

NAFA Funds

Monthly Report (June 2010)



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National Fullerton
Asset Management Limited
(A Subsidiary of National Bank of Pakistan)

Is The Pakistani Stock Market Expensive?

Dr. Amjad Waheed, CFA
Chief Executive Officer

To value the stock market, we use a basic model known as the Gordon Growth Model. The model is as follows:

$$P = D_1 / (K - g) \quad (1)$$

Where P is the value of the stock market, D_1 is next year's dividend of the market, K is the rate of return that the investor requires for investing in the stock market, and g is the sustainable corporate earnings growth rate. It is assumed that corporate earnings will grow at the same rate as nominal GDP over the long run. The required rate of return $K = K_{rf} + (K_m - K_{rf})$, where K_{rf} is the risk free rate, and $(K_m - K_{rf})$ is the market risk premium. The risk-free rate is a function of inflation and the real GDP growth rate, whereas the risk-premium is the extra return that the investors expect over and above the risk-free rate for taking the extra risk of investing in the stock market. In other words, the risk premium is the difference between the return on the stock market and the long-term PIB rate. Equation 1 can be elaborated as follows:

$$P = \frac{D_1}{[K_{rf} + (K_m - K_{rf})] - g} \quad (2)$$

Some of the basic relationships that we can observe from equation 2 are as follows:

1. As the earnings and dividends of stock market rise, the value of the stock market is expected to rise.
2. As inflation rises, the stock market is expected to decline as the required rate of return of investors (K) increases.
3. The rise in real GDP growth has a two-fold impact. On the one hand, the required rate of return rises, which is negative for the stock market. Whereas on the other hand, corporate earnings rise that is positive for the stock market.
4. As the business, financial, political and/or security risks rise, investors demand a higher risk premium to invest in risky assets, which may result in a decline in the stock market.
5. Finally, the higher the long-term corporate earnings growth rate, the higher the expected rise in the stock market.

To value the stock market based on its price-to-earnings ratio, the above model (equation 2) can be modified further as follows:

$$P/E = \frac{(D_1/E)}{[K_{rf} + (K_m - K_{rf})] - g} \quad (3)$$

Where E is the expected earnings of the companies listed on the stock market.

We now evaluate the Pakistani stock market using Equation 3. Our long-term estimates for various variables are as follows:

Dividend payout ratio of the Pakistani stock market (D_1/E): 54%

Risk free rate using the 10-year PIB rate as a proxy (K_{rf}): 12.8%

Equity risk-premium ($K_m - K_{rf}$): 8.5%

Inflation rate: 10%

Real GDP growth rate (IMF forecast): 5%

Sustainable corporate earnings growth rate (g). (Assuming this equals inflation plus real GDP growth rate): 15%

Inputting the above estimates in Equation 3:

$$P/E = \frac{(0.54)}{[(0.128 + 0.085) - (0.10 + 0.05)]}$$

$$P/E = 8.6$$

Based on the above, the intrinsic price-to-earnings ratio of the Pakistani stock market is estimated at 8.6 times. The price-to-earnings ratio based on FY11 earnings is presently around 7 times. Thus the Pakistani stock market seems to be trading at a 23% discount to its intrinsic value. We expect the stock market to gradually move towards its intrinsic value.



**National Fullerton
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Capital Market Review

June 2010

Stock Market Review

During the month of June 2010, the Stock market remained volatile. The month started with KSE-30 Index at 9243 level. We witnessed rally despite apprehension over the modalities of the Capital Gain Tax (CGT) and KSE 30 Index touched a high of 9780 level as on June 7, 2010 showing an increase of 5.80% over the May-end level. Budget announcement remained a non-event for the majority of the listed sectors of the economy. The confusion of capital gain tax, its modalities and collection mechanism gripped the market during the second half of the month. We saw selling by the local investors to book their capital gains as CGT is applicable on the sale of share from July 1, 2010. As a result, KSE-30 Index touched a low of 9104 level as on June 15, 2010, showing a decline of 6.91% from the June 7th level. Overall, KSE-30 Index increased by 3.39% during the month.

Oil and Gas, Banks, Personal Goods, Construction & Materials sectors outperformed the market during the month. While, Fixed Line Communication, Automobile and Parts, and Chemicals sectors lagged the market. The index heavy weight Oil and Gas Exploration companies performed better than the market due to foreign buying. Cement sub sector performed well due to increase in cement prices in the North. We have seen rally in the banking stocks, as against the rumors, no additional tax was levied on the banks in the budget. The lower off-take numbers and gas supply cut to the fertilizer companies weakened the investor confidence in the sub sector. Net Foreign Portfolio Investment (FPI) activity remained low during the month and was recorded at around US \$ 29.75 million. Trading activity was abysmally low during the month with average daily traded volume recorded at around 100 million shares.

Going forward, the key triggers for the market are: (i) inflation trend; (ii) progress on the financing product; (iii) foreign portfolio investment; and (iv) the law and order situation. Valuations have become fairly attractive with the market placed at a forward PE of around 7x and the dividend yield rising to around 8.1%.

Fixed Income Review

During the month, the market witnessed ample liquidity which was a function of both USD 2.14 Billion foreign inflows from the previous month as well as payment to PSO of PKR 46 Billion by the Government to reduce circular debt. Inflation remained fairly constant as CPI for May'10 was recorded at 13.07% YoY, which was marginally lower by 19bps as compared to that of April 10.

Economic indicators, on the whole, continued to improve and both current account deficit and trade deficit for 11M FY10 improved by 65.65% and 13.39% respectively over the corresponding period last year. Remittances for the period July 2009-May 2010 registered an increase of about 14%. On the fiscal side, the total tax collection has improved by 19.3% for 11M FY10. Two areas which still require improvement are inflation and Government borrowing which show negligible signs of improvement and hence the general interest rate level has failed to ease.

Prices in the TFC market remained fairly stable, however, gains were realized due to repricing of a cement sector TFC which was upgraded post restructuring. On the other hand a textile sector TFC and a fertilizer sector TFC were classified as non-performing which resulted in provisioning in some Funds. Both these TFCs are undergoing restructuring and are expected to be finalized by end of July. We advise that income funds' investors should take a longer term view in order to take advantage of the attractive yields on debt issues and avoid short term volatility. Conversely, for investors with a shorter investment horizon, NAFA Government Securities Liquid Fund and NAFA Savings Plus Fund continue to post satisfactory returns in line with the market.

In the T bills auctions of June, SBP accepted Rs. 220.25 billion (combined for both auctions) versus the target of Rs. 180 billion. The cut off yields for the last auction of the month were noted at 12.10%, 12.30% and 12.41% for the 3 months, 6 months and 12 months T Bills, respectively. Going forward, interest rates are not expected to ease as Government borrowing remains excessive coupled with persistent inflation.

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NAFA Fund's Performance Summary Sheet

"JUNE 2010"

FUND NAME	FUND SIZE (Rs. in million)	FUND LAUNCH DATE	STABILITY RATING	JUNE - 2010	LAST ONE YEAR	SINCE LAUNCH
NAFA Government Securities Liquid Fund *	5,805	16-May-09	AA+ (f)	10.24%	10.53%	10.68%
NAFA Savings Plus Fund *	586	21-Nov-09	AA- (f)	9.26%	n/a	10.06%
NAFA Cash Fund *	3,915	22-Apr-06	A+ (f)	6.85%	5.81%	8.06%
NAFA Income Fund *	582	29-Mar-08	A (f)	35.97%	8.69%	6.52%
NAFA Islamic Income Fund *	202	29-Oct-07	***	**24.94%	-4.87%	-1.52%
NAFA Islamic Multi Asset Fund **	387	29-Oct-07	***	5.29%	17.46%	0.70%
NAFA Multi Asset Fund **	996	22-Jan-07	***	1.06%	12.38%	17.97%
NAFA Stock Fund **	959	22-Jan-07	***	2.54%	16.74%	-11.84%
Total AUM	13,432					

* Annualized return
** Cumulative return
*** Not applicable/available

Note: Detailed monthly reports on NAFA Funds are available on our website at www.nafafunds.com

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NAFA Government Securities Liquid Fund (NGSLF)

**National Fullerton
Asset Management Limited**
(A Subsidiary of National Bank of Pakistan)

Unit Price (30/06/2010): Rs. 10.2742

June 2010

Performance

Performance (%)*	June 2010	Jan. - June 2010	Since Launch May 16, 2009
NAFA Government Securities Liquid Fund	10.24%	10.51%	10.68%

* Represents Annualized Return
(Returns are net of management fee & all other expenses)

General Information

Launch Date:	May 16, 2009
Fund Size:	Rs. 5,805 million
Type:	Open-end – Money Market Fund
Dealing Days:	Daily – Monday to Friday
Dealing Time:	9:00 am – 4:30 pm
Settlement:	2-3 business days
Pricing Mechanism:	Forward Pricing
Load:	No entry or exit load
Management Fee:	1.25% per annum
Risk Profile:	Very Low
Fund Stability:	“AA+(f)” by PACRA
Listing:	Lahore Stock Exchange
Custodian & Trustee:	Central Depository Company (CDC)
Auditors:	A. F. Ferguson & Co. Chartered Accountants
Benchmark:	70% 3-Month T-Bills and 30% average 3-Month deposit rates (AA and above rated banks)
Fund Manager:	Ahmad Nouman, CFA
Minimum Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-
Asset Manager Rating:	AM2- by PACRA
Leverage: (Amount of leveraging /borrowing done by the Fund.)	Nil

Investment Objective

To generate optimal return with minimum risk, to provide easy liquidity and reasonable income to its unit holders by investing primarily in short-term Government Securities.

Fund Manager’s Commentary

The Fund earned an annualized return of 10.24% during the month. The Fund’s return may slightly improve in the coming months due to higher T-Bills rates and reduction in the management fee by NAFA by 25 basis points. The return on your Fund for FY 2010 is 10.53%.

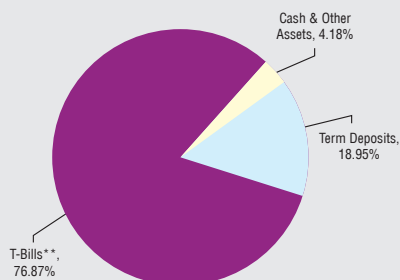
The internal risk guideline of NGSLF is to buy T-Bills of maximum 3-months remaining maturity. For the first quarter of FY 2011, the State Bank of Pakistan has announced T-Bills auction target of Rs 535 bln against maturities of Rs 502 bln, thus an excess target of Rs 33 bln. This indicates that short-term interest rates may not decline.

The investment value of NGSLF has not declined on any day since the launch of Fund in May, 2009. This is an indicator of the stability and safety of your Fund based on its investment policy of investing only in short-term Govt. T-Bills and AA & above rated Banks.

The average maturity of your Fund is 43 days and that of T-Bills asset class is 41 days. Credit split of Fund’s Assets is as follows:

Rating	% Allocation (June)	% Allocation (May)
AAA	76.91%	81.78%
AA+	6.97%	6.49%
AA	17.07%	11.61%
Accrued, deferred costs & unrealized sales/(Payables)	(0.95)%	0.12%

Asset Allocation (as on 30th June 2010)



* Includes Reverse Repo via Master Repurchase Agreement (MRA)

Name of the Members of Investment Committee

Dr. Amjad Waheed, CFA
Irfan Malik, CFA
Ahmad Nouman, CFA
Sajjad Anwar, CFA
Tanvir Abid, CFA

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NAFA Multi Asset Fund (NMF)

**National Fullerton
Asset Management Limited**
(A Subsidiary of National Bank of Pakistan)

Unit Price (30/06/2010): Rs. 9.3640

June 2010

Performance

Performance (%) *	June 2010	CYTD Jan. - June 2010	Since Launch January 22, 2007
NAFA Multi Asset Fund	1.06%	2.54%	17.97%
Benchmark	2.23%	1.59%	5.79%

*Cumulative returns are net of management fee & all other expenses

General Information

Launch Date:	January 22, 2007
Fund Size:	Rs. 996 million
Type:	Open-end – Balanced Fund
Dealing Days:	Daily – Monday to Friday
Dealing Time:	9:00 A.M to 4:30 P.M
Settlement:	2-3 business days
Pricing Mechanism	Forward Pricing
Load:	Front end – 3%, Back end - 0%
Management Fee:	2.5% per annum
Risk Profile:	Moderate
Listing:	Lahore Stock Exchange
Custodian & Trustee:	Central Depository Company (CDC)
Auditors:	A. F. Ferguson & Co. Chartered Accountants
Benchmark:	50% KSE-30 Index & 50% 1-month KIBOR
Fund Manager:	Sajjad Anwar, CFA
Minimum Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-
Asset Manager Rating:	AM2- by PACRA

Investment Objective

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.

Fund Manager's Commentary

During the month under review, NAFA Multi Asset Fund's (NMF) Net Asset Value (NAV) increased by 1.06% while the benchmark (50% KSE-30 index & 50% 1-month KIBOR) increased by 2.23%. Thus, your Fund under-performed the benchmark by 1.17% during the month. Since inception on January 22, 2007, your Fund has increased by 17.97%, while the benchmark has increased by 5.79%. Thus, to-date, the out-performance of your Fund stands at 12.18%.

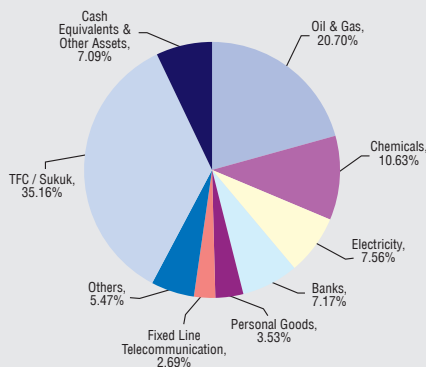
NMF is a Balanced Fund and market weight implies 50% weight in equities and 50% in fixed income asset class. Anticipating weak investor sentiments in the Stock Market ahead of the budget for FY 2011, NMF was around 35.6% invested in equities. However, witnessing an upward trend in the first week of the month, we increased our allocation in equities to around market weight. During the second half of the month, we further increased the weight in equities in high dividend yielding stocks in Chemical, Oil and Gas and Banking sectors. Our under-weight strategy in banks and over-weight in General Industries sectors contributed to the under performance of the Fund during the month. Some of our holdings in the Electricity (Hubco) and Chemical sectors under performed the market. In our view, these stocks are expected to out perform the market due to their attractive valuations going forward. Currently we are around 57.75% invested in equities.

NMF is invested in high dividend yielding stocks with stable earnings stream and attractive valuations.

Asset Allocation %

	June-10	May-10
Equities / Stock	57.75%	35.59%
TFC / Sukuk	35.16%	35.38%
Cash Equivalents & Other Assets	7.09%	19.22%
T-Bills	Nil	9.81%
Leverage	Nil	Nil

Asset Allocation (as on 30th June 2010)



Top Five Holding (Alphabetical)

Fauji Fertilizer Co. Ltd.
MCB Bank Limited
Oil & Gas Development Co. Ltd.
Pakistan Petroleum Ltd.
The Hub Power Co. Ltd.

Name of the Members of Investment Committee

Dr. Amjad Waheed, CFA
Sajjad Anwar, CFA
Tanvir Abid, CFA
Irfan Malik, CFA

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NAFA Islamic Multi Asset Fund (NIMF)

**National Fullerton
Asset Management Limited**
(A Subsidiary of National Bank of Pakistan)

Unit Price (30/06/2010): Rs. 10.0702

June 2010

Performance

Performance (%)*	June 2010	CYTD Jan. - June 2010	Since Launch October 29, 2007
NAFA Islamic Multi Asset Fund	5.29%	8.00%	0.70%

*Cumulative returns are net of management fee & all other expenses

General Information

Launch Date:	October 29, 2007
Fund Size:	Rs. 387 million
Type:	Shariah Compliant - Open-end Balanced Fund
Dealing Days:	Daily - Monday to Friday
Dealing Time:	9:00 A.M to 4:30 P.M
Settlement:	2-3 business days
Pricing Mechanism	Forward Pricing
Load:	Front end -3%, Back end-0%
Management Fee:	3% per annum
Risk Profile	Moderate
Listing:	Lahore Stock Exchange
Custodian & Trustee:	Central Depository Company (CDC)
Auditors:	A. F. Ferguson & Co. Chartered Accountants
Benchmark:	50% KMI - 30 Index & 50% average 1-month profit rate of Islamic banks.
Fund Manager:	Sajjad Anwar, CFA
Minimum Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-
Asset Manager Rating:	AM2- by PACRA

Investment Objective

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.

Fund Manager's Commentary

During the month of June 2010, Net Asset Value (NAV) of NAFA Islamic Multi Asset Fund (NIMF) increased by 5.29%, whereas the benchmark increased by 1.21%, thus your Fund out-performed the benchmark by 4.08%.

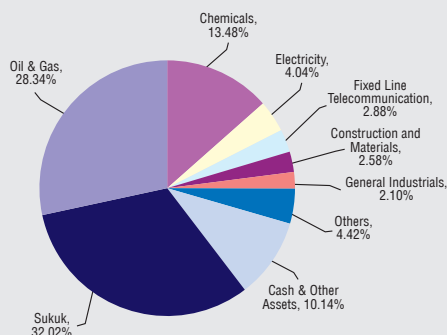
NIMF is a Balanced Fund and market weight implies 50% weight in equities and 50% in fixed income asset class. The month started with around 34% weight in equities due to weak investors' sentiments ahead of the budget for FY 2011. However, witnessing an upward trend in the market along with attractive valuations of the market, we increased our allocation in equities to around market weight. Post budget when all the uncertainties were removed, we further increased allocation in equities. We have increased weight in the high dividend yielding stocks of Chemical and Oil & Gas sub sectors. We reduced allocation in Hub Power Co. shares due to its change in Shariah compliance status. Some of our holdings in General Industries, Electricity and Chemical sectors under performed the market during the month. Towards the end of the month NIMF was around 57.8% invested in the equities.

NIMF is invested in high dividend yielding stocks with stable earnings stream, low business risk, and attractive valuations.

Asset Allocation %

	June-10	May-10
Equities / Stock	57.84%	34.02%
Sukuk	32.02%	28.52%
Cash Equivalents & Other Net Assets	10.14%	37.46%
Leverage	Nil	Nil

Asset Allocation (as on 30th June 2010)



Top Five Holding (Alphabetical)

Fauji Fertilizer Co. Ltd.
Oil & Gas Development Co. Ltd.
Pakistan Oil Fields Ltd.
Pakistan Petroleum Ltd.
Pakistan State Oil

Name of the Members of Investment Committee

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NAFA Stock Fund (NSF)

**National Fullerton
Asset Management Limited**
(A Subsidiary of National Bank of Pakistan)

Unit Price (30/06/2010): Rs. 7.0844

June 2010

Performance

Performance (%)*	June 2010	CYTD Jan. - June 2010	Since Launch January 22, 2007
NAFA Stock Fund	2.54%	(1.71)%	(11.84)%
Benchmark	3.39%	(2.98)%	(28.64)%

*Cumulative returns are net of management fee & all other expenses

General Information

Launch Date:	January 22, 2007
Fund Size:	Rs. 959 million
Type:	Open-end – Equity Fund
Dealing Days:	Daily – Monday to Friday
Dealing Time:	9:00 A.M to 4:30 P.M
Settlement:	2-3 business days
Pricing Mechanism	Forward Pricing
Load:	Front end-3%, Back end-0%
Management Fee:	3% per annum
Risk Profile	Moderate-to-High
Listing:	Lahore Stock Exchange
Custodian & Trustee:	Central Depository Company (CDC)
Auditors:	A. F. Ferguson & Co. Chartered Accountants
Benchmark:	KSE-30 Index
Fund Manager:	Sajjad Anwar, CFA
Minimum Subscription:	Growth Unit: Rs. 10,000/- Income Unit: Rs. 100,000/-
Asset Manager Rating:	AM2- by PACRA

Investment Objective

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.

Fund Manager's Commentary

During the month under review, KSE-30 Index increased by 3.39%, whereas NAFA Stock Fund's (NSF) Net Asset Value (NAV) increased by 2.54%, thus an under-performance of 0.85% was recorded. Since inception on January 22, 2007 the NAV of NSF has declined by 11.84% while that of the benchmark has declined by 28.64%, thus to-date, out-performance is 16.80%.

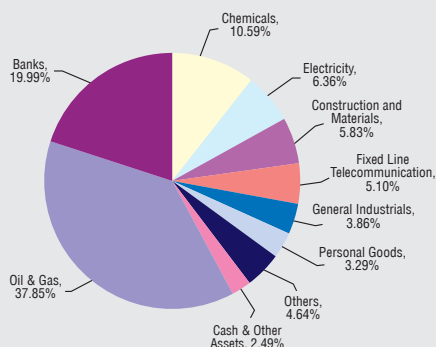
At the start of the month NSF was 83.9% invested in equities. Despite imposition of Capital Gains Tax, the budget announcement reduced overall concerns and uncertainties. Consequently, the Stock Market recovered despite low investor confidence and trading volumes. In line with the market trend, NSF gradually enhanced its weight in equities, mainly in Banks, Oil & Gas and Cement sectors. No new taxes were imposed on the banking sector in the budget. Consequently, we increased our exposure in this sector. However, the weight of NSF in banks remained below the market weight, which contributed to the underperformance of the Fund. In the Oil & Gas sector, the weightage was enhanced to the market weight. We also increased our exposure to the Cement sub sector following recovery in cement prices in the North and reports of price agreements among cement manufacturers. Similarly, in the Textile sub sector, the weightage of NSF was slightly increased. On the other hand, the weightage of sub sector Power Generation was marginally decreased on the weak performance of the sector during the month. At the end of the month, NSF was 97.5% invested in equities.

The market is trading at attractive valuations and NSF is invested in stocks that offer significant upside potential and growth prospects.

Asset Allocation %

	June-10	May-10
Equities / Stock	97.51%	83.92%
Cash & Other Assets	2.49%	16.08%
Leverage	Nil	Nil

Asset Allocation (as on 30th June 2010)



Top Five Holding (Alphabetical)

MCB Bank Ltd.
Oil & Gas Development Co. Ltd.
Pakistan Oilfields Ltd.
Pakistan Petroleum Ltd.
The Hub Power Co. Ltd.

Name of the Members of Investment Committee

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