

NAFA Funds

Monthly Report (January 2009)



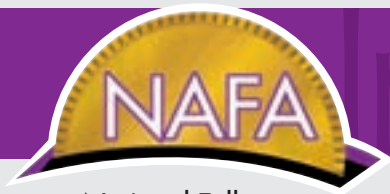
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Investment Outlook

Dr. Amjad Waheed, CFA
Chief Executive Officer

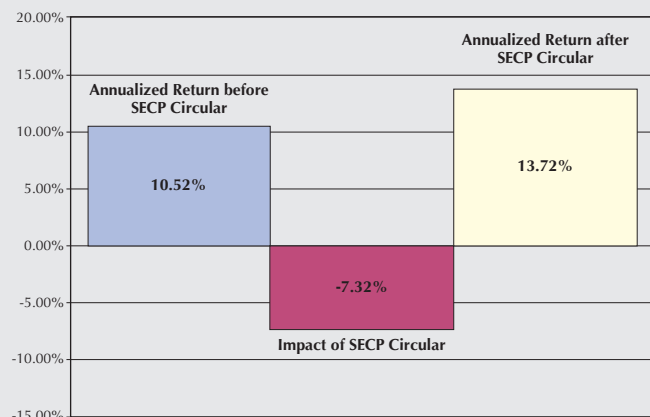
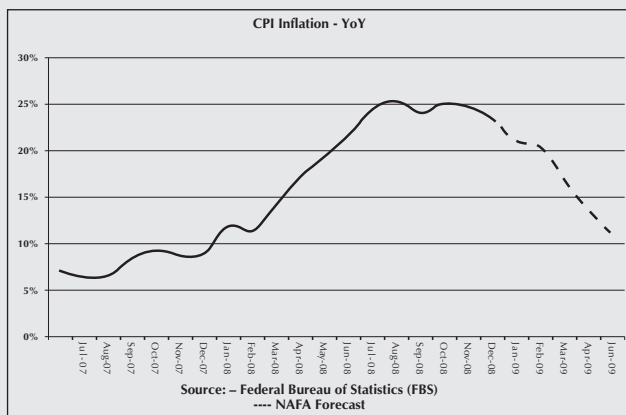
Economic Performance and Asset Valuations

Pakistan's economy is showing clear signs of improvement. Pakistan received around US\$ 700 million in Foreign Direct Investment in December 2008, and a similar amount in worker remittances. The current account deficit reduced to under US\$ 500 million in December versus over US\$ 2 billion in October. Government fiscal deficit has remained on target in 1HFY09 at around 2% of GDP. Inflation (Consumer Price Index) has declined from 25% in August 2008 to 23% by end-December 2008 on a year-on-year basis, and is expected to further decline to 12% by June-end, 2009 (See the chart below).

The global economy, especially the Western economies, are in their worst crises in decades and most global experts feel that the worst is yet to come. These economies have leveraged themselves to unsustainable levels, and it will now take years to reverse the excesses of the last two decades. The total public and private sector debt of the United States is over 350% of its GDP, which makes the United States one of the most highly leveraged countries in the world. The global economic slowdown has been a blessing in disguise for Pakistan. If the global economy was still robust and oil was still trading at over US\$ 100 per barrel, Pakistan would have been in deep trouble by now. Pakistani exports have been hit slightly by the global recession. However, due to a substantial decline in the import bill stemming from reduction in prices of crude oil, palm oil, steel and other commodities, Pakistan has been a net gainer from the global situation.

Why has the slow but steady improvement in Pakistan's economic situation not translated into improving asset valuations - stock market, TFCs or real estate? There are several reasons for this. First, there is an overhang of supply that has to clear before we move into a net positive investment mode. Global economic situation and resultant panic selling of all assets by foreign investors is keeping the Pakistani stock market depressed. Second, some of the major local brokerage houses who have suffered huge losses over the last six months, have been forced to sell their shares. Third, some banks which were forced to acquire shares due to defaults on CFS and / or margin financing have been off-loading these shares in the market. Fourth, lack of confidence, and "once bitten twice shy" mentality is keeping even genuine investors away from the market despite very attractive valuations. In my view, there is still about Rs. 20 billion of supply of shares in the market. With the Rs. 20 billion NIT State Enterprise Fund and gradual return of genuine investors in the market, this excess supply is expected to be cleared in the next few weeks. The Circular debt, which is still keeping liquidity tight in the market, is expected to be substantially paid off over the next 3-months. This is due to expected government budgetary support from the donor agencies such as The World Bank and Asian Development Bank. The resultant improvement in liquidity is expected to boost asset values.

In some cases, distress selling has already come to an end. Those double AA rated TFCs, which were trading at 25% discount to their face values 3-months ago, are today trading at 15% discount to their face values. It is expected that by June these TFCs may start trading at their par value. Thus, the losses that cash / income fund investors experienced in November as a result of the SECP Circular, are expected to be reversed in 2009. This makes cash / income funds a very attractive investment for investors with a one-year investment horizon. Below, please see the performance of our largest fund – NAFA Cash Fund before and after the SECP Circular.



I still expect a substantial recovery in asset values in 2009. In 1998-99, the stock market recovered by 48% in 12-months after dropping by 53% in 3-months. However, the recovery was very volatile with several good and bad months. I expect that 2009 recovery will also not be smooth, but similar to the 1998-99 recovery. Those who will be patient, and will not get disheartened by the ups and downs of the stock market, will reap the rewards.



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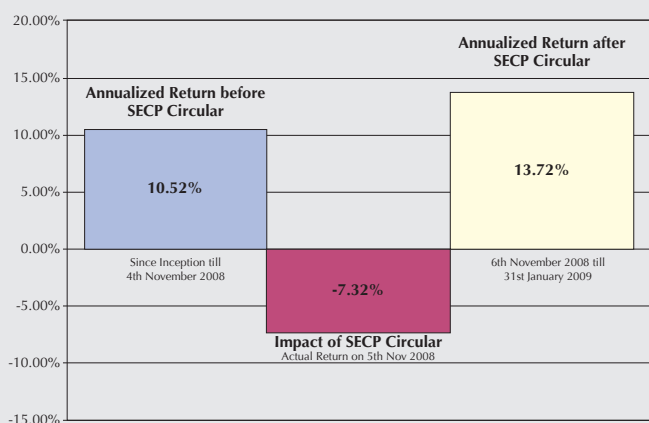
NAFA Cash Fund (NCF)

Unit Price (31/01/2009): Rs. 9.7031

January 2009

| Investment Objective | Performance | | | | | |
|---|---|-----------------|------------------|--------------|---------------|-------------------------------|
| | Performance (%) | Jan - Jun 2008* | Jul - Dec 2008** | Dec 2008* | Jan 2009* | 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. | NAFA Cash Fund | 9.88% | (1.80)% | 6.70% | 14.87% | 23.24% |
| | Benchmark | 11.20% | 7.17% | 15.32% | 14.37% | 34.32% |
| | * Represents Annualized Return ** Represents cumulative Return (Returns are net of management fee & all other expenses) | | | | | |

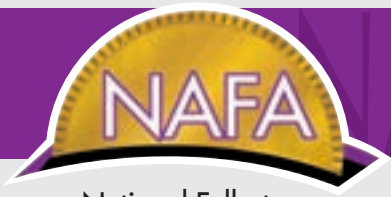
| General Information | Fund Manager's Commentary |
|--|---|
| Launch Date: April 22, 2006 Fund Size: Rs. 7,886 million Type: Open-end – Fixed Income Fund Dealing: Daily Settlement: 2-3 business days Load: No entry or exit load Management Fee: 1.5% per annum Fund Stability Rating: A(f) | <p>NAFA Cash Fund (NCF) earned an annualized rate of return of 14.87% during the month of January 2009. Annualized rate of return of 14.87% offered by NCF during the month is 0.50% better than the benchmark return of 14.37% per annum.</p> <p>As on January 31, 2009 TFCs, Term Deposits and Cash & other assets account for around 75%, 22% and 3% of the Fund size respectively. Weighted average yield to maturity (return) of the TFC portfolio is around 23% p.a. and weighted average duration is around 88 days. We have seen significant trading volume in TFCs/ sukuks during the month of January 2009. In our view, this increased trading activity indicates the upside in prices of TFCs with further improvement in the liquidity conditions, which will benefit our existing and fresh investors in the coming months.</p> |
| 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/- | |



The improvement in liquidity conditions, slowdown in the private sector borrowing and easing of inflation is putting downward pressure on the KIBOR. As a result, the 6-M KIBOR dropped to 15.10% as against 15.70% the previous month. Moreover, reversal in the trend as seen in 2008 has also been witnessed in the recently conducted T-Bill auction on January 28, 2009. There was active participation in long tenors and also decrease in T-bills cut off yields for three months and twelve months. This points to improvement in liquidity situation in the market and expectation of rising asset values including TFCs.

We expect the performance of the Fund to improve further in the coming months due to attractive yield on the TFCs portfolio and improvement in the prices of TFCs and sukuks.

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NAFA Multi Asset Fund (NMF)

NAV Unit Price (31/01/2009): Rs. 6.9898

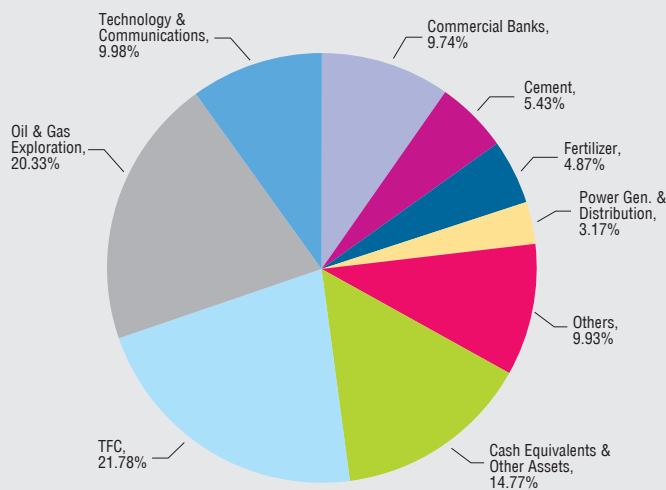
January 2009

| Investment Objective | Performance | | | | | |
|--|--|----------------|----------------|----------------|---------------|----------------|
| | Return (%)* | Jan - Dec 2007 | Jan - Jun 2008 | Jul - Dec 2008 | Jan 2009 | Since Launch |
| 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. | NAFA Multi Asset Fund | 44.06% | -5.90% | -36.04% | -1.61% | -14.70% |
| | Benchmark (50% KSE-30 Index & 50% 1-month KIBOR) | 17.50% | -4.38% | -35.39% | -1.85% | -28.75% |

*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. 1,522 million</p> <p>Type: Open-end – Balance 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: 2.5% per annum</p> | <p>During the month under review, NAFA Multi Asset Fund's (NMF) Net Asset Value (NAV) decreased by 1.61% while the benchmark (50% KSE-30 index & 50% 1-month KIBOR) decreased by 1.85%. Thus your Fund out-performed the benchmark by 0.24% during the month. Since inception on January 22, 2007 your Fund has declined by 14.70%, while the benchmark has declined by 28.75%. Thus, to date the out performance of your Fund stands at 14.05%.</p> <p>After the removal of the price floor mechanism at the Karachi Stock Exchange on December 15, 2008, the market witnessed continuous lower locks for 13 trading sessions. From January 02, 2009 normal trading activity returned to the market and on 5th January 2009 NMF resumed normal dealing of its units.</p> <p>Market closure of more than 100 days created a gap between the true prices and the prevailing rates which caused these continuous lower locks. During the month, the stock market showed a negative return. NMF remained overweight in equities through out the month but still out performed the benchmark. This was achieved through better stock selection.</p> <p>Liquidity in the fixed income markets improved thereby increasing the prices of TFCs in NMF's portfolio. Going forward the liquidity and macro-economic situation point towards a declining interest rate scenario. Thus all asset classes including equities and TFCs are expected to perform well.</p> <p>On the basis of our expectation, the weightage of NMF in equities has been increased to more than 63%. Furthermore, a carefully maintained mix of defensive and growth stocks is ensured to benefit from significant upside potential expected in 2009.</p> |
| <p>Listing: Lahore Stock Exchange</p> <p>Trustee: Central Depository Company</p> <p>Auditors: A. F. Ferguson & Co. Chartered Accountants</p> <p>Benchmark: 50% KSE-30 Index & 50% 1-month KIBOR</p> <p>Fund Manager: Khurram Shehzad, CFA</p> <p>Minimum Subscription: Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-</p> | |

Asset Allocation (on 31st January 2009)



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NAFA Stock Fund (NSF)

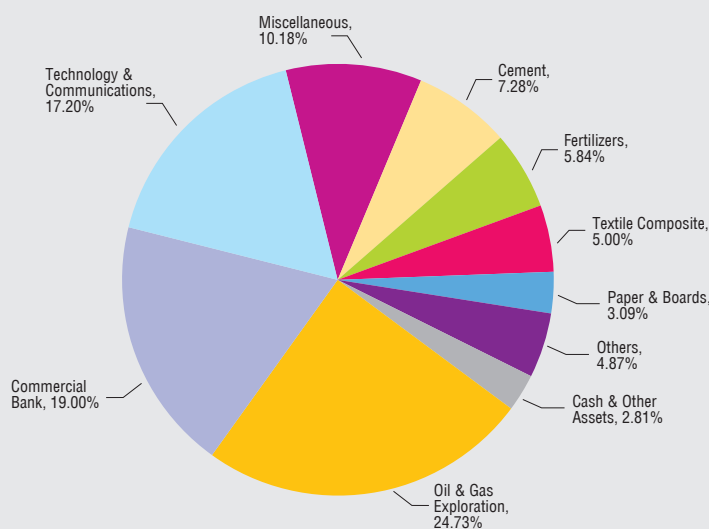
NAV Unit Price (31/01/2009): Rs. 4.7645

January 2009

| Investment Objective | Performance | | | | | |
|--|--|----------------|----------------|----------------|---------------|----------------|
| | Return (%)* | Jan - Dec 2007 | Jan - Jun 2008 | Jul - Dec 2008 | Jan 2009 | Since Launch |
| 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. | NAFA Stock Fund | 61.59% | -14.04% | -53.72% | -7.78% | -40.71% |
| | Benchmark | 24.82% | -14.30% | -61.71% | -5.28% | -61.20% |
| | * 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. 958 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>During the month under review, KSE-30 Index decreased by 5.28%, whereas NAFA Stock Fund's (NSF) Net Asset Value (NAV) decreased by 7.78%, thus an under-performance of 2.50% was recorded. Since inception on Jan. 22, 2007, the NAV of NSF has declined by 40.71% and the benchmark has declined by 61.20%, thus to date out-performance is 20.49%.</p> <p>As the trading volume improved from 2nd January 2009, NSF also resumed normal dealing in its units from 5th January 2009. After every massive fall, the initial investor interest always pours in high dividend yielding stocks followed by growth stocks.</p> <p>In line with its investment objective, NSF invests in growth stock which could not out-perform in this initial rally and an under-performance was reported. We firmly believe that as the dividend yield play subsides, the investor focus will shift towards growth stocks resulting in NSF's out-performance.</p> |
| <p>Listing: Lahore Stock Exchange</p> <p>Custodian & Trustee: Central Depository Company</p> <p>Auditors: A. F. Ferguson & 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 (on 31st January 2009)



The market PER is still hovering around 5x and NSF's PER is close to 3.8x. Therefore, the potential for out-performance is substantial. The key ingredients for continued performance of stock market are stability in macro-economic balance and improvement in liquidity situation. We believe that a declining inflation scenario bodes well for the economy. Furthermore, inflow of foreign assistance along with improvement in external balance will help ease the liquidity situation.

NSF will maintain its focus to keep on exploring extremely undervalued stocks and implementing a buy and hold strategy for out-performance. We expect 2009 to be a very good year for the stock market and NSF.

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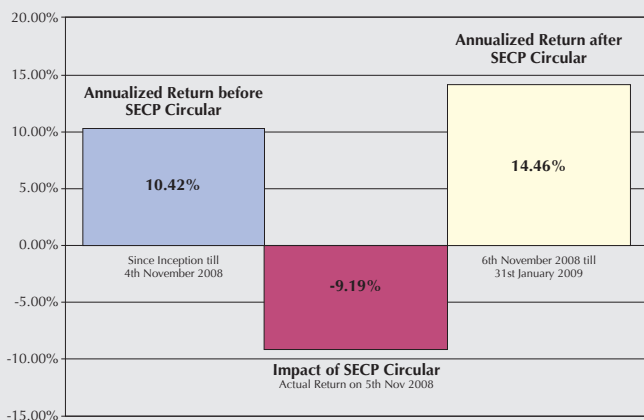
NAFA Income Fund (NIF)

Unit Price (31/01/2009): Rs. 9.5015

January 2009

| Investment Objective | Performance | | | | | |
|---|---|-----------------|------------------|---------------|---------------|-------------------------------|
| | Performance (%) | Apr - Jun 2008* | Jul - Dec 2008** | Dec 2008* | Jan 2009* | Since Launch March 29, 2008** |
| To earn a competitive rate of return while preserving capital to the extent possible by investing in liquid assets. | NAFA Income Fund | 8.50% | (3.59)% | 13.99% | 14.42% | (0.42)% |
| | Benchmark | 10.89% | 6.54% | 14.15% | 14.28% | 10.66% |
| | * 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 Fund Size: Rs. 1,125 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 | <p>During January 2009, NAFA Income Fund (NIF) earned an annualized rate of return of 14.42%. This is 43 basis points more than the last month.</p> <p>In the secondary market, TFCs' prices have already started to improve, as compared with previous few months. This trend is expected to continue. As on January 31 2009, TFCs, money market instruments and cash and other assets account for around 73%, 11% and 16% of the Fund size respectively. This high allocation in TFCs shall be a positive for your Fund in coming months, as TFCs are presently yielding 24% p.a.</p> <p>Positive developments on other fronts are also being observed. Stabilization in Balance of Payments, stable PKR/USD rates, declining commodity prices and improving liquidity of banking system have all been contributing to relative macro-economic stability, as against last half of CY 2008. We expect Foreign Direct Investment inflows into Pakistan in the coming months and the circular debt issue to be largely resolved by June 2009. If this happens, one can expect further improvement in domestic liquidity which shall be a positive for your Fund, via higher TFCs prices.</p> <p>6-M KIBOR, to which the coupons of TFCs in your Fund are linked, declined to 15.10% as compared to 15.70% a month earlier. Declining interest rates and inflation should help TFCs recover to their par values in due course of time. This should help investors earn good profits going forward.</p> <p>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 unit price of NIF.</p> |
| Listing: Lahore Stock Exchange Custodian & Trustee: Central Depository Company (CDC) Auditors: A. F. Ferguson & Co. Chartered Accountants Benchmark: 3-Month T-Bills Fund Manager: Ahmad Nouman Minimum Subscription: Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/- | |



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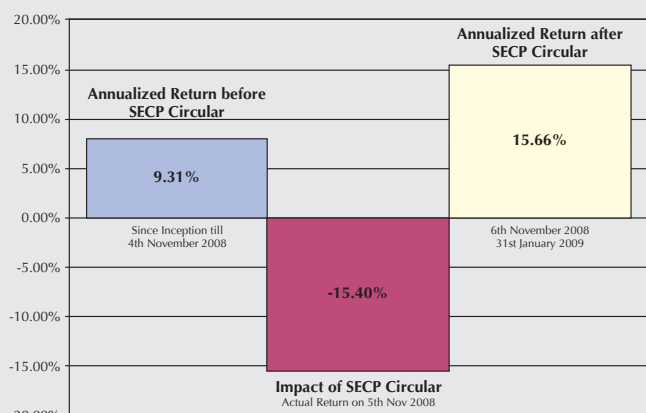
NAFA Islamic Income Fund (NIIF)

Unit Price (31/01/2009): Rs. 8.9425

January 2009

| Investment Objective | Performance | | | | | |
|---|---|-----------------|------------------|----------------|---------------|---------------------------------|
| | Performance (%) | Jan - Jun 2008* | Jul - Dec 2008** | Dec 2008** | Jan 2009* | Since Launch October 29, 2007** |
| 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. | NAFA Islamic Income Fund | 8.62% | (11.62)% | (1.09)% | 38.77% | (4.07)% |
| | Benchmark | 5.31% | 2.90% | 0.53% | 7.74% | 7.22% |
| | * 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 | During the month of January 2009, NAFA Islamic Income Fund (NIIF) generated an annualized return of 38.77% per annum. Average annualized rate of return offered by the Islamic banks during the month of January 2009 was calculated at 7.74% per annum. |
| Fund Size: | Rs. 525 million | |
| Type: | Open-end – Fixed Income Fund | <p>With the improvement in the liquidity condition in the market, we saw significant trading activity in the sukuk market. As mentioned in the last monthly report, during the month of January, prices of the sukuk started improving. As on January 31, 2009, Sukuk portfolio comprises around 86% of the Fund size as against around 79% during the previous month. Currently our sukuk portfolio offers Yield to Maturity (return) of around 27% per annum. Mudaraba placements & others comprise around 14% of the Fund size as against around 15% during the previous month.</p> <p>Currently the focus of our investment strategy is to maintain high allocation in sukuks in the Fund. This will benefit the Fund due to higher yield of sukuks and expected price appreciation of the sukuk in the coming months. 6 month KIBOR declined by 60 basis points to close the month at 15.10% as against 15.70% during the previous month. This should help price appreciation of the sukuks in due course of time.</p> <p>Going forward, we expect that return on our Fund to remain healthy due to: (I) expected improvement in the prices of sukuk portfolio; (II) attractive Yield to Maturity of the sukuk portfolio; and (III) better return on the mudaraba placements.</p> |
| 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/- | |



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NAFA Islamic Multi Asset Fund (NIMF)

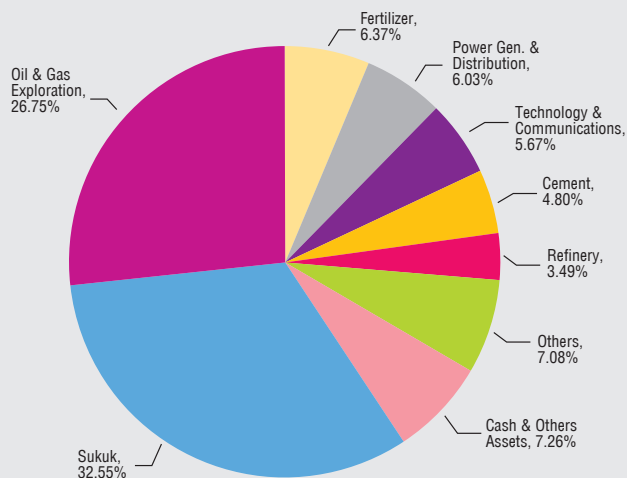
NAV Unit Price (31/01/2009): Rs. 6.5661

January 2009

| 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 (%)* | Nov - Dec 2007 | Jan - Jun 2008 | Jul - Dec 2008 | Jan 2009 | Since Launch |
| | NAFA Islamic Multi Asset Fund | -2.42% | -2.06% | -34.59% | 5.27% | -34.34% |
| | Benchmark** | - | - | - | 4.06% | - |
| *Returns are net of management fee & all other expenses ** KMI - 30 Index was launched on 1st Sep, 2008 | | | | | | |

| General Information | Fund Manager's Commentary |
|--|--|
| <p>Launch Date: October 29, 2007</p> <p>Fund Size: Rs. 415 million</p> <p>Type: Shariah Compliant - Open-end Balanced 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>During the month under review, Net Asset Value (NAV) of NAFA Islamic Multi Asset Fund (NIMF) increased by 5.27%, whereas benchmark increased by 4.06%, thus an out-performance of 1.21% was recorded.</p> <p>After a lot of volatility during the month, the stock market ended the month on a positive note. It closed well above its bottom. Trading volumes were good during the month, which shows that buying interest among domestic investors has revived.</p> |
| <p>Listing: Lahore Stock Exchange</p> <p>Trustee: Central Depository Company</p> <p>Auditors: A. F. Ferguson & Co. Chartered Accountants</p> <p>Benchmark: 50% KMI - 30 Index & 50% average 1-month profit rate of Islamic banks</p> <p>Fund Manager: Sajjad Anwar, CFA</p> <p>Min. Subscription: Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-</p> | |

Asset Allocation (on 31st January 2009)



Macroeconomic indicators are improving. Headline inflation numbers (CPI as well as SPI) for the month of December 2008 show an easing in inflation rates. Core inflation at 18.5% has also tapered off over the past three months and seems set to decline going forward. Foreign exchange reserves have stabilized around USD 10 billion. Fiscal deficit has also remained within the limits set by IMF for the first half of the current fiscal year. These trends suggest that there will be a strong case for lowering of interest rates in the near future.

During the month, we remained market weight in equity and fixed income asset classes. NIMF is a balanced fund and market weight implies a 50% weight in equity and 50% weight in fixed income. The Fund was able to beat the benchmark through combination of stock selection and a high yield on the fixed income portfolio.

Towards the end of the month, we increased our exposure to equity to 60%. Our strategy is to remain overweight in equity in the near future. Current stock prices are very attractive considering the earnings potential of the companies especially those in the defensive sectors like Oil & Gas, Fertilizer & Power. Going forward, it is our view that the Fund will perform well as we expect significant improvement in sukuks' and stocks' prices during 2009.

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