

## Stock Market Review

During November 2010, the stock market performed well mainly due to healthy foreign inflows, positive development on the leverage product and the forthcoming IMF Tranche. The month started with the KSE-30 Index at 10154.91 level and gained by 6.72% till November 22, 2010 to reach 10837.18 level. Later on, local investors became jittery on the back of news of flood Surcharge on CGT liability, Reformed General Sales Tax in a VAT mode and hike in the Policy rate. The KSE- 30 Index closed the month at 10838.15 levels translating into an overall gain of around 6.73% during the month.

The State Bank of Pakistan increased the Discount Rate by 50 basis points to 14% from 13.5% in its monetary policy decision on November 29, 2010. Key factors for the hike in discount rate were persistent inflationary trend and excessive monetary expansion due to Government borrowing. The inflationary pressures are showing persistence driven by food inflation due to post flood supply side shocks and upward adjustment of POL product prices. However, for the month of October 2010 inflation as measured by CPI recorded an increase of 0.62% on a month-on-month basis. Net Foreign Portfolio Investment (FPI) activity improved during the month. Net FPI during the month of November was recorded at around US \$ 39.02 million, as against US \$ 31.82 million during October 2010. Trading activity improved significantly and Average Daily Traded Volume during November 2010 was recorded at 125.98 million shares, compared to 106.95 million shares in October 2010.

The Oil and Gas Exploration, Oil and Gas Marketing, Refineries, Textile and Fertilizer sub-sectors out-performed the market. While, Banking sector and Cement sub-sector lagged the market. The Oil & Gas Exploration sub-sector out-performed the market due to expected higher earnings in the key companies and healthy foreign inflows. The Refineries sub-sector performed better than the market as a result of healthy earnings expectations. The expectations of earnings growth due to reduction in turnover tax to 0.5% on Oil and Gas Marketing sub-sector helped its out-performance versus the market. Banking sector lagged the market driven by higher Non-Performing Loans for the previous quarter. Expectations of higher earnings due to Strong DAP and urea sales improved confidence in the Fertilizer sub-sector.

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

## Fixed Income Review

The State Bank of Pakistan has increased the Policy/ Discount Rate for the third consecutive time by 50 basis points on Nov 29, 2010. Presently, the Discount Rate is at 14%, the benchmark six-month KIBOR is at 13.6%, YoY inflation is at 15.3%, private sector credit growth is at a mere 0.78%. These suggest the seriousness of the economic challenges the country is facing. Gradual removal of power subsidies, introduction of Reformed GST and infrastructure investment requirements owing to floods may all contribute to inflation going forward. Thus the benchmark interest rate is expected to remain high. High interest rates will result in improved returns on the money market and income funds. Due to the floating rate nature of corporate bonds in our income funds, these funds also stand to benefit from the rising interest rate scenario.

A few positive economic developments are simultaneously occurring. Current account deficit for the first four months i.e. July-Oct FY 2011 was 121% better as compared to the same period last year. Aside for healthy exports this is attributable to rising workers' remittances. The trend remains clear as shown below:

July-October	FY 09	FY10	FY11
Remittances(USD millions)	2,345.8	3,088.9	3,501.4

A summary of key macro-economic variables driving the fixed income markets over the last six years is as below:

	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11Expected
Inflation %	9.0	8.0	8.0	12.0	21.0	12.0	14%
Over all Fiscal Deficit % of GDP	3.3	4.3	4.4	7.6	5.3	6.3	5.5%
Current Account Deficit % of GDP	1.5	4.4	5.1	8.5	5.7	1.7	3.5%
Money Supply (%)	19.1	15.1	19.3	15.3	9.6	12.5	12.5%
Pvt./FDI/Portfolios (US\$ billion)	2.0	4.5	8.4	5.4	2.6	2.1	n/a

We advise 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, NAFA Savings Plus Fund and NAFA Riba Free Savings Fund continue to post satisfactory returns in line with the market rates.