Islamic Fund	AM3	83.8	2				
Alfalah GHP Value Fund	AM3	64.4	3	71.2	4	79.5	2
Pakistan Capital Market Fund	AM2	64.3	4	86.3	1	83.8	1
United Composite Islamic Fund	*AM2-	62.3	5	73.2	3		
Pakistan Int'l Element Isl. Fund	AM2	61.6	6	80.9	2		
Askari Asset Allocation Fund	AM3	47.7	7				
JS Aggressive Asset Alloc. Fund	AM2+	39.3	8	39.1	5	38.7	3
KSE-100 Index		41.1		57.5		60.5	
KSE-30 Index		33.0		44.0			
DJIMPK Index		46.9		57.1		53.3	

* AMC Ratings by JCRVIS Credit Rating Co. Ltd. All AMC Ratings are as of Jan. 15, 2009

Furthermore, the extent of capital erosion in one instant is even greater than the KSE-100 index, even though asset allocation funds have the explicit mandate to switch asset classes. For instance, the investment objective of Askari Asset Allocation Fund (AAAF) states that:

The fund seeks to maximize long-term total return (stocks plus income) while incurring less stock market risk than a fund made entirely of stocks.

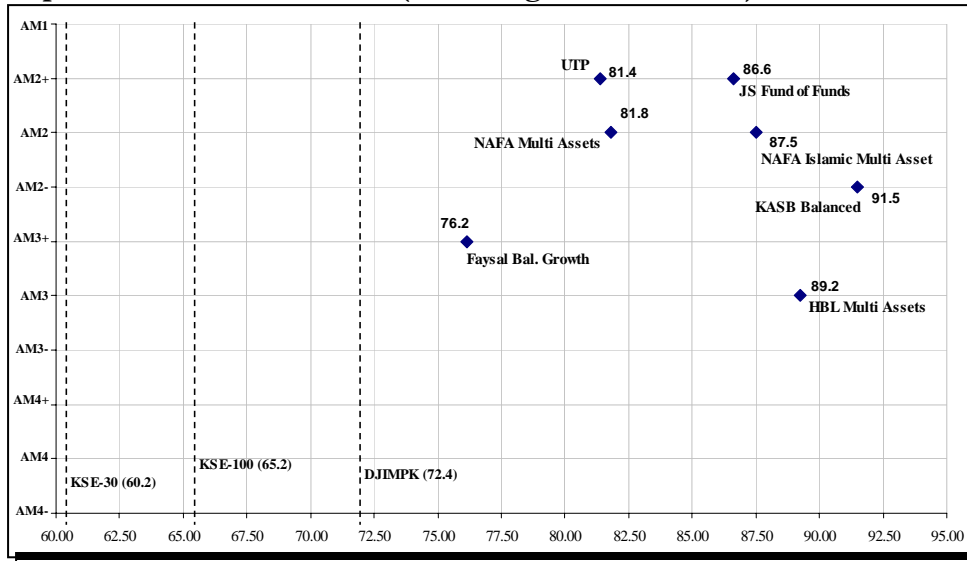
The performance of AAAF was worse than the KSE-100 Index. Also presented below is the investment objective of another fund which increased allocation to equities post March 2008 and experienced considerable capital erosion:

JS Aggressive Asset Allocation Fund (JS AAA) is a dynamic asset allocation fund that aims to achieve superior risk adjusted growth in investors' capital over the long term. The fund operates a diverse portfolio of equity and fixed income investments and it may constantly adjust the mix as equity markets rise or fall and the economy strengthens or weakens.

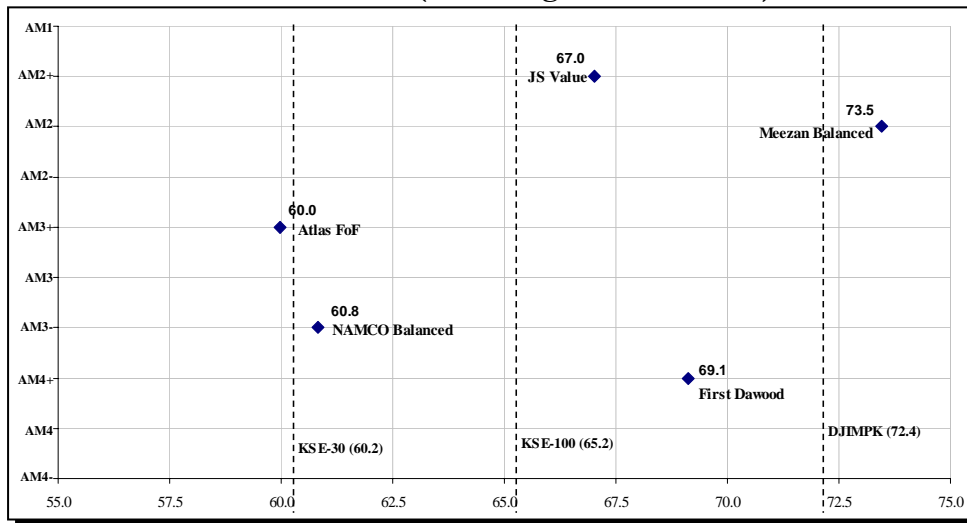
BALANCED FUNDS

In comparison to the open-end asset allocation funds, the extent of capital erosion in case of most open-end balanced funds has been significantly lesser, which may be a case of more disciplined investment management as opposed to complete flexibility of switching asset classes. By maintaining a constant proportion of net assets invested in fixed income instruments, balanced funds were able to provide better protection against downside risk relative to asset allocation funds.

Open-End Balanced Funds (Including Islamic Funds)



Closed-End Balanced Funds (Including Islamic Funds)



What is surprising though that closed-end balanced funds have posted inferior performance relative to their open-end counterparts and the logic of greater fund manager flexibility does not hold true in this case.

The performance trend of open-end and close-end balanced funds is presented in the tables below:

Table 8: Open-End Balanced Funds (Including Islamic Funds)

	AMC Ratings	1 Year	Rank	2 Years	Rank	3 Years	Rank
Faysal Balanced Growth Fund	*AM3+	61.1	6	75.66	3	76.15	3
HBL Multi Asset Fund	*AM3	70.7	3				
JS Fund of Funds	AM2+	73.6	1	91.9	1	96.53	1
KASB Balanced Fund	*AM2-	72.9	2				
NAFA Islamic Multi Asset Fund	*AM2	68.0	4				
NAFA Multi Asset Fund	*AM2	61.8	5	88.9	2		
Unit Trust of Pakistan	AM2+	59.9	7	74.8	4	78.50	2
KSE-100 Index		41.1		57.5		60.5	
KSE-30 Index		33.0		44.0			
DJIMPK Index		46.9		57.1		53.3	

* AMC Ratings by JCRVIS Credit Rating Co. Ltd. All AMC Ratings are as of Jan. 15, 2009

Table 9: Closed-End Balanced Funds (Including Islamic Funds)

	AMC Ratings	1 Year	Rank	2 Years	Rank	3 Years	Rank
Atlas Fund of Funds	AM3+	60.0	5	69.5	4	71.8	4
First Dawood M. Fund	AM4+	69.1	2	98.6	2	94.9	2
JS Value Fund	AM2+	67.0	3	103.6	1	113.8	1
Meezan Balanced Fund	*AM2	73.5	1	89.0	3	94.6	3
NAMCO Balanced Fund	*AM3-	60.8	4	66.8	5		
KSE-100 Index		41.1		57.5		60.5	
KSE-30 Index		33.0		44.0			
DJIMPK Index		46.9		57.1		53.3	

* AMC Ratings by JCRVIS Credit Rating Co. Ltd. All AMC Ratings are as of Jan. 15, 2009

INCOME FUNDS

As of June 30, 2008, almost 45% of the mutual fund industry's assets belonged to either the income or money market fund categories. At the outset, it is important to distinguish between income and money market funds. A fixed income mutual fund is a professionally managed pool of money invested primarily in bonds that have been determined to be appropriate for its investment goal. Money market funds are mutual funds that invest in short term debt instruments. More specifically, in the United States, money market funds, restricted by the Rule 2a-7 of the Investment Company Act of 1940, are restricted in their type of exposures. Under this rule, a money market fund mainly buys the highest rated debt which matures in under 13 months. While the prices of fixed income funds may move as interest rates change, money market funds aim to never lose money.

In order to undertake a more detailed analysis of this class of funds, we have identified the 6 largest income/money market funds that represented almost 57% of the total income/money market fund universe. In order of fund size, as at June 30, 2008, these are as follows:

Management Company	Fund Name	Fund Size Rs. (b) FY08
National Fullerton Asset Management Limited	NAFA Cash Fund	24.043
UBL Fund Managers	United Growth & Income Fund	14.625
MCB Asset Management Limited	MCB Dynamic Cash Fund	12.896
JS Investments Limited	JS Income Fund	11.253
KASB Funds	KASB Liquid Fund	8.828
Askari Investment Management Limited	Askari Income Fund	8.436

Almost three-fourths of the funds raised by the six largest funds were mobilized from financial institutions, corporates and retirement funds, while individuals held only about 14% of the outstanding units. Parent and related party support in terms of investment, however not always the largest, is considerable in two of these funds and was the second largest source of growth of these funds for the period ended June 2008.

Unit-holder Composition		
	FY08	FY07
Financial Institutions	34%	43%
Corporates	17%	21%
Individuals	14%	13%
Associated Companies	10%	7%
Others*	25%	15%
Total (Rs. in millions)	79,308.8	48,649.7

**These mostly include retirement funds.*

Within the locally available income and money market funds, it is difficult to make distinction on the basis of type of exposures. The nature of exposures, common across income and money market funds, include bank deposits, money market placements, term finance certificates, financing against shares i.e. CFS, ready-future spread transactions and in some cases, government securities and commercial paper.

The following table presents the asset mix of the 6 largest funds listed above:

Asset Mix	
Bank Balances	16%
Money Market Placements	27%
Ready-Future Spread Transactions	1%
CFS	11%
TFCs	36%
Commercial Paper	1%
Government Securities	0%
Others	9%
Total	Rs. 79,995.9m

As the size of income / money market funds increased, a shadow banking system started to develop as mutual funds became financiers to non-banking finance companies while demand for corporate debt instruments also increased. However, the systematic development of debt market continued to lag with mutual funds continuing to rely on broker quotes to price debt securities instead of market driven prices. One may question the transparency of the entire process as actual trades were not being reported at any centralized platform.

Following the floor placed on stock price levels in August 2008 which dried up volumes at the bourses, the Securities & Exchange Commission of Pakistan issued a directive to suspend the issuance and redemption of funds with equity exposures. The resulting investor anxiety almost caused a *run on the bank* like situation for income and money funds, as investors redeemed their holdings and funds were forced to liquidate assets while a few chose to impose limits on redemptions. The aggregate size of income/money market funds was reduced to Rs. 84.3b (FY08: Rs. 150b). All of the funds listed above had investment from FIs in excess of 30% of net assets, whereas in case of JS Income Fund and MCB Dynamic Cash Fund, it was even higher at 41% and 47%, respectively. For some fund managers, liquidity pressures were acute as asset side had been constructed without due consideration of the unit-holders' mix.

In the US, as money market funds broke the buck (NAV fell below \$1) in the week of September 2008, we saw the Department of Treasury coming forward with an optional program to "insure the holdings of any publicly offered eligible money market mutual fund" - both retail and institutional - that pays a fee to participate in the program. Locally, despite much deliberations between the regulators and MUFAP, the industry was left on its own.

Some of the reduction in net assets can also be attributed to the valuation discount applied to TFCs, as per the SECP issued directive. Based on the credit quality of TFCs, fund managers were required to apply a progressively higher discount factor on the holding value of TFCs, beginning from 5% for 'AAA' rated debt and increasing to 20% for instruments rated 'A-'. Depending on both the allocation to TFCs and quality of holdings, the extent of erosion varied from 23.8% for Dawood Money Market Fund to under 0.5% for Faysal Savings Growth Fund. This circular remained effective till January 10, 2009, when a new pricing formula was developed for TFCs. More recently, the SECP has also asked fund managers to report all transactions in any debt security to MUFAP. This is expected to ensure greater transparency. However, the importance of centralized trading platform for TFCs remains paramount and technical listing of privately placed instruments may also be considered.

Following the redemptions faced by income and money market funds, the proportion of TFCs has increased considerably in almost all funds. The current economic scenario may have some impact on the quality of the corporate debt portfolio and future trends in this respect will have to be tracked closely.

CONCLUDING REMARKS

By comparing performance of funds in various categories, one can easily conclude that most fund managers have not been able to post consistent results for their entire portfolio of funds. This also warrants further investigation into the unit-holder/shareholder details. In one of the comparative data sheets presented above, two funds managed by the same company, are the best and worst performing fund respectively. It is also interesting to note that few of the most poorly performing funds in the categories above are managed by the highest rated asset management company.

Whether the capital market crisis is over still remains to be seen. What is clear though that the road ahead is arduous! In our next edition, we would like to pen down the learning gathered from this experience.

Calculation Methodology:

Returns are not adjusted for sales load.

In case of open-end funds, dividends are assumed to be re-invested.

Returns have been calculated over 3 time horizons:

1-year return: January 2008 to December 2008.

2-year return: January 2007 to December 2008.

3-year return: January 2006 to December 2008.

On account of suspension of dealing in units by some fund managers, NAVs of all funds were not available for December 2008. Therefore, in case of open-end funds, returns have been calculated up to January 15, 2009. Returns have not been annualized.

CY: Calendar Year

FY: Financial Year

Note: All information used in this article is from public sources.