NBP FUNDS
Managing Your Savings

Dr. Amjad Waheed, CFA
Chief Executive Officer

Historical Performance of Investment Avenues

The last two years have been challenging for the stock market, where the market declined by 10% and 19%, respectively. This subdued performance of the stock market has come after eight consecutive years of robust returns during which the KSE-100 Index surged by around 550%. Looking at the long-term performance of the stock market, it is evident that these depressed periods do not stay for long. In the long run, equities have outperformed all the other asset classes, although it is volatile in the short-term. We have examined past performance of key domestic asset classes for a 19-year period from January 2001 to December 2019. We have included six asset categories for which long-term data is available: Treasury Bills, Bank Deposits, National Savings Schemes (NSS), Pakistan Investment Bonds (PIBs), Capital Protected Strategy (CPS), and Equities. CPS is a synthetic asset class under which portfolio is dynamically managed between the low-risk and high-risk components with the aim of capital preservation, while also capturing some upside of the stock market. The results of the CPS are based on back-testing as this strategy was not in practice during this entire period. Inflation, as measured by CPI, has averaged 7.9% per annum, and Pak Rupee has depreciated against the US Dollar by 5.3% per year, over the last nineteen years.

The historical analysis, as given in the Table below depicts that equities offered the highest nominal and real return amongst all the asset classes. An investment of PKR 100 in equities in January 2001 would be worth PKR 2,702 by the end of December 2019. During the same period, PKR 100 investment in bank deposits or T-Bills would have increased to a paltry PKR 298 and PKR 496, respectively.

Asset class	Bank Deposit	T-Bill	Special Savings Certificates (SSC)	Pakistan Investment Bonds (PIB)	Capital Protected Strategy (CPS)	Equity (Stock Market)
Nominal annualized return	5.9%	8.8%	9.7%	12.3%	13.8%	18.9%
Inflation	7.9%	7.9%	7.9%	7.9%	7.9%	7.9%
Real return (adjusted for inflation)	-1.9%	0.8%	1.7%	4.0%	5.4%	10.2%
Annualized Standard Deviation (Risk)	0.5%	1.1%	6.4%	12.0%	7.9%	25.2%
Sharpe Ratio*	N/A**	N/A	0.15	0.29	0.63	0.40
Future Value of Rs. 100 at the end of 19 years - Nominal value	298	496	584	904	1,162	2,702
Future Value of Rs. 100 at the end of 19 years - Real value (Net of Inflation)	70	116	137	212	273	634

***Sharpe Ratio = Excess return per unit of risk = (Expected return – Risk free rate)/(Standard deviation), we have used 6M T-Bill as a proxy for risk free rate**

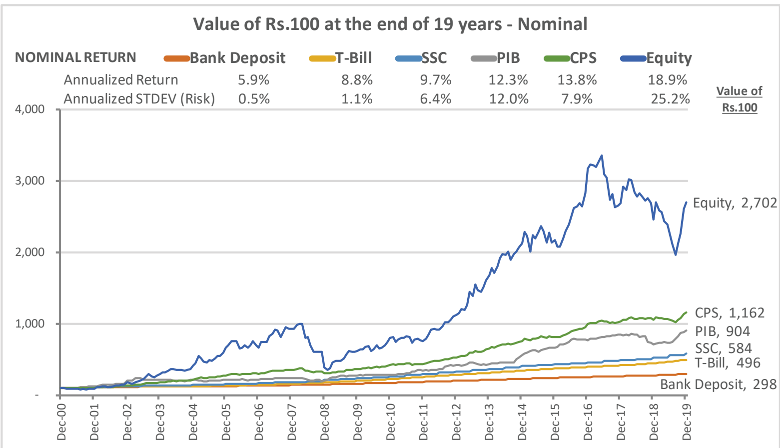
****Due to negative excess return, standard Sharpe ratio is meaningless**

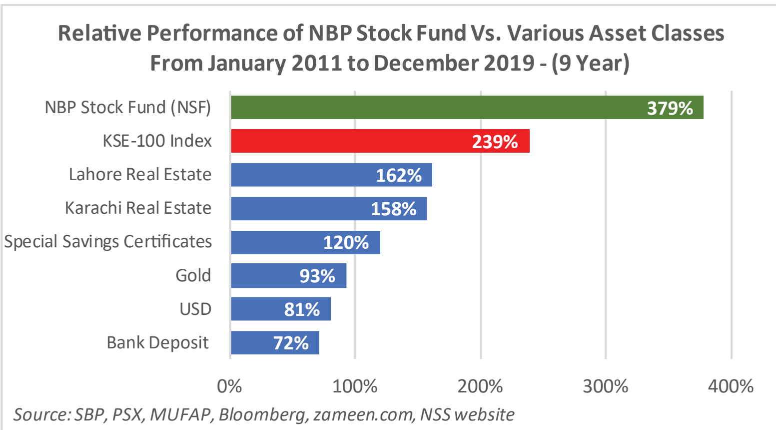
Source: SBP Statistical Bulletin, PSX, NSS website, NBP Funds Research

The outcome of the above analysis supports the basic notion that there is a positive relationship between risk and return, meaning higher the risk, the higher the return. In line with the expectation, equities exhibited the highest volatility, and bank deposits and T-Bills have the lowest risk. The analysis shows that over a long investment horizon, equities delivered the highest return.

Another take away from this analysis is that investors with long-term goals like educating their children, owning a house, or saving for retirement should have some of their assets invested in equities, preferably through equity mutual funds, while investors with low risk appetite based on short term investment needs, should invest in bank deposit or as an alternative in money market / income funds.

Investors have asked us to compare return of our flagship NBP Stock Fund with real estate. Zameen.com has been maintaining real estate indices over the last nine years. As the chart shows, NSF has out-performed the stock market by 140% over the last 9 years by earning a return of 379% versus 239% rise in the stock market. During the same period, Lahore real estate has provided a return of 162% versus 158% rise in Karachi real estate. This out-performance of the Fund is net of managemnet fee, and all other expenses.





January 2020

Stock Market Review

January remained a tale of two halves for the stock market. Carrying forward the positive momentum, the market started off the outgoing month on a positive note as the benchmark KSE-100 Index hit the recent high of 43,219 points on January 13th, a hefty rise of 6% from the last month's closing level. However, the rally lost steam with the Index falling by 3.7% during the subsequent trading days of the month, taking the month-on-month gains to 2.2%. What has caused lukewarm performance of the stock market during the latter half of month? Rising noise in the domestic politics has raised questions on the continuity of ongoing structural reforms on the economic front under the IMF programme. Investors also seemed worried about the proposal by the Petroleum Ministry, which sought considerable increase in industrial gas tariffs, with negative implications for the profitability of multiple sectors. Market also remained concerned about downward sticky food commodity prices and rationalization in power tariffs that may dial back the monetary easing cycle. The news-flow surrounding the proposed divestment of up to seven percent shares of OGDCL and some stake in the PPL also weighed on the market sentiment. The decline in international crude oil prices - though it bodes well for the country's economy - also weighed on select E&P sector stocks which dragged the Index down. Sell-offs in the global stocks amid fear of spread of Coronavirus that broke out in China also sent jitters at the local bourse.

What is next? While the market may depict bouts of volatility sporadically amid developments on the policy front, we reiterate our sanguine outlook on the market for 2020, and beyond. From the valuation standpoint, the market is trading at an undemanding forward Price-to-Earnings (P/E) multiple of 7 and offers about 6% dividend yield. Corporate earnings are expected to grow at double-digit rate for 2020 and 2021. There is abundant local liquidity sitting on the side line, awaiting further signs of the economic recovery and macroeconomic stability before entering the market. External account has improved significantly as the Current Account Deficit (CAD) for 1HFY2020 has clocked-in at USD 2.2 billion versus USD 8.6 billion for the same period last year. Moreover, amid unprecedented interest of the foreign investors in the government securities, FX reserves of the SBP have reached USD 11.9 billion as of January 24th – the highest level since March-18. The FX reserves accumulation in turn has lent much-needed stability to the PKR-US Dollar parity. We also expect net foreign buying in the market during 2020 as the ongoing economic stabilization under the IMF Extended Fund Facility (EFF) takes root.

Thus, we advise investors to consolidate their position in the stock market, keeping their long-term investment objectives in mind, unfazed by the short-term volatility.

Money Market Review

State Bank of Pakistan (SBP) in its last bi-monthly monetary policy left the policy rate unchanged at 13.25%. The SBP through its Monetary Policy Committee (MPC) highlighted that inflation has been on the higher side primarily due to increase in food and utility prices. After recording 12.6% YoY in Dec 2019, inflation as measured by CPI for January 2020 clocked in at 14.6%. We expect inflation to start declining henceforth. Accordingly, we expect monetary easing to start from May 2020 with a cumulative cut of 200 bps in CY2020 with the bulk of the adjustment taking place in the latter half of CY2020.

During the outgoing month, SBP held two T-Bill auctions with a combined target of Rs. 900 billion against the maturity of Rs. 909.7 billion. In the first T-Bill auction, an amount of Rs. 309 billion was accepted at a cut-off yield of 13.47%, 13.29% and 13.13% for 3-month, 6-month and 12-month tenures, respectively. In the second T-Bill auction, an amount of Rs. 605 billion was accepted at a cut-off yield of 13.43%, 13.29% and 13.13% for 3-month, 6-month and 12-month tenures, respectively. In the PIB auction, bids worth Rs. 104 billion were realized for 3-year, 5-year and 10-year at a cut-off yield of 11.75%, 11.19% and 10.90%, respectively; while bids for 20-year were rejected. Furthermore, SBP in the recent floating rate PIB auction dated 08-Jan-20, attracted bids worth Rs. 87 billion. Out of the total bids, only Rs. 62 billion was accepted at a cut-off margin of 38 basis points over the benchmark (i.e. weighted average yield of the 06-month Market Treasury Bills).

We have calibrated the portfolio of our money market and income funds based on our interest rate outlook and will remain alert to any developments that may influence our investment strategy.