Investment Outlook & NAFA Funds' Performance

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Stock Investing for the Long Term

In Pakistan, investors generally invest in the stock market to make a quick, hefty gain. They mostly end up losing money, and quit the market with the promise never to return. The culture of investing in the stock market for the long term has not yet established here. Stock markets are volatile every where in the world. However, they also tend to grow faster than other modes of investments such as bank deposits.

A short-term investor, invested in stocks, and in urgent need of cash, may be forced to sell when the market is down. However, a long-term investor can afford to wait and benefit from a market recovery, which is bound to occur sooner or later.

Investors should in general only invest money in the stock market that they do not need for five years or longer. This is typically the money that they are saving for their retirement, to build a house, marry their daughters, or send their sons for higher education. Provident / pension funds have longer investment horizons. If the average age of the employees of a company is 45 years, the investment horizon of the provident / pension fund is 15 years. Due to their longer investment period, they can afford to invest in stocks, and should typically have 30% - 40% of their portfolios invested in stocks. Of course, the best way to invest in the stock market is through well-managed mutual funds as they offer benefits of diversification and professional management, among others.

As can be seen in the chart below, the Pakistan stock market, like all global stock markets, has rewarded those investors very well who have the patience and time on their side. If an investor had invested Rs 100,000 in a bank 30 years ago, the value of that investment would have grown to Rs 976,613 today, at an annualized return of 7.9%. Inflation in this period at 8.1% per year, was higher than the bank deposit rate. Cost of products and services have risen 10 times over the last 30 years. Rs 100,000 invested in Defence Saving Certificates 30 years ago, would be worth Rs 5.44 million today, at an annualized rate of return of 14.2%. However, the best investment over this period was that in the stock market, where Rs 100,000 invested 30 years ago would have grown to Rs 19.4 million today, at an annualized rate of return of 19.2%. This is the total return from stock investing including dividends and capital gains.

One may argue that 30 years is a long time to wait to earn a high return. However, with average expected life span in the affluent class around 70 years, if one starts investing in the stock market in his 40s, he/she can still expect to reap good rewards. Even over 10-year periods the stock market has given a higher return than other modes of investments – more on this in the next monthly issue.

Alternative Investments