



Vector Analysis

August 2011

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Sources: SBP; SECP; NCCL; KSE; MUFAP; FBS; AMC; Newspapers & TV Channels.

Suggested Investment Approach

Suggested Investment Strategy

Managing Investments In A Volatile Market

Rising Interest Rates
Good Investment
 Floating Rate Bonds
 Money/Income Funds
 Short term Investments

Bad Investments
 Fixed Rate Bonds

Topped Interest Rates
Good Investment
 Fixed Coupon Bonds
 Income/Bond Funds
 Long term Investments

Bad Investments
 Floating Rate Bonds

Falling Interest Rates
Good Investment
 Equities
 Bond Funds
 Long term Investments

Bad Investments
 Floating Rate Bonds

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ASSUMPTIONS

- * Pakistan's efforts towards sustained economic recovery continue to be hindered. Industrial productivity has been severely hurt by energy outages as circular debt continues to mount. Rising lawlessness is taking its toll too, particularly in the main hub of economic and industrial activity, Karachi. The city contributes over 60% of the total revenues, produces 30% of value added in LSM and contributes to 20% of GDP of Pakistan (KCCI Report). According to an estimate, for every hour Karachi is 'shut', national exchequer incurs a loss of Rs.2bn. The country is already facing fiscal pressures and the Karachi situation will only add to an already weak revenue base.
- * Foreign investment continue to run dry with 27% and 17% YoY decline in FY11 and July FY12 respectively. Apart from global economic recovery concerns, the domestic law and order situation is keeping foreign investors shy of investing in Pakistan.
- * IMF program which remains suspended since May last year, expires in September 2011. Tokyo pledges have also failed to materialise as has the issue of OGDC exchangeable bonds. Exports numbers have declined on MoM basis in July FY12 and there are concerns whether the exports would remain 'robust' as last year given substantial fall in prices of Pakistan's exportable items notably cotton. Given external and internal fragility on the revenue front, it is likely that Pakistan would struggle to pay USD1.4bn to the IMF due in 2012 and would seek a new program which would likely have tougher terms.
- * The non-performing loans (NPL) of banks and DFIs have hit historical high of Rs.594.4bn as of June 30, 2011. Banking NPLs increased from Rs.573.5bn in March 2011 to Rs.579.2bn in June 2011, evident of economic slowdown.
- * Government reliance on domestic source of funding continued with domestic debt rising to Rs.6.2trillion in 4QFY11 registering QoQ growth of 11.3%. Floating debt stood at Rs.3.2 trillion and constituted 52% of the total domestic debt and liabilities in FY11. This has raised concerns regarding the roll over risk (risk rising on account of liquidity shortage making conversion of maturing debt into new debt costly). SBP 3QTRFY11 report on state of the economy mentions government's requirement to roll over Rs.2.8trillion (March 2011 position) of short term debt atleast once a year. That figure has now grown to Rs.3.2trillion as of June 30, 2011.

CRITICAL TO WATCH

- * Ongoing political events measures to restore peace and stability in Karachi.
- * Progress on the IMF suspended program given its importance with regards to lending programs of other international agencies.
- * Global economics and its impact on the country's trade and economics.
- * Foreign portfolio investment given its significant impact on the local bourse.
- * Inflation numbers with change in base period and increase in items in the CPI basket given its importance to monetary policy decisions.

INVESTMENT APPROACH

- * Although taking a view on long term interest rates is difficult given economic fundamentals, near term outlook is stable. Cash/sovereign funds are recommended. Cautious stance on corporate bonds remains given existence of credit concerns.
- * Result season and attractive multiples may induce interest in equities. However, volatility is likely to prevail. Stocks offering attractive dividend yield/capital gains prospects primarily in the power, textiles, oil and gas and fertilizer sectors are recommended at the dips.

Economic Snapshot

Economic numbers for the first month of new fiscal year FY12 (July 2011-June 2012).

CURRENT ACCOUNT

After closing FY11 with a current account surplus of USD437mn, the economy posted a current account deficit of USD75mn in July 2011 (the first month of new fiscal year FY12) largely due to declining exports.

EXPORTS

Exports were recorded at USD2.1bn during July 2011 registering YoY increase of 28%. However, on monthly basis, exports fell by 19.7% largely due both in terms of quantity and prices (due to global decline in commodity prices), of items in food and textile group. Textile group accounted for 56% of exports during July 2011, declined by 13% MoM. Petroleum constituted 7% of export receipts in July 2011 and grew by 14.5% MoM primarily due to export of Naphta.

IMPORTS

Import of goods grew by 7.8% YoY during the first month of FY12. On monthly basis, imports fell by 8.6% in July 2011. Commodity wise data shows 51% MoM increase in import of food bill mainly on account of substantial increase in import of cooking oil i.e. palm and soya bean. Fertilizer imports also grew substantially in July 2011 as the country imported 100mt to meet domestic shortfall. Petroleum accounted for 37% of imports during July 2011 declined by 15% MoM.

HOME REMITTANCES

Home remittances maintained their impressive trend witnessed in FY11. During July, remittances exceeded USD1bn for the second consecutive month. Remittances from Saudi Arabia topped the list followed by UAE and USA.

FOREIGN INVESTMENT

Foreign Direct Investment (FDI) continued to falter declining by 44%MoM in July 2011. Foreign portfolio investment also fell substantially during July 2011 as global economic concerns coupled with domestic economic and law and order situation resulted in exist of foreigners from the local bourse.

INFLATION

Consumer Price Index (CPI) for July 2011 was recorded at 13.8% (period average) mainly on account of increase in prices of food items which constitute highest weight in the CPI basket. On monthly basis, CPI increased by 1.8% in July 2011 while CPI food grew by 3.2% MoM in July 2011.

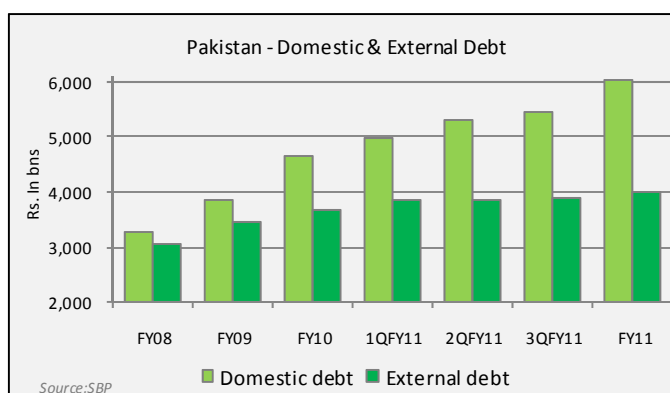
Selective Indicators	FY12 July	FY11
GDP	-	2.4%
Import of goods	3.1	35.7
Export of goods	2.1	25.4
Trade Deficit	1.0	10.3
Current account balance	(0.07)	0.4
CPI*	13.8%	13.9%
Food	17.6%	18.0%
Non-Food	10.6%	10.5%
Net Foreign Investment	0.06	1.9
FDI	0.09	1.6
Portfolio	(0.03)	0.3
Remittances	1.1	11.2
Reserves	**17.9	18.2
Pvt Sector Disbursement (Rs. bn)	*** (84)	3,141
Govt Borr from SBP (Rs. bn)	*** (21)	1,239
Govt Borr from scheduled banks	*** 110	1,663
Net Govt Sector Borrow (Rs.bn)	127	3,020

All figures in USD bn unless specified in PKR

*Period Average

**As on August 20, 2011

***Position as on Jul 1—Aug 20 FY12 (Govt borr represents fed govt)



Source: SBP & Federal Bureau of Statistics

Snapshot — Interbank Market

Market Highlights

Treasury Bill Auctions Held			
	Cut-off (%)	Chg bps	Amt Accepted (Rs. In bn)
Aug 10			
3M	13.06	47 ▼	4.0
6M	13.27	53 ▼	64.8
12M	13.37	56 ▼	115.9
Aug 24			
3M	13.06	-	1.4
6M	13.27	-	4.7
12M	13.37	-	113.1

PIB Auction Held			
	Cut-off (%)	Chg bps	Amt Accepted (Rs. In bn)
Aug 17			
3 yr	13.47	53 ▼	10.0
5 yr	13.49	56 ▼	10.6
7 yr	Rej	-	-
10 yr	13.51	58 ▼	15.9
15 yr	13.5	60 ▼	2.2
20 yr	Rej	-	-
30 yr	Rej	-	-

Upcoming Auctions

T-Bill

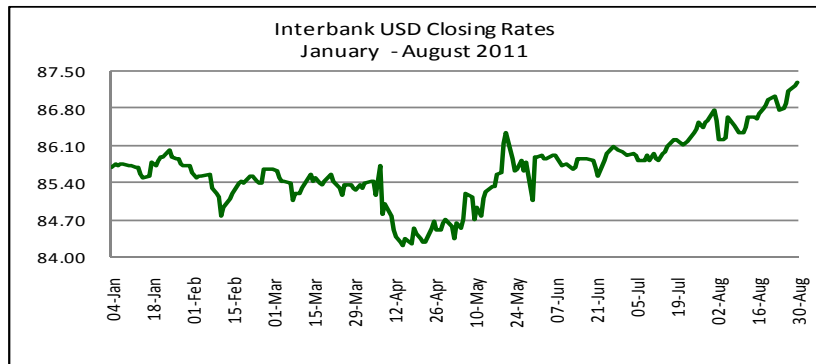
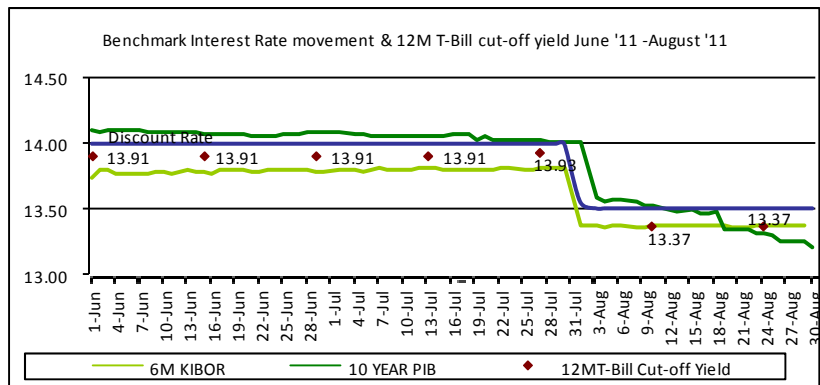
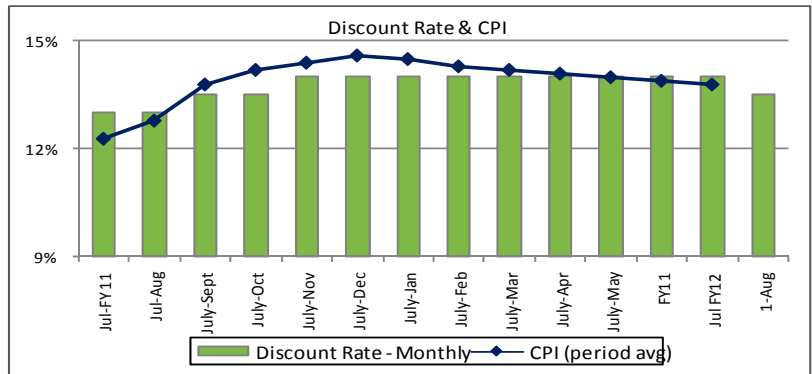
	Target	Maturity
Sept 7	Rs.150bn	Rs.150.26bn
Sept 21	Rs.130bn	Rs.116.85bn

PIB

Sept 14	Rs.20bn
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Interbank Forex Rates			
	30.06.11	30.07.11	30.08.11
PKR	30.06.11	30.07.11	30.08.11
USD	85.99	86.59	87.31

Discount rate reduced to 13.5% w.e.f. August 1, 2011

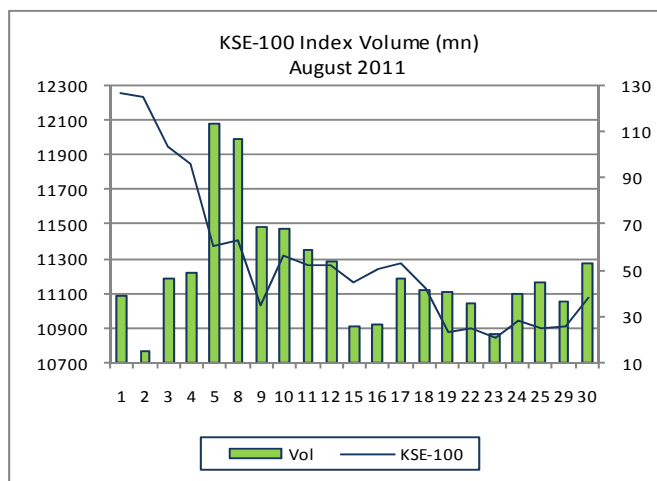
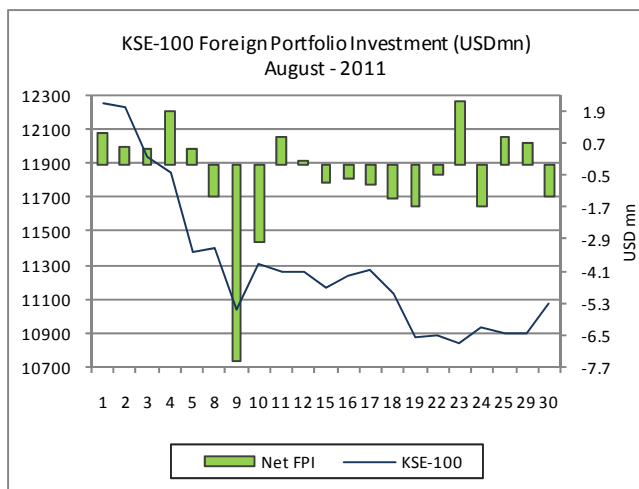


COMMENTARY

The interbank market faced liquidity crunch on account of Ramzan and Eid factors leading to withdrawals from the banking system and resulting in SBP injections to ease liquidity. The cut-off yields came off on the first T-Bill auction after the 50bps reduction in the Discount Rate. Banks continued to participate heavily in the T-Bill auctions as credit concerns kept them away of lending to the private sector. Buying interest remained heavily skewed towards one year paper, particularly in the second auction, signifying stability of interest rates in the near term.

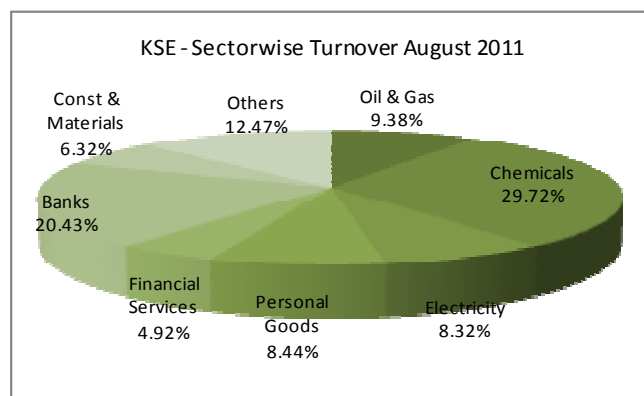
In the forex market, the PKR came under pressure mainly due to outflows on account of debt servicing and oil payments. As a result, the PKR hit historical low of Rs.87.36 in the interbank market.

Snapshot — Equities Market



Equity Market Highlights

	July 29	Aug 30	% Change
KSE-100 Index	12190	11070	9.1 ▼
KSE-30 Index	11560	10545	8.7 ▼
KMI-30 Index	21203	20061	5.3 ▼
Mkt Capitalization Rs. Mn*	3,259	2,999	8.0 ▼
Monthly Turnover (T+2) mn*	57	49	14.8 ▼
*Average daily			



COMMENTARY

Equity market continued to be marred by volatility and low volumes as investors stayed on the sidelines. Corporate result season and 50bps reduction in the Discount Rate and was overshadowed by Karachi violence, domestic political and security concerns and its adverse affect on the state of the economy and non-performing loans of banks hitting historical high levels. Global economic scenario i.e. US and Eurozone debt crisis, that weighed heavily on global equities also trickled into our local bourse as foreigners continued to exit.

The first session after the 50bps reduction in the Discount Rate started on a positive note as KSE-100 hit a high of 12330 in inter-day trading. However, as global equities faltered and domestic issues surfaced, the local stock market came under pressure. As a result, the benchmark KSE-100 index fell below 10800 point barrier for the first time in eight months. Although the market recovered towards month-end aided by global equity recovery, rising fertilizer prices and ongoing result season, trading remained largely volatile amid thin volumes.

Foreign portfolio investment remained in the negative territory for the third consecutive month, although the net outflow tapered to USD11.5mn as against USD29mn in July 2011.

Corporate Results	Period	EPS	Payout
Engro Foods	HYCY11	0.30	Nil
Engro Polymer & Chem	HYCY11	(0.31)	Nil
Engro Corporation	HYCY11	8.43	20%(i)
Allied Bank	HYCY11	5.90	25%(i)
Bank Alfalah	HYCY11	1.41	Nil
Habib Bank	HYCY11	9.00	Nil
National Bank	HYCY11	4.84	Nil
Standard Chartered	HYCY11	0.44	Nil
ICI Pakistan	HYCY11	7.01	35%(i)
Lotte PTA	HYCY11	2.44	Nil
Adamjee Insurance	HYCY11	2.57	10%(i)
PSO	FY11	86.17	20%(f)
PPL	FY11	26.31	20%(f)

Snapshot — Mutual Funds Industry

Top AMC's & funds based on asset sizes—July 2011

AMCs AUMs (Rs. in bns)		
	June	July
National Investment Trust	45.5	41.5
Al-Meezan Investments	29.9	30.5
UBL Fund Managers	25.9	28.8
ABL Asset Management	16.9	21.6
NAFA	17.1	18.5
MCB Asset Management	16.4	17.2
PICIC Asset Management	14.9	14.8
JS Investments	12.3	12.6
Arif Habib Investment	13.1	12.0
HBL Asset Management	8.6	10.4

Open-end funds AUMs—Category wise (Rs. in bns)		
	June	July
Money Market/Cash Funds*	77.3	90.4
Islamic Cash Funds	7.5	7.4
Income Funds	47.5	48.5
Islamic Income Funds**	20.2	21.1
Equity Funds	53.4	49.4
Islamic Equity	5.9	6.0
Others***	12.3	11.7

*Includes sovereign cash funds

**Includes sovereign bond funds

***Includes balanced, asset allocation, pensions, capital protect

COMMENTARY

Open-end funds recorded a MoM growth of 4.6% and a YoY growth of 30.6% in the first month of the new fiscal year 2012. Total mutual fund industry size grew to Rs.256bn in July 2011 from Rs.210bn in July 2010. Money market funds continued to remain attractive as investors opted for low risk attractive-return products. The category's asset base (including Islamic cash funds) recorded YoY growth of over 100% in July 2011 while on MoM basis, cash funds grew by 15% in July 2011.

On the equity market, mutual funds were net sellers at Rs.128mn in August as against net buyers at 139mn in July 2011.

