

# NAFA Funds

Monthly Report (December 2008)



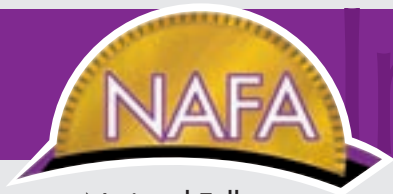
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# Investment Outlook

Dr. Amjad Waheed, CFA  
Chief Executive Officer

## 2009 - A Year of Recovery!

Year 2008 will be remembered as one of the toughest that Pakistan has experienced over the last few decades. The economy slowed down substantially under the burden of high inflation, falling foreign exchange reserves, country's deteriorating credit rating, poor law and order situation, liquidity crunch, energy shortages, rising debt servicing and defense expenditures, and diminishing investments in human and physical infrastructure.

As the economy deteriorated, the value of all assets including stocks, real estate and TFCs declined. The Stock Market (KSE 100 Index) declined by 63% from its peak level of 15700 in April 2008 to 5865 at present. TFCs started trading at about 15% below their face value, on average. Real estate lost around 20% of its value in developed sectors, and 40% in developing sectors. The confidence of the investors, both domestic and foreign, has eroded due to the present situation.

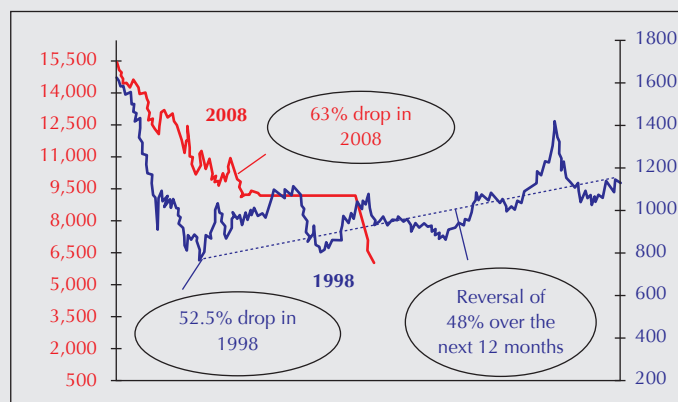
The key question now is whether the worst is over or yet to come. In my view, we hit the bottom the day we received funding from the IMF on November 27, 2008, and the situation is expected to slowly but steadily improve from here. Pakistan's credit rating has already been improved marginally by Standard and Poor's from CCC to CCC+. Pakistan's exports are up 12% year-on-year in the July-November, 2008 period. Pakistan's imports peaked at around US\$ 3.55 billion in September, 2008, but declined by 36% to US\$ 2.27 billion in November, 2008. The Current Account deficit is expected to decline from around US\$14 billion last fiscal year to US\$ 9.3 billion this year. Inflation (Sensitive Price Index) has declined from its peak of 34% year-on-year in August 2008 to 23.6% at present. This is projected to further decline to 16% in July, 2009, which may encourage the State Bank of Pakistan to reduce the discount rate by about 2% at that time.

Asset values are expected to recover substantially in 2009. The projected price-to-earnings ratio on the Pakistani Stock Market at present is around 5 times, which is half of its historical average of 10 times (see Chart 1). Year 2008 reminds me of 1998, when Pakistan carried out the nuclear blasts, resulting in economic sanctions by the West and freezing of foreign currency accounts by the government. During that period, the Pakistani stock market dropped by 52.5% from its peak, however over the next 12 months, despite the continuation of economic problems, the stock market provided a 48% total return to its investors (see Chart 2). I expect a similar performance of the stock market in 2009.

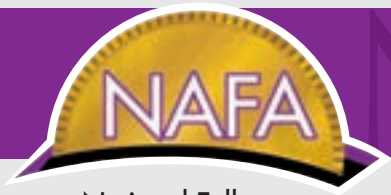
**Valuation of Pakistan Share Market**  
Chart 1

Particular	10-Year average	2009 F	Under-Valuation
Price/Earnings	10.5 X	4.7 X	55%
Price/Book Value	2.4 X	1.1 X	54%
Dividend Yield	5.21%	9.9%	47%

**A Comparison with 1998**  
Chart 2



Based on the SECP directive that resulted from the liquidity crunch, Asset Management Companies (AMCs) reduced the value of TFCs held in their income / cash mutual funds. This resulted in a reduction in the unit prices of these funds. It is expected that in 2009 as liquidity improves in the system, and inflation and interest rates decline, TFCs will again start trading at around their par values. Thus, in addition to the regular income earned by the income / cash funds, which is presently around 14% per annum, the losses experienced by investors on account of decline in value of TFCs in 2008 are also expected to reverse. This being the case, the total return on NAFA income / cash funds in 2009 may exceed 20% per annum.



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# NAFA Cash Fund (NCF)

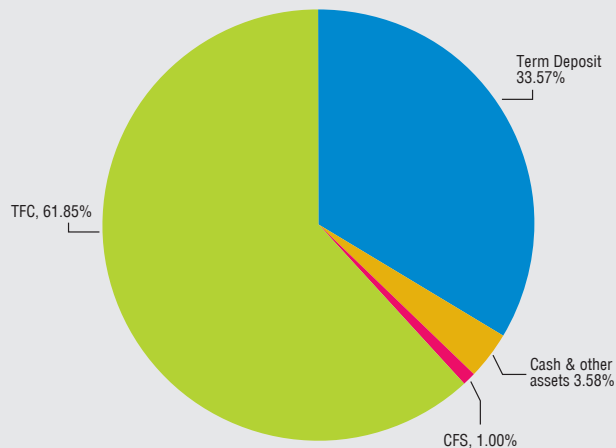
Unit Price (31/12/2008): Rs. 9.5895

December 2008

Investment Objective	Performance					
	Performance (%)	Apr - Dec 2006*	Jan - Dec 2007*	Jan - Dec 2008*	Dec 2008**	Since Launch April 22, 2006**
To seek preservation of capital and earn a reasonable rate of return via investing in money market and debt securities with investment-grade rating, CFS and spread transactions.	<b>NAFA Cash Fund</b>	<b>10.65%</b>	<b>10.28%</b>	<b>2.92%</b>	<b>0.55%</b>	<b>21.79%</b>
	<b>Benchmark</b>	9.87%	10.07%	12.95%	1.22%	32.80%
	<b>Profit on Rs. 100,000 invested</b>	Rs. 7,299	Rs. 10,279	Rs. 2,928	Rs. 553	Rs. 21,793
	* Represents Annualized Return ** Represents cumulative Return (Returns are net of management fee & all other expenses)					

General Information		Fund Manager's Commentary
Launch Date:	April 22, 2006	NAFA Cash Fund has earned an annualized rate of return of 6.70% in December 2008. The return is low, less than half of what would have been earned, but for the credit rating downgrades of some of the TFC holdings in the cement sector. The management has prudently taken the entire mark-down in one day on Dec 16 (rating downgrade announcement was on Dec 15). This is in stark contrast to what was practiced by other fixed income funds across the industry i.e. they did not provide for it.
Fund Size:	Rs. 10,373 million	
Type:	Open-end – Fixed Income Fund	Recently, liquidity in the financial sector has improved as compared to the previous two months. Many factors contributed to this positive development including IMF loan disbursement, improved sovereign credit rating of Pakistan from CCC to CCC+, SBP measures and relatively stable PKR/USD rates. We expect the economic / liquidity situation to improve, and inflation/ interest rates to decline significantly by June 2009. If this scenario materializes, the 8% or so loss suffered by our investors in last quarter of 2008 is expected to reverse to a large extent.
Dealing:	Daily	
Settlement:	2-3 business days	
Load:	No entry or exit load	
Management Fee:	1.5% per annum	
Listing:	Lahore Stock Exchange	
Custodian & Trustee:	Central Depository Company (CDC)	
Auditors:	A. F. Ferguson & Co. Chartered Accountants	
Benchmark:	1-Month KIBOR	
Fund Manager:	Rukhsana Narejo, CFA	
Minimum Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-	

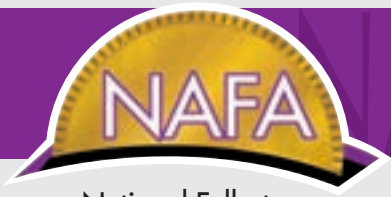
Asset Allocation (as on 31st December 2008)



The weighted average rating of the TFCs in the portfolio is AA-, while the maturity is 5.60 years. The yield to maturity (return) in this period is about 22.00% p.a. In other words, for investors who remain invested, the expected return on the TFC portfolio of the Fund is 22.00% per year.

TFCs coupons are linked with 6-M KIBOR, which was stable all month and ended at 15.70%. NAFA Cash Fund will maintain its strategy to keep a low duration of its portfolio to minimize any interest rate risk.

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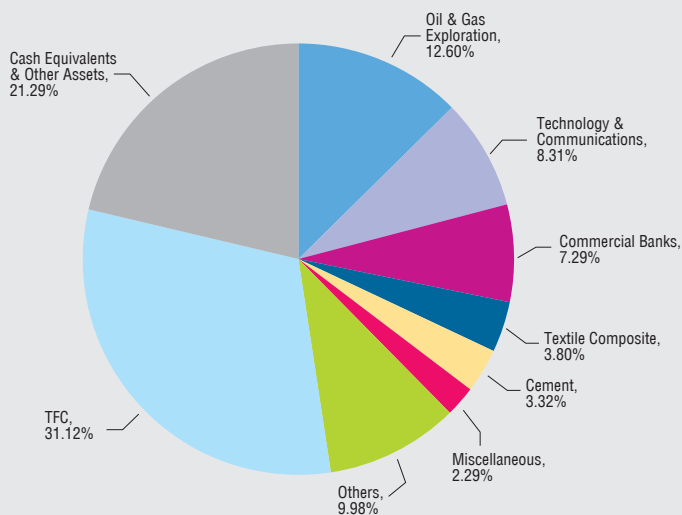
# NAFA Multi Asset Fund (NMF)

December 2008

Investment Objective	Performance					
To provide investors with a combination of capital growth and income. NMF aims to achieve attractive returns at moderate levels of risk by investing in a variety of asset classes such as stocks, bonds, money market instruments, CFS etc.	<b>Return (%)*</b>	<b>Jan - Dec 2007</b>	<b>Jan - Jun 2008</b>	<b>Jul - Sep 2008</b>	<b>Sep 2008</b>	<b>Since Launch Till Sept 30, 2008</b>
	<b>NAFA Multi Asset Fund</b>	<b>44.06%</b>	<b>-5.90%</b>	<b>-13.13%</b>	<b>-0.02%</b>	<b>17.76%</b>
	<b>Benchmark (50% KSE-30 Index &amp; 50% 1-month KIBOR)</b>	17.50%	-4.38%	-14.37%	-0.05%	-3.79%
*Returns are net of management fee & all other expenses						

General Information		Fund Manager's Commentary
Launch Date:	January 22, 2007	On December 15, 2008 the price floor mechanism imposed on August 27, 2008 was removed. Subsequently, the market fell by 37%, and from its peak level (15,700) it has fallen by 63%. As per the valuations, Pakistani stock market is almost 50% cheaper than its historical averages as well as regional markets.
Fund Size:	Rs. 1,590 million	
Type:	Open-end – Balance Fund	The money market yields declined due to 3.13% growth in Money Supply (M2) during November as compared to a 2% decline during July to October period. Liquidity in TFC market also improved and they traded above the prices set by SECP. We believe that after December 31, 2008 liquidity lying with the large financial institutions may also find its way in the capital markets. Thus, an improvement in TFC prices is likely.
Dealing:	Daily	
Settlement:	2-3 business days	
Load:	Front end – 3%, Back end - 0%	
Management Fee:	2.5% per annum	The macro-economic situation seems to be improving as the FY 2009 trade deficit is expected to be USD 16 billion, which is likely to be financed by USD 7 billion foreign remittances and USD 9 billion inflows from International Financial Institutions (IFIs). Thus, further pressure on the exchange rate seems unlikely. Expectations with respect to budget deficit and inflation points towards declining interest rates and rising asset prices across the board.
Listing:	Lahore Stock Exchange	
Trustee:	Central Depository Company	
Auditors:	A. F. Ferguson & Co. Chartered Accountants	
Benchmark:	50% KSE-30 Index & 50% 1-month KIBOR	
Fund Manager:	Khurram Shehzad, CFA	NMF is 48% invested in equities. Due to extremely low daily traded values at the stock exchanges, sale of assets and determination of their saleable prices have become impossible. Therefore, if we had not suspended the dealing in units, investors redeeming would have benefited at the expense of those not redeeming.
Minimum Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-	

Asset Allocation (as on 31st December 2008)



The macro-economic situation seems to be improving as the FY 2009 trade deficit is expected to be USD 16 billion, which is likely to be financed by USD 7 billion foreign remittances and USD 9 billion inflows from International Financial Institutions (IFIs). Thus, further pressure on the exchange rate seems unlikely. Expectations with respect to budget deficit and inflation points towards declining interest rates and rising asset prices across the board.

NMF is 48% invested in equities. Due to extremely low daily traded values at the stock exchanges, sale of assets and determination of their saleable prices have become impossible. Therefore, if we had not suspended the dealing in units, investors redeeming would have benefited at the expense of those not redeeming.

NMF is well positioned to capitalize upon any uptrend in the equity markets as an additional 22% of the Fund can be deployed in equities depending upon the market conditions. The fixed income portfolio is already yielding returns in excess of 20% due to resetting of coupon rates on TFCs & Sukuks at higher KIBOR levels and SECP directed discounts on TFCs & Sukuks prices.

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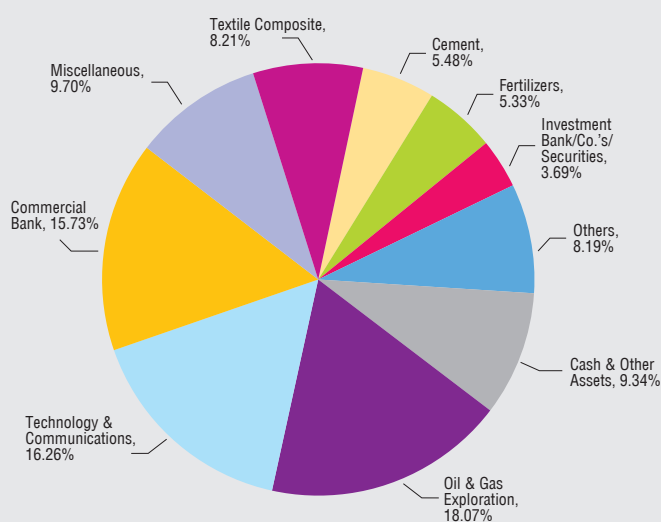
# NAFA Stock Fund (NSF)

December 2008

Investment Objective	Performance					
To provide investors with long-term capital growth from an actively managed portfolio invested primarily in listed companies in Pakistan. The risk profile of the Fund will be moderate to high.	<b>Return (%)*</b>	<b>Jan - Dec 2007</b>	<b>Jan - Jun 2008</b>	<b>Jul - Sep 2008</b>	<b>Sep 2008</b>	<b>Since Launch Till Sept 30, 2008</b>
	<b>NAFA Stock Fund</b>	<b>61.59%</b>	<b>-14.04%</b>	<b>-26.16%</b>	<b>-0.43%</b>	<b>2.57%</b>
	<b>Benchmark</b>	24.82%	-14.30%	-29.75%	-1.31%	-24.85%
* Returns are net of management fee & all other expenses						

General Information	Fund Manager's Commentary
<p>Launch Date: January 22, 2007</p> <p>Fund Size: Rs. 960 million</p> <p>Type: Open-end - Equity Fund</p> <p>Dealing: Daily</p> <p>Settlement: 2-3 business days</p> <p>Load: Front end - 3%, Back end - 0%</p> <p>Management Fee: 3% per annum</p>	<p>After a de-facto closure of almost 110 days, the price floor mechanism was removed on December 15, 2008 at the Karachi Stock Exchange. Since then the KSE-100 index has fallen by 37%, and from its peak (15700) it has shed 63%. For the 8-month period before the market closure, the average daily traded value was Rs.21 billion, which has been Rs.0.3 billion during the last 15 days. Thus, sale of assets and determination of their saleable prices have become impossible.</p> <p>In an open-end fund when someone redeems the investment, assets of equivalent value are sold and vice versa. Therefore, valuation of funds' assets at their saleable price is essential to treat all unit holders equally. In the present situation, if we had not suspended the dealing in units, investors redeeming would have benefited at the expense of those not redeeming.</p>
<p>Listing: Lahore Stock Exchange</p> <p>Custodian &amp; Trustee: Central Depository Company</p> <p>Auditors: A. F. Ferguson &amp; Co. Chartered Accountants</p> <p>Benchmark: KSE-30 Index</p> <p>Fund Manager: Khurram Shehzad, CFA</p> <p>Min. Subscription: Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-</p>	

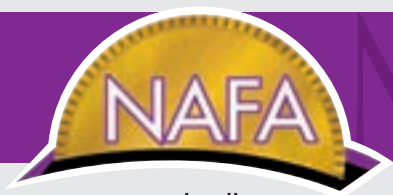
Asset Allocation (as on 31st December 2008)



Currently, the Price to Earnings Ratio (PER) of the market is 4.7x whereas historically the lowest ever PER is 4.4x. Thus, the market is almost hitting its trough. The dividend yields on some of the stocks have jumped to almost 24%, which is 5% above the core inflation. The PER of the NAFA Stock Fund (NSF) portfolio is 3.4x which is 27% less than the market PER- which means that the shares in NSF portfolio are cheaper than the market. Thus any recovery in the market provides an opportunity for the NSF investors to out-perform the market by a significant margin.

We expect that the Stock Market as well as NAFA Stock Fund will display a very good performance during the Calendar Year 2009. We also expect that further investment will come in the capital markets as currently asset prices are at one of their cheapest levels. It is advised that this is one of the best opportunities to invest more and bring down the cost of your investment.

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# NAFA Income Fund (NIF)

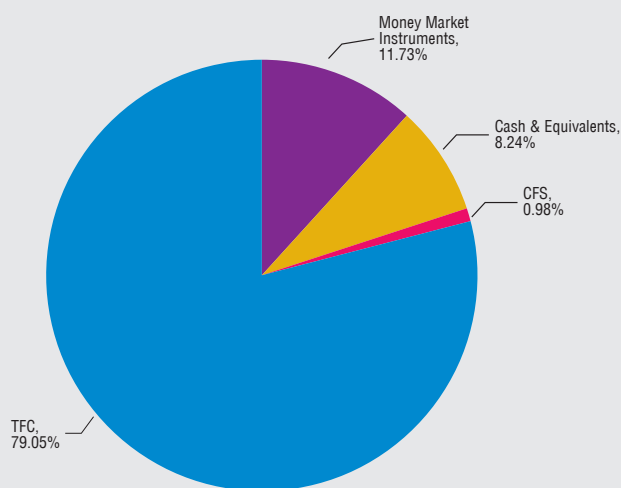
Unit Price (31/12/2008): Rs. 9.3934

December 2008

Investment Objective	Performance					
	Performance (%)	Apr - Jun 2008*	Jul - Sep 2008*	Oct - Dec 2008**	Dec 2008**	Since Launch March 29, 2008**
To earn a competitive rate of return while preserving capital to the extent possible by investing in liquid assets.	<b>NAFA Income Fund</b>	<b>8.50%</b>	<b>11.06%</b>	<b>(6.10)%</b>	<b>1.12%</b>	<b>(1.55)%</b>
	<b>Benchmark</b>	10.89%	12.90%	3.33%	1.13%	9.41%
	<b>Profit on Rs. 100,000 invested</b>	Rs. 2,055	Rs. 2,680	Rs.(6,102)	Rs. 1,118	Rs. (1,554)
	* Represents Annualized Return ** Represents cumulative Return (Returns are net of management fee & all other expenses)					

General Information		Fund Manager's Commentary
Launch Date:	March 29, 2008	During December 2008, NAFA Income Fund earned an annualized rate of return of 13.99%. Apart from a one time mark-down of the TFC portfolio in November as per the Securities and Exchange Commission of Pakistan Circular, the return of your Fund has been improving every quarter, as interest rates (6-M KIBOR) have risen. 6-M KIBOR was stable all month and ended at 15.70%. These levels are expected to sustain over next months.
Fund Size:	Rs. 1,036 million	
Type:	Open-end – Fixed Income Fund	
Dealing:	Daily	
Settlement:	2-3 business days	
Load:	Front end: 1.0%	The mark-down of TFCs, as communicated in the previous month's report, has increased the yield to maturity (return) of TFCs allocation of your Fund. This is around 22.00% now. With a high allocation in this asset class, the annual return of your Fund is expected to be attractive in the coming months.
Management Fee:	1.5% per annum	
Listing:	Lahore Stock Exchange	
Custodian & Trustee:	Central Depository Company (CDC)	
Auditors:	A. F. Ferguson & Co. Chartered Accountants	
Benchmark:	3-Month T-Bills	Recently, liquidity in the banking sector has improved as compared to the previous two months. Many factors contributed to this positive development including IMF loan disbursement, improved sovereign credit rating of Pakistan from CCC to CCC+, SBP measures and relatively stable PKR/USD rates. With political stability, falling commodities prices, expected Foreign Direct Investment after the IMF loan, and hopefully better law and order situation, we project improving macro-economic conditions in Pakistan in 2009. This should translate into higher demand of financial assets over the medium-term, which will be positive for your Fund.
Fund Manager:	Ahmad Nouman	
Minimum Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-	

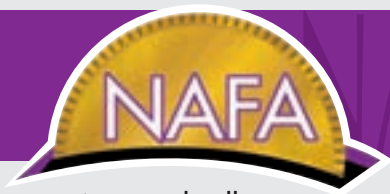
Asset Allocation (as on 31st December 2008)



We reiterate our stance that these times offer meaningful opportunity to 1) existing unit-holders to increase their investment in NIF 2) new investors, to earn extra yields at current depressed NAV of NAFA Income Fund.

NAFA Income Fund will maintain its strategy to keep a low duration of its portfolio to minimize any interest rate risk.

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# NAFA Islamic Income Fund (NIIF)

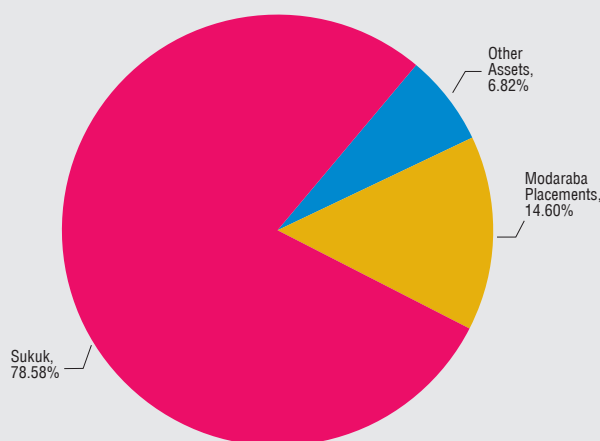
Unit Price (31/12/2008): Rs. 8.6971

December 2008

Investment Objective	Performance					
To seek maximum possible preservation of capital and a reasonable rate of return via investing primarily in Shariah Compliant money market & debt securities having good credit rating and liquidity.	<b>Performance (%)</b>	<b>Jan - Jun 2008*</b>	<b>Jul - Sep 2008*</b>	<b>Oct - Dec 2008**</b>	<b>Dec 2008**</b>	<b>Since Launch October 29, 2007**</b>
	<b>NAFA Islamic Income Fund</b>	<b>8.62%</b>	<b>10.62%</b>	<b>(13.84)%</b>	<b>(1.09)%</b>	<b>(6.70)%</b>
	<b>Benchmark</b> (Average 1-month deposit rate of Islamic Banks)	5.31%	5.46%	1.53%	0.53%	6.55%
	<b>Profit on Rs. 100,000 invested</b>	Rs. 4,209	Rs. 2,577	Rs.(13,843)	Rs.(1,091)	Rs. (6,700)
* Represents Annualized Return ** Represents cumulative Return (Returns are net of management fee & all other expenses)						

General Information		Fund Manager's Commentary
Launch Date:	October 29, 2007	<p>As per directives of Securities &amp; Exchange Commission of Pakistan (SECP) dated November 5, 2008, Sukuks and TFCs have been revalued based on their credit rating. During the month of December 2008, sukuk issues of Maple Leaf Cement and Kohat Cement were marked down by 5.00% and 10.00% respectively due to downgrade by the credit rating agency.</p> <p>As a result of the revaluation impact of the sukuks of around 3.20%, during the month of December 2008, NAV of NAFA Islamic Income Fund (NIIF) went down by 1.09%. Due to the mark-down in the value of the sukuk portfolio, through a book entry only, the weighted average Yield To Maturity (return) on the sukuk portfolio has now increased to 30.00% per annum. We expect that as liquidity improves in the system, Sukuk prices will revert back to the level where they were prevailing before the SECPs' Circular was issued and losses experienced by our investors will reverse.</p> <p>The attached chart shows asset allocation of the Fund as on December 31, 2008. Sukuk comprises 78.58% of the Fund size compared to 80.75% during the previous month and Investment in Modaraba placements accounts for 14.60% of the Fund size.</p> <p>During the month of December 2008, liquidity conditions improved as indicated by the overnight lending rate which was calculated at 4.56% as against 6.67% during the previous month. Similarly, in tenors we have seen a downward trend in the lending rates.</p> <p>Going forward, we expect the performance of the Fund to improve substantially due to attractive yield on the sukuk portfolio and reversal of sukuks prices.</p>
Fund Size:	Rs. 562 million	
Type:	Open-end – Fixed Income Fund	
Dealing:	Daily	
Settlement:	2-3 business days	
Load:	Front end - 1.0%	
Management Fee:	1.5% per annum	
Listing:	Lahore Stock Exchange	
Custodian & Trustee:	Central Depository Company (CDC)	
Auditors:	A. F. Ferguson & Co. Chartered Accountants	
Benchmark:	Average 1-month deposit rate of Islamic Banks	
Fund Manager:	Sajjad Anwar, CFA	
Min. Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-	

Asset Allocation (as on 31st December 2008)



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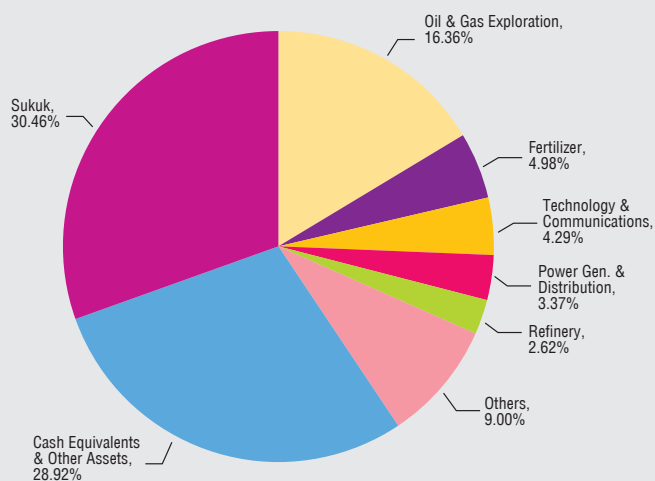
# NAFA Islamic Multi Asset Fund (NIMF)

December 2008

Investment Objective	Performance					
To provide investors with a combination of capital growth and income by investing in Shariah compliant investments. NIMF aims to achieve attractive returns at moderate levels of risk by investing in a variety of Shariah compliant securities, instruments and avenues such as Equities, Musharakah, Murabahah, Ijarah etc.	Return (%)*	Jan - Jul 2008	Jul - Sep 2008	Aug 2008	Sep 2008	Since Launch Oct 29, 2007 to Sept 30, 2008
	<b>NAFA Islamic Multi Asset Fund</b>	<b>-6.96%</b>	<b>-10.63%</b>	<b>-5.69%</b>	<b>-0.23%</b>	<b>-14.78%</b>
	*Returns are net of management fee & all other expenses					

General Information		Fund Manager's Commentary
Launch Date:	October 29, 2007	Securities and Exchange Commission of Pakistan finally intervened and directed to remove, w.e.f 15 Dec 2008, the floor placed under stock prices by the Karachi Stock Exchange. Potential buyers did not show any buying interest knowing that there was a significant selling pressure on behalf of the investors who were unable to sell over the past three months when the market remained frozen. Stock prices continued to fall sharply until the end of the month.
Fund Size:	Rs. 398 million	
Type:	Shariah Compliant - Open-end Balanced Fund	The selling pressure attributable to CFS has been resolved towards the end of the month through an agreement between the stakeholders. This is a positive development which should lead to higher buying interest going forward. The Government sponsored Market Opportunity Fund (MOF) is in place and ready to invest. Buying activity by MOF will encourage private investors to follow suit.
Dealing:	Daily	
Settlement:	2-3 business days	
Load:	Front end - 3%, Back end - 0%	
Management Fee:	3% per annum	
Listing:	Lahore Stock Exchange	The macroeconomic indicators are stabilizing and are showing gradual improvement. Inflation numbers seem to have peaked and are set to come down over the next few months. Trade deficit is narrowing. Foreign exchange reserves have improved and currency is not depreciating any further. If these trends continue, we can expect that the focus of macroeconomic policy will soon shift from inflation and external account management to economic growth.
Trustee:	Central Depository Company	
Auditors:	A. F. Ferguson & Co. Chartered Accountants	
Fund Manager:	Abdul Rehman Warraich	Stocks are very attractive at their current prices. Our strategy is to invest about 60% in stocks with stable earnings and high dividend yield. Profit rates on debt investments are also expected to remain high in the near future. We believe that balanced funds (which invest in a combination of equity & debt) will provide very good returns over the next year. This is an appropriate time to build and/or enhance your investments in the Fund.
Min. Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-	

Asset Allocation (as on 31st December 2008)



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