

December 2010

Stock Market Review

During December 2010, despite hike in the Discount Rate by SBP in November 2010 the stock market remained buoyant. Key factor for this performance was hefty foreign portfolio inflows. The bilateral agreement between People's Republic of China and Pakistan during the Chinese Prime Minister's visit to the country boosted the investors' confidence. Moreover, both local and foreign investors brushed aside tensions in the local politics. The month started with KSE-30 Index at around 10838 levels and closed the month at 11588 levels, showing a gain of around 6.9%.

IMF extended the SBA program for nine months for the pending tranches of US \$ 3.6 billion. During the month release of around US \$ 633 towards the Coalition Support Fund supported the external account. Inflation as measured by CPI was recorded at 15.5% on Year on Year basis and is expected to remain high in the coming months. Net Foreign Portfolio Investment (FPI) activity significantly improved during the month. Net FPI during the month of December was recorded at around US \$ 72.95 million, as against US \$ 39.02 million during November 2010. Trading activity slightly improved and Average Daily Traded Volume during December 2010 was recorded at 139.60 million shares, compared to 125.98 million shares in November 2010.

Banking, Chemical and General Industries sectors out-performed the market during the month of December 2010. While, Oil and Gas; Construction and Materials; and Fixed Line Communication sectors lagged the market. We have witnessed rally in the Banking sector ahead of the year-end. Key companies in the Oil and Gas Exploration sub-sectors performed well due to the attractive valuations and earnings growth. Significant off-take of the urea and DAP coupled with the increase in the urea prices helped the outperformance of the Fertilizer sub-sector against the market. Volatile cement prices and upsurge in the coal prices weakened the investors' confidence in the Cement sub-sector. Refineries sub-sector under-performed the market due to expected earnings decline following the removal of the incidental charges and up-tick in the crude oil prices.

Going forward, we believe that the key drivers of the stock market are: (i) Foreign Portfolio Investment (FPI) activity; (ii) Launch of the Leverage Product; (iii) Foreign assistance and aid; (iv) Law and order situation; (v) Inflation; and (vi) SBP monetary stance.

Fixed Income Review

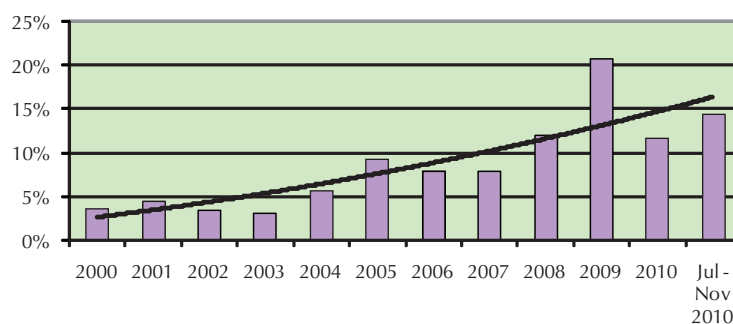
The year 2010 ended with more concerns than good news. Floods, rising inflation and interest rates, Government excessive borrowing from SBP, political uncertainties, removal of subsidies in energy sector, upward direction of crude oil prices and rising external borrowings cast shadows over growth prospects of the country. On the other hand, improved current account deficit on the back of healthy trend in workers' remittances and exports is a breather. Long term inflation trend is upwards, as can be seen from the graph. Respite to this does not appear likely in near term. Interest rates have risen and the Discount Rate has increased by 1.5% during the last five months.

Also, the Government has so far borrowed about Rs 307 billion in this Fiscal Year from the State Bank, an increase of 27% in around five and a half months. YoY CPI during the last three months has averaged 15.5%. The Government's borrowing appetite is putting upward pressure on interest rates and is also being matched by banks' risk aversion as can be seen from the Table. Banks prefer investing in Government T-Bills rather than lending to private sector. Liquid assets mentioned in the Table are T-Bills mainly.

Incorporating the above developments and trends on interest rates in our analysis, we recommend that income funds' investors should take a longer term view in order to take advantage of the attractive yields on current prices of the debt securities. For investors with a shorter investment horizon, NAFA Government Securities Liquid

Fund (NGSLF), NAFA Savings Plus Fund and NAFA Riba Free Savings Fund continue to post attractive returns in line with the market rates. These Funds carry minimal interest rate risk and do not take exposure in debt securities. Rather, they invest in short-term money market instruments primarily Government securities.

INFLATION (CPI%) OVER TEN YEARS



| Banks' Liquidity Position shows risk aversion | | | | |
|---|-----------------------------------|------------------------------|-----------------------|-----------------------------------|
| Last Saturday / Friday | Minimum Statutory Liquid Assets * | Liquid Assets actually held* | Excess Liquid Assets* | Excess over statutory requirement |
| Jun-08 | 990.9 | 1,172.1 | 181.2 | 18.3% |
| Jun-09 | 783.6 | 1,327.6 | 544.0 | 69.4% |
| Jun-10 | 789.1 | 1,325.9 | 536.8 | 68.0% |
| Aug-10 | 864.0 | 1,611.7 | 747.7 | 86.5% |

*Rupees in billions