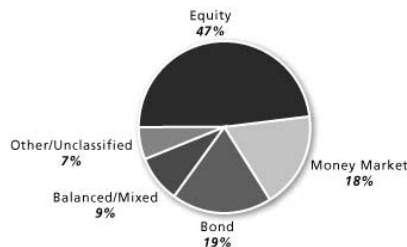


MUTUAL FUNDS

Rating Methodology

Mutual funds are an effective tool for mobilizing resources from a large pool of investors and providing them wider access to capital markets, which might otherwise be difficult to achieve. The idea of pooling money together for investing purposes was floated in Europe in the mid-1800s. The first pooled fund in the U.S. was created in 1893 for the faculty and staff of Harvard University. On March 21st, 1924 the first official mutual fund was born. It was called the Massachusetts Investors Trust. Since then, mutual fund assets have recorded significant growth, worldwide.

¹By the end of second quarter, calendar year 2006, mutual fund assets have increased to US \$19.41



trillion globally, having recorded a growth of about 18.6% on a year-

¹Source: Investment Company Institute (www.ici.org)

²Source: The Association of Mutual Funds in India (www.amfiindia.com)

on-year basis. Almost 47% of mutual fund assets are equity funds.

By region, 53% of funds are invested in America, 35% in Europe and 12% in Africa and Asia/Pacific. Mutual funds in the US aggregated \$9.34 trillion and represented about 48% of the global assets.

²In India there are 29 asset management companies with about US \$57.21 billion in assets under management. An overview of the type of funds is presented in the following tabulation:

US \$ in billions

	Open end	Closed end	Total
Income	6.25	5.41	11.66
Growth	17.29	1.49	18.79
Balanced	1.33	0.17	1.50
Liquid/ Money Market	23.43	-	23.43
Others	1.57	0.26	1.83
	49.87	7.33	57.21

Locally, the sector has seen significant growth in recent times. ³As of October 31, 2006, 29 asset management/investment advisory

Conversion Rates:
<http://www.oanda.com/convert/fxhistory>
1 USD=46.4176 INR; 1 USD= 60.1277 PKR

³Source: www.mufap.com

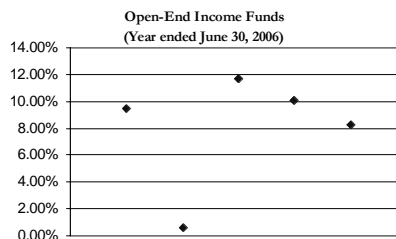
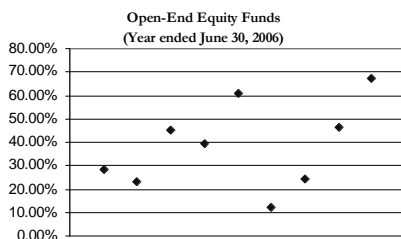
companies were registered with the Mutual Fund Association of Pakistan, managing 30 open-end and 18 closed-end funds. The size of assets under management increased from about US \$ 2.08b (Rs. 125b) at the end of FY2005 to about US \$ 2.66b (Rs. 160b) by the end of

A large part of the growth has come about through mobilization of funds from financial institutions while the retail market remains largely untapped

FY2006. During the year 2006, 12 mutual funds were launched, with only two of these being closed-end schemes, while the remaining were open-end funds.

However, a large part of the growth has come about through mobilization of funds from financial institutions while the retail market remains largely untapped, especially in case of open-end funds. In the case of closed-end funds, which have an aggregate net asset value of almost US \$ 0.73b (Rs. 44b) and a market capitalization of US \$ 0.58b (Rs. 35b) as of June 2006, retail investors have a much greater level of participation, holding over 32% of net assets.

The equity funds have yielded as high as 67% return during the year ended June 2006 while the returns from income funds have largely been in the range of 10-11%, which implies a significant equity risk premium. The average return of equity funds during 1Q FY07 has dropped significantly. The distribution of returns posted by open-end income and equity funds for the year ended June 30, 2006 is reflected by the following:



RATING METHODOLOGY

The growth in mutual fund assets has led to an increasing demand by investors for simple measures of the performance of such funds. JCR-VIS serves the varying needs of investors of mutual funds through:

1. Fund Performance Rankings
2. Management Quality Ratings
3. Fund Stability Ratings

While fund stability ratings are assigned only to income & bond funds, performance rankings may be assigned to any fund type. A significant weight of performance rankings is taken into the management quality ratings. Where stability ratings are assigned, the management quality ratings are built in.

FUND PERFORMANCE RANKINGS

JCR-VIS' "Fund Performance Rankings" are based on a pure quantitative model, comparing historical risk-adjusted returns of funds investing in largely the same asset class.

On a basic level, open-end funds are distinguished from closed-

Fund Performance Rankings are based on a pure quantitative model, comparing historical risk-adjusted returns of funds investing in largely the same asset class

end funds due to their varying dynamics. Mutual funds are characterized on the basis of their average asset allocation. When necessitated by changes in fund composition, we

will change classification accordingly. Broad classifications include:

1. Income Funds
2. Stock Funds
3. Balanced Funds

For ranking of funds, it is important to ensure that categories are appropriately populated. While JCR-VIS is considering a minimum of three funds per category at present, the requirement will be increased as the industry matures. Currently, this

Currently, this consideration necessitates 'clubbing together' of funds on a broader basis of asset class concentration in any fund

consideration necessitates 'clubbing together' of funds on a broader basis of asset class concentration in any fund.

For instance, JCR-VIS recognizes Islamic finance, international equities and alternative investments as fundamentally different asset classes and funds falling in these categories will be segregated under their specific asset category as soon as the number of funds to be ranked has reached the minimum of three per category.

Furthermore, based on their style and portfolio composition, funds may also be categorized as conservative, moderate or aggressive. Another distinction in income funds will be made on the basis of the duration/average maturity of their portfolio. Funds specializing in specific types of issues will also be distinguished.

Although the analysis presently covers fund performance history for the preceding two years, a minimum performance history of 1 year is required for funds to become eligible for ranking. As the mutual fund industry matures, performance periods under consideration may increase up to 10 years, with different weightage assigned to sub-periods.

Change in the fund's net asset

value (NAV) during the performance review period is used to gauge the returns earned by the investor, assuming that the dividends earned during the period are reinvested in the fund. For open-end funds, returns are automatically adjusted for sales load by taking the offer and redemption prices at the start and end of the investment period, respectively.

JCR-VIS fund performance rankings are based on risk adjusted performance. Traditional risk frameworks that rely on standard deviation generally assume that returns conform to a normal bell shaped curve. An underlying assumption of the normal curve is 'perfect symmetry' which implies that the frequency and magnitude of upside price movements are considered just as "risky" as downside movements. Consequently, traditional models treat all uncertainty as risk, regardless of direction. In the practical world, while investors do worry about their losses, they are hardly concerned over the quantum of their gains. For this very reason, JCR-VIS emphasizes downside risk when calculating the risk-adjusted returns.

Change in the fund's NAV during the performance review period is used to gauge the returns earned by the investor, assuming that the dividends earned during the period are reinvested in the fund

Changes in NAV are expected to reflect concentration related risks that the fund may be exposed to. However, changes in counterparty risk may not be reflected in prices unless tracked over a long period of time and even then, only prices of listed investments may satisfactorily reflect adjustments to counterparty risk. Therefore, adjustment for varying level of credit risk in case of income funds is made.

A basic score is arrived at by comparing the risk adjusted return of individual funds relative to the best in the peer group. In case of

income funds, the basic score is adjusted downwards depending on the degree of credit risks present in the portfolio.

Top 10 and bottom 10 percentiles of the overall scores are assigned rankings of MFR-5(s) and MFR-1(s) respectively, while the middle 35 percentile is assigned MFR-3(s) rank. The remaining 22.5 percent on the upper and lower side are assigned MFR-4(s) and MFR-2(s) rank, respectively. In order to provide useful benchmarks to market participants, JCR-VIS may announce unsolicited performance rankings for other market players as well. These will be based on the following scale:

Top 22.5% - High Rank
Next 55% - Medium Rank
Last 22.5% - Low Rank

MANAGEMENT QUALITY RATING

The Management Quality Rating provides an opinion on the overall quality of the management company as a fund manager, includ-

The criterion for management quality rating entails greater reliance on qualitative factors

ing organizational structure, quality of human resources, degree of oversight and accountability, particularly as regards risk management capabilities.

The criterion for management quality rating entails greater reliance on qualitative factors. Ability to manage funds is assessed with special emphasis on the extent to which management has been able to put in place sound governance practices and systems to facilitate the manager's ability to maximize the risk-return proposition for unit-holders while keeping in view the stated investment objectives. JCR-VIS also considers the financial strength of a management company in terms of

its continuing ability to manage these funds and sustainability of its operations. Any form of external support available to the management company is factored in where appropriate.

Organizational Structure

JCR-VIS evaluates how the organizational structure facilitates decision-making and timely response to environmental influences. To avoid ambiguity, the organization's hierarchical pattern must be distinctly defined so that the employees are aware of their job definitions, responsibilities and authorities.

While JCR-VIS views an independent management, which has powers to manage the day-to-day operations of the company, favorably; the quality of input provided by the Board of Directors (BoD) in terms of the broad policy guidelines is also important. The ultimate policy responsibility for any mutual fund lies with its board of directors. A BoD comprising a blend of professionals with relevant industry experience can provide better guidance in strategic matters to the management team, to benefit all stakeholders.

Quality of Human Resources

An important aspect of the rating process includes in-depth review of profile of key personnel. The experience and discipline of key personnel are critical to the success of the fund. They are assessed for their educational background and experience of portfolio management, research & financial analysis. This also involves appraising senior management and any committees involved in management of the funds. Reliance on few key employees and lack of succession planning

may adversely impact ratings.

JCR-VIS also reviews the company's marketing expertise in terms of growth in open-end funds over time, the aggregate size of portfolio under management and penetration in the market.

Operational Environment and Investment & Risk Management Policies

An assessment of the fund's management strategies, policies and procedures is a critical element of measuring management quality.

Adherence to the fund's investment policies, as well as its risk management policies is evaluated. The ratings are not just based on invest-

The ratings are not just based on investment performance but mainly depend on the fund manager's ability to achieve consistent results under different market scenarios

ment performance but mainly depend on the fund

manager's ability to achieve consistent results under different market scenarios. The objectives stated by mutual funds are also reviewed and the strategies implemented by the investment committees are evaluated in accordance with these objectives.

JCR-VIS also reviews in-house research capabilities, including stress testing capacities. Access to economic data and analysis can help the fund manager in taking informed decisions.

Management quality rating process also involves review of the practices and procedures to monitor and manage risks that are inherent in the business of investee companies, pricing policies, must-sell limits and exposure restrictions in addition to analytical techniques employed to arrive at fair values.

A disciplined investment environment also involves evaluation of own performance through various tracking mechanisms. Use of such techniques ensures internal monitor-

ing on a continuous basis.

The assessment of the management company's internal control procedures includes adequacy of written policies and procedures designed to monitor trading positions and buy/sell approval processes. JCR-VIS analyzes the adequacy of the management procedures and its ability to effectively carry out the operating functions.

This analysis includes historical review of fund manager's compli-

ance with regulations. An inquiry is made as to the existence, frequency and causes of any violation with respect to regulations. Any deficiency with respect to a fund's policies and operations from a regulatory perspective are highlighted. While compliance with regulatory minimums is mandatory, JCR-VIS also reviews additional internal requirements for diversification and any written policies in this regard.

Where the management company is involved in activities other than management of its own funds, the extent of firewalls between the various functions to guard against potential sources of conflict is also evaluated.

A review of information systems is also carried out to evaluate fund manager's ability to efficiently conduct day to day trading activities and generate the relevant reports for management's review. JCR-VIS favors automated monitoring procedures and reviews interface between transaction entry, portfolio management and back office systems.

It is important to reiterate here that substantial weightage is assigned to actual performance of funds being managed either through the use of performance rankings or any other indicators deemed relevant for the type of fund under study.

JCR-VIS analyzes the adequacy of the management procedures and its ability to effectively carry out the operating functions

FUND STABILITY RATING

The Fund Stability Rating measures the sensitivity of a fund's Net Asset Value (NAV) and total return to changing market conditions with an emphasis on downside risk. As mentioned earlier, fund stability ratings are assigned only to income and bond funds. JCR-VIS places

JCR-VIS' stability ratings provide an indicator of the fund's ability to maintain its NAV

significant emphasis on the qualitative processes used to manage the primary areas of risk in the fund including the level of conservatism used in the portfolio selection process. JCR-VIS' stability ratings provide an indicator of the fund's ability to maintain its NAV and limit exposure to losses due to credit, market and/or liquidity risks.

Credit Risk

Fundamental to the rating analysis is a detailed evaluation of the risk profile of the different securities in the fund's investment portfolio. In order to determine the credit risk appetite of a fund, an analysis of the approved issuer and counterparty list, including relevant maturity, percentage and ratings limitations is undertaken. Portfolio holdings are segmented by credit ratings and calculation of the percentage of the portfolio in each level of risk, including that in unrated instruments is performed to determine the credit quality of the overall portfolio. Funds with a high degree of NAV stability would have a large percentage of their holdings in securities with higher ratings. Funds that undertake reverse repurchase transactions have indirect exposure to the underlying securities in addition to being exposed to credit risk. For this purpose, internal investment policies, including the list of acceptable collateral and the level of over-col-

lateralization required for each type of collateral, are analyzed to measure the fund's exposure to these risks.

JCR-VIS also reviews fund's investments to measure the extent of diversification. The funds can be diversified at several levels. JCR-VIS examines how the fund has diminished risks associated with each asset class by investing in securities across industries and investing in issues of several companies. Mutual funds typically invest in a variety of instruments and spread their holdings over many segments of the economy. The risk profile of funds is determined based on their level of diversification. However, an important point to note is that risk cannot be entirely eliminated. The goal must be to reduce unsystematic risk through diversification.

Market Risk

The market risk assessment is used in conjunction with the credit risk analysis to assess overall fund risk. Price fluctuations of fixed-income instruments can stem from a number of factors including interest rate movements, maturity, liquidity, credit risk and the supply & demand for each type of security. These factors combined, can impact the NAV of a fund and render it unstable.

Quantitative measures such as weighted average maturity / duration provide an important framework for the evaluation of a fund's sensitivity to interest rate movements. A portfolio with a lower sensitivity to interest rate changes has a more favorable influence on the fund's rating.

Quantitative measures such as weighted average maturity / duration provide an important framework for the evaluation of a fund's sensitivity to interest rate movements

An analysis of the fund's past performance, its historical yield and

NAV variability combined with the present investment portfolio, level of market risk exposure and market risk appetite indicating future composition of the portfolio provides a reasonable measure of NAV stability. Although the historical NAV variations analysis has many limitations in estimating future NAV declines, a study of empirical results provides a good analytical foundation.

Funds claiming to follow a particular strategy may drift from their investment styles. To evaluate fund's risk profile, JCR-VIS also examines changes in fund's investment style over time.

Liquidity Risk

Ratings include a detailed assessment of the fund's liquidity position. Liquidity is of prime importance for open end mutual funds as they are required to meet redemption requests. Liquidity problems could arise due to a fund having insufficient cash, investments with longer maturities and fewer readily marketable securities in a period of heavy cash outflows. Redemptions could force an open-end fund to raise cash by selling its investments at depressed prices.

Liquidity analysis is conducted in context of the fund's unit-holders' mix. Pattern of unit-holding in terms of corporate and individual unit-holders and average subscription/redemption requests as a percentage of the fund is analyzed.

Concentration in unit holding pattern could potentially lead to large single day redemption requests for open-end funds, which may pose significant risk to a fund's ability to maintain a stable NAV. However, this has to be viewed in context of the fund's duration.

Impact of Fiscal Policies and Applicable Regulations

Present regulatory environment and the tax laws are studied to assess their impact on performance of mutual funds. The effects of any likely change in the present regulatory policies and tax laws on a fund's future performance are also to be considered. **JCR-VIS**

MANAGEMENT QUALITY RATING SCALE

AM1
Highest Management Quality

AM2
High Management Quality

AM3
Good Management Quality

AM4
Adequate Management Quality

AM5
Weak Management Quality

Management Quality Ratings may be appended with +/- sign to indicate the relative degree of strength within each category.

AA+(f), AA(f), AA-(f)
High degree of stability in returns. Risk is modest but may vary slightly from time to time because of changing economics conditions.

A+(f), A(f), A-(f)
Moderate degree of stability in returns. Risk factors may vary with possible changes in the economy.

BBB+(f), BBB(f), BBB-(f)
Adequate degree of stability in returns. Risk factors are considered variable if changes occur in the economy.

BB+(f), BB(f), BB-(f)
Low degree of stability in returns. Risk factors are sensitive to changes in the economy.

B(f)
Very low degree of stability in returns. Risk factors are capable of fluctuating widely if changes occur in the economy.

Being based on actual performance, no outlook or rating watch is assigned to fund performance rankings. While no outlook is assigned to either of the management quality rating or fund stability rating, these may be placed under 'Rating Watch' if JCR-VIS views that the status of the assigned rating is uncertain and there are conditions present that necessitate reevaluation of the assigned rating. JCR-VIS also designates direction, Positive, Negative or Developing, to ratings placed under 'Rating Watch'. This shows JCR-VIS's opinion regarding the likely direction of a rating. Developments in factors other than those that necessitated the 'Rating Watch' may result in a rating change, while the rating continues to be placed under 'Rating Watch'.

Ratings/rankings are not a recommendation to buy, sell, or hold any investment, in as much as they do not comment as to the yield or suitability for a particular investor. Eventually the risk/reward trade-off should be solely determined by investors.

FUND PERFORMANCE RANKING SCALE

MFR 5-Star
(top 10%) Very good performance

MFR 4-Star
(next 22.5%) Good performance

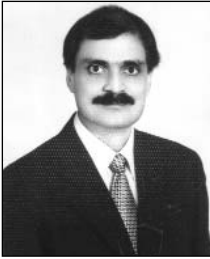
MFR 3-Star
(next 35%) Average performance

MFR 2-Star
(next 22.5%) Below average performance

MFR 1-Star
(last 10%) Weak performance

FUND STABILITY RATING SCALE

AAA(f)
Highest degree of stability in returns. Risk is negligible with very low sensitivity to changing economic conditions.



Faheem Ahmad

President & CEO, JCR-VIS
Founder, VIS Group

Faheem Ahmad has diverse experience with international consulting agencies in USA & Middle East. He has also held senior positions with local industrial and financial groups. In 1994, he established Vital Information Services (Pvt.) Limited, which is a leading capital market research house. VIS has the largest data bank of corporate Pakistan. His major research work includes copy-righted F&J financial strength rankings, Musharaka Variable Income Securities and stock market indices. VIS group includes JCR-VIS Credit Rating Company Limited and News-VIS Credit Information Services (Pvt.) Limited, the first private credit bureau of Pakistan. The majority of shareholders in group companies include the largest publication house in Pakistan and major financial institutions.

He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters degrees in Engineering and Business Administration from USA. His research work has been published in various international journals.



Sabeen Saleem

Group HEad - Financial Institutions

Sabeen Saleem leads ratings of Financial Institutions at JCR-VIS Credit Rating Company Limited. Prior to joining JCR-VIS, she worked on several projects with local financial consultants. She holds a Masters degree in Business Administration, graduating from the Institute of Business Administration, Karachi in 1997.



Sobia Maqbool

Senior Manager

Sobia Maqbool is in Non-Bank Financial Companies Group. She holds a Masters degree in Business Administration from the Institute of Business Administration, Karachi in 2003.

Jahangir Kothari Parade (Lady Lloyd Pier)
Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose generosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.



Jahangir Kothari
Parade

National Excellence, International Reach

JCR-VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve

the domestic financial markets. With its international reach, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, JCR-VIS continues its endeavor to remain an emblem of trust.

JCR-VIS Credit Rating Company Limited

Affiliate of Japan Credit Rating Agency, Ltd.
Founder Shareholder of Islamic International Rating Agency, Bahrain
JV Partner in CRISL, Bangladesh
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