ANNUAL REPORT - 2017

The Management Committee of Punjab Pension Fund (PPF) is pleased to present to Government of the Punjab the Annual Report for the year ended 30 June 2017.

FUND SIZE

- A summary of changes in fund size during FY2016-17 is given in the following table:

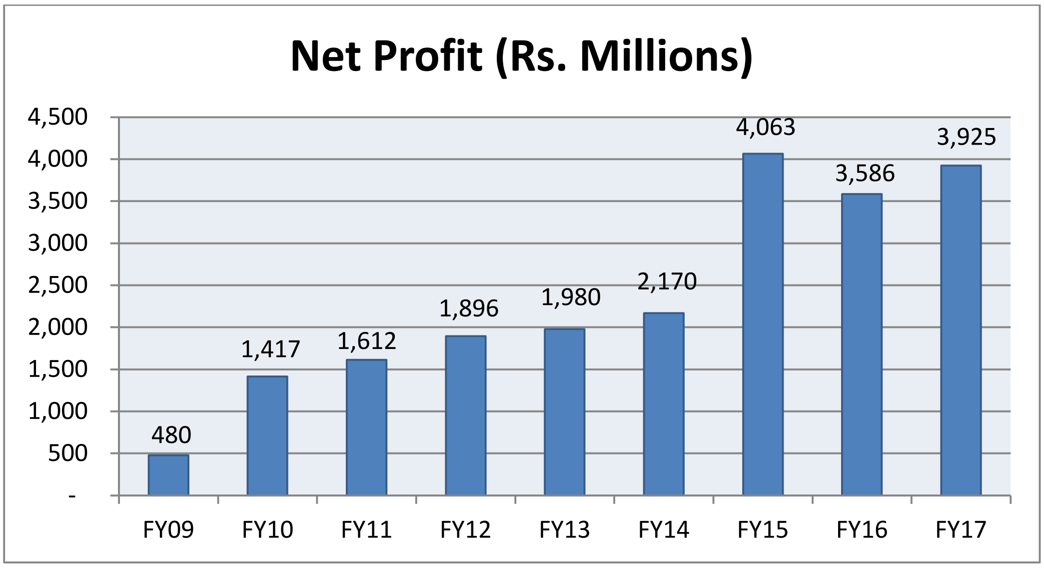
Rs. millions

	Jul 2016 - Jun 2017
Beginning fund size (1st July 2016)*	38,204
Add: Contribution during the year	5,000
Add: Income during the year	3,978
Less: Expenses during the year	(53)
Ending fund size (30th June 2017)*	47,129

* The above numbers exclude unrealized capital gains. Market value of Fund's assets at 30 June 2017 is Rs. 49,269 million. Hence, the Fund is carrying unrealized capital gain of Rs. 2,140 million at 30 June 2017.

PROFITABILITY

- The Fund made a net profit of Rs. 3,925 million during FY2016-17 which is 9.4% higher than last year's net profit of Rs. 3,586 million. As yield curve remained low during the year, Punjab Pension Fund continued its strategy of investing in short term instruments yielding comparatively lower returns. A comparison of profitability with past years is as under:



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FUND'S PORTFOLIO

- The Fund's exposure to different investment types is as under:

Amounts: Rs. millions
%:as percentage of Total Fund Size

	30-Jun-16		30-Jun-17	
	Amount	%	Amount	%
Pakistan Investment Bonds (PIBs)	7,511	19.7	7,526	16.0
Term Finance Certificates (TFCs)	393	1.0	321	0.7
National Savings Schemes-Special Saving & Regular Income Accounts	17,600	46.1	19,058	40.4
Medium term Bank Deposits	1,000	2.6	1,000	2.1
Short term Bank Deposits	9,800	25.7	10,800	22.9
Cash at bank**	1,165	3.0	7,621	16.2
Accrued Markup	675	1.8	735	1.6
Other assets*	60	0.1	67	0.1
Total Fund Size	**38,204**	**100**	**47,128**	**100**

*Other assets include prepaid operating expenses etc.

- Cash at bank reflects a higher figure at 30 June 2017 as it includes Rs. 6.0 billion transferred until 29 June 2017 to the Bank Alfalah Limited for placement in a term deposit receipt. The bank could not complete its internal approvals until the year-end, hence the amount remained in the saving account of the bank. The Fund did not suffer any loss of profit due to this delay on part of the bank as it earned the same rate of return on the saving account as was agreed for the term deposit receipt. The amount was subsequently placed in the term deposit receipt on 31 July 2017.

- Long-term investments consist of Pakistan Investment Bonds (PIBs) and Term Finance Certificates (TFCs), medium-term investments consist of medium-term bank deposit, Special Saving and Regular Income Accounts and short-term investments consist of short-term bank deposits and Treasury Bills.

- In order to lock-in higher yields for longer period of time, the Fund has invested a large proportion of its assets in long and medium term instruments at fixed-rate consisting mainly of PIBs, Special Saving and Regular Income Accounts. As interest rates remained low during the year, Punjab Pension Fund continued to invest coupons and fresh contribution received from the Government in short term instruments avoiding locking in low yields for longer period. This shift in strategy adopted in FY2014-15 is evident from portfolio composition as investment in long and medium term instruments has decreased from 69.4% of fund size at 30 June 2016 to 59.2% of fund size at 30 June 2017.

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FUND'S PERFORMANCE

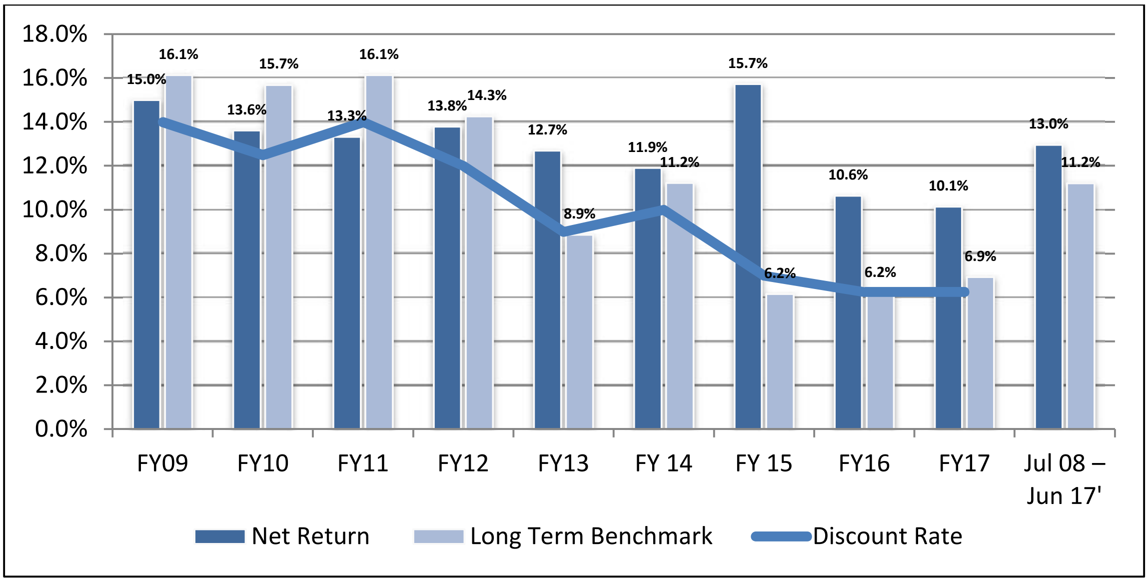
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period				Long-term Benchmark
	Gross Return	Net Return*	Year End Discount Rate	YoY CPI Inflation	CPI Inflation + 3%
FY 2008-09	15.21%	15.00%	14.00%	13.14%	16.14%
FY 2009-10	13.79%	13.61%	12.50%	12.69%	15.69%
FY 2010-11	13.48%	13.32%	14.00%	13.13%	16.13%
FY 2011-12	13.96%	13.79%	12.00%	11.26%	14.26%
FY 2012-13	12.85%	12.69%	9.00%	5.85%	8.85%
FY 2013-14	12.05%	11.90%	10.00%	8.22%	11.22%
FY 2014-15	15.88%	15.71%	7.00%	3.16%	6.16%
FY 2015-16	10.79%	10.63%	6.25%	3.19%	6.19%
FY 2016-17	10.28%	10.14%	6.25%	3.93%	6.93%
Jul 2008 – Jun 2017 (CAGR)**	13.12%	12.96%	10.07%	8.20%	11.20%

*Net Return means return after deducting management expenses of Punjab Pension Fund.
**CAGR means Compound Annualized Growth Rate.

- The Fund posted a net return of 10.14% during FY2016-17 against a net return of 10.63% during the preceding year. The Fund posted a real return of 6.21% over CPI inflation during FY2016-17 and outperformed its benchmark (CPI+3%) by 3.21%. The discount rate during the year remained stagnant at 6.25%. Performance history of the Fund is as under:

Performance History



- In last nine years, the Fund has managed to earn net cumulative average return of 12.96% against cumulative average CPI inflation of 8.2%. Hence the Fund managed to post a real return of 4.76% p.a. in the last nine years; beating its benchmark

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return of 11.2% by 1.76% despite the fact that the Fund remained invested in debt securities only.

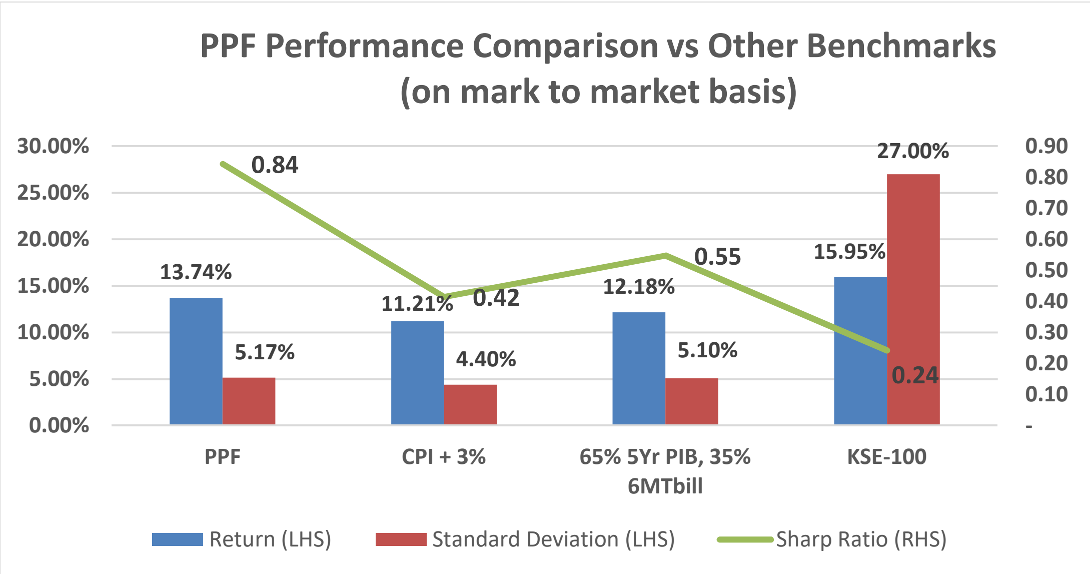
FUND'S PERFORMANCE IN COMPARISON WITH CPI BASED AND MARKET BASED BENCHMARKS

- At the end of June 2017, the Fund completed nine years of operations. We have undertaken a performance comparison of Punjab Pension Fund with some other valid benchmarks. For this comparison PPF's return has been taken on mark-to-market basis.

- During the last nine years, PPF performed far better than other valid benchmarks. PPF's performance seems further magnified when we see it in risk-adjusted terms measured by the Sharp Ratio.

- Performance Comparison of Last Nine Years (from July-08 to June-17)

	Return	Standard Deviation	Sharp Ratio
Punjab Pension Fund (on mark-to-market basis)	13.74%	5.17%	0.84
CPI + 3%	11.21%	4.40%	0.42
Market Based Benchmark (65% 5Yr PIB, 35% 6MTbill)	12.18%	5.10%	0.55
KSE-100 Index	15.95%	27.00%	0.24



- As the Economy is passing through a low inflation cycle since FY-12, yields on Fixed Income Instruments are prevailing at historical low levels. YoY CPI for the last five years averaged at 4.9% as against its long term average of 8.0 - 9.0 percent. A graph is depicting the shift in CPI is shown below:

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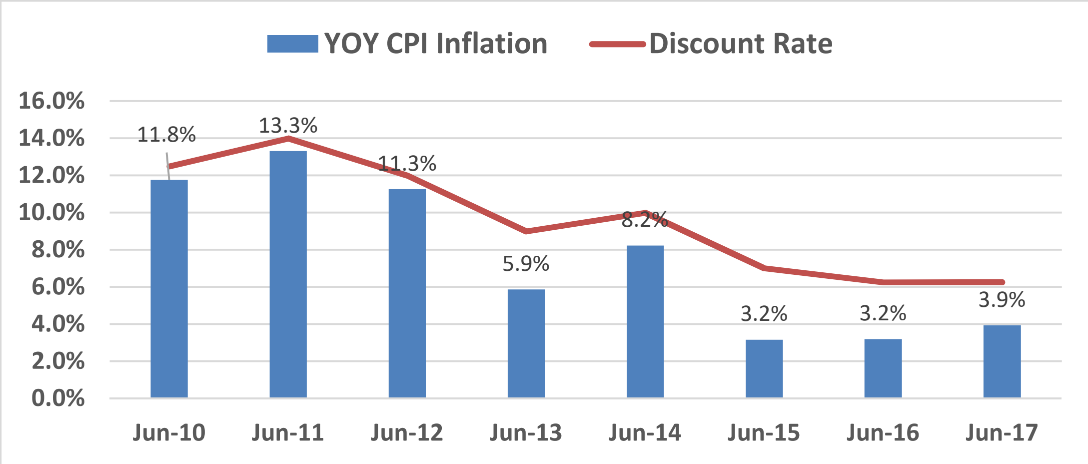
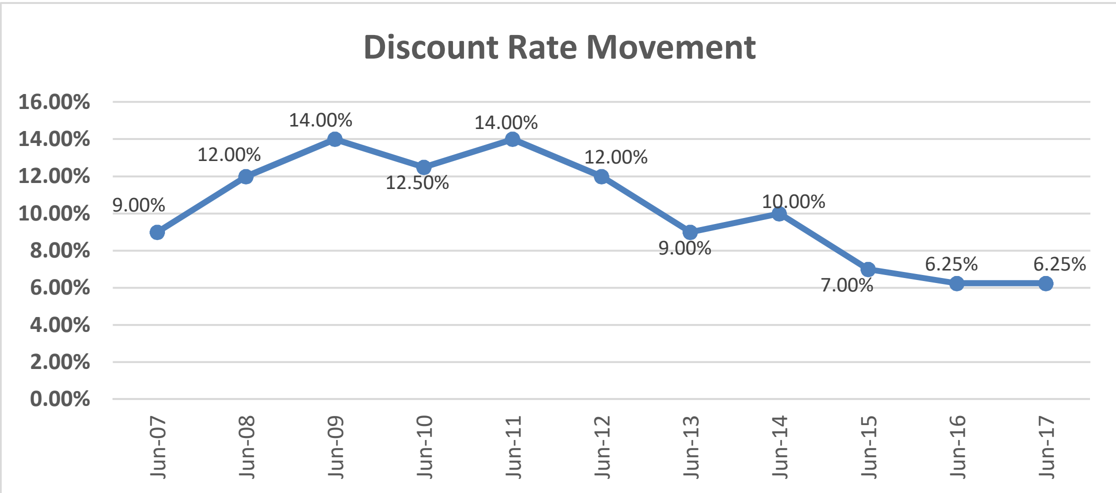


- In our view, the fall in inflation is not as a result of economic policies but rather a windfall due to sharp decline in international oil and commodity prices. Coupled with lower oil & commodity prices, the PKR exchange rate has been kept pegged with US dollar which has made imports artificially cheaper which provided deterrence against imported inflation. Independent economists and Financial Institutions e.g. IMF are continuously reporting that PKR is overvalued by around 15 -20 percent against the Greenback.
- As a result of lower inflation, the SBP slashed its discount rate from 14.0% in Nov-10 to historical low of 6.25% (Policy Rate is 5.75%) in May-16 which has remained unchanged since then. Due to lower inflation and discount rate, yields on PIBs and other Fixed Income instruments fell sharply.



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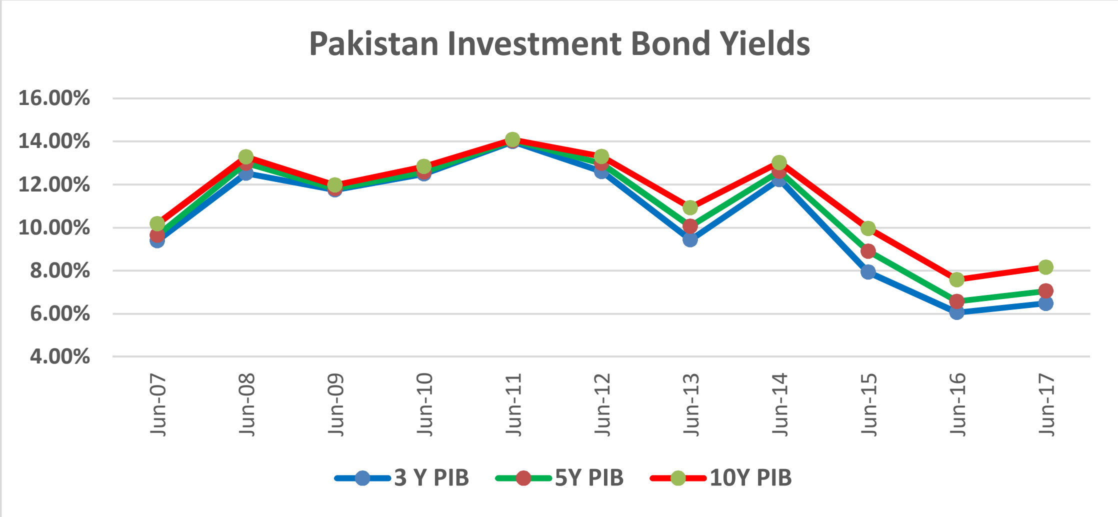
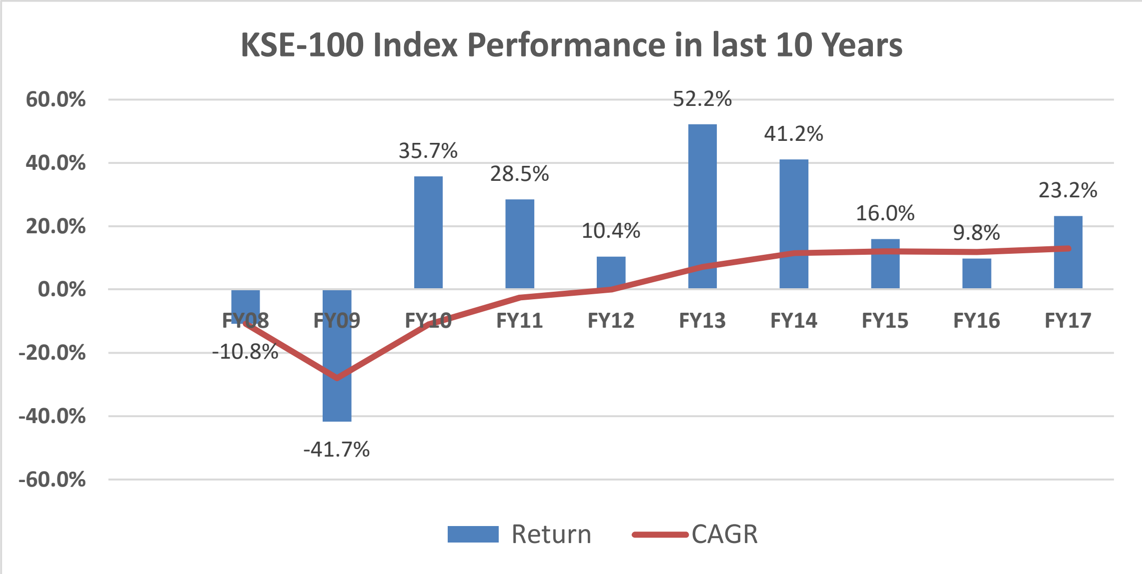


- The investment strategy followed over the past few years i.e. investment in long and medium term fixed-rate instruments at attractive yields, has paid off. Despite lower inflation and interest rates, the Fund continues to earn an attractive return because of its high yielding portfolio of PIBs, Special Saving and Regular Income Accounts. The Fund not only outperformed its benchmark in each of the last five years but it also outperformed its benchmark on cumulative basis since inception. The Fund has shifted its investment strategy towards short term securities in order to avoid risk of locking in lower yields for longer time period and grasp opportunities of interest rate reversal expected in near term.

EQUITY MARKET OVERVIEW:

- The Management Committee of Punjab Pension Fund in its 22nd meeting held on 23.06.2017 approved 10 percent allocation in equities. However, the Fund has not invested in equities so far. An overview of the stock market is given below:
  - In FY17, Pakistan Stock Exchange was one of the best performing markets as the KSE-100 index rose by 23.2%. However, due to multiple economic and political factors, the market could not keep its momentum in FY18 and the index has until now dropped by more than 20% from its all-time high of 52,876 points.
  - The reasons due to which the equity market faltered are still intact. Looming currency devaluation, deteriorating balance of payment situation, unfavorable geo-political environment and domestic political uncertainty are factors which will keep in check performance of the stock market in near future. Domestic political noise is expected to rise further in the wake of general elections due in middle of next year.
  - In last 10 years, KSE-100 index posted a Compounded Annual Growth Rate (CAGR) of 13.0% ranging from -41.7% in FY09 to 52.2% in FY13. Performance of the equity market, indicated by KSE-100 index, in last 10 years is as under:



- Overall historical return of KSE-100 index for last 26 years since its inception in November 1991 is 15.5% per annum. The historical data of Index shows that over a longer period of time, usually 10 years or more, we can expect 15 to 16 percent average annual return from equity market.

GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- As per the last Actuarial Assessment Report, the present value of pension liabilities of the Government of the Punjab at 30 June 2015 stood at Rs. 3,866 billion. The present value of the pension liabilities at 30 June 2017 is estimated at Rs. 4,836 billion.
- The market value of PPF assets at 30 June 2017 stood at Rs.49.3 billion. This translates into a Funding Ratio (Assets / Liabilities) of 1.02%.
- If PPF were envisaged as a fully funded pension plan, the value of its assets would match the value of the total pension liability of the Government of the Punjab, and the Funding Ratio would equal 100%. This would mean that for the accrued pension liabilities, the Government of the Punjab would not have to earmark any budgetary resources because these would be met by PPF from the return on its assets.
- Currently, the Government of the Punjab does not have an explicit target for the Funding Ratio. Previous funding strategy was adopted in 2010. A new funding strategy is being contemplated after the actuarial valuation for 2015 to cater to the needs of funding growing pension liabilities. During FY2016-17, the Government made a fresh contribution of Rs. 5 billion into the Fund; and has budgeted Rs. 4 billion for FY2017-18 for capitalization of Punjab Pension Fund.
- In order to properly manage a pension plan, two things are important.

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- Firstly, the Funding Ratio of the pension plan should be high so that sufficient assets vis-à-vis the liabilities are available. A Funding Ratio of 100% or more is ideal.
    - Currently, the Funding Ratio of the pension plan is 1.02% which means that the current level of assets is sufficient to meet only 1.02% of accrued pension liabilities of the Government of the Punjab.
    - This Funding Ratio is clearly quite low and the government may consider increasing this ratio. To make PPF fully funded would need an asset base of about Rs. 4,836 billion at 30 June 2017. To achieve this magnitude of asset base, a long-term and sustainable plan of gradual injection of funds into the pension plan is required.
- Secondly, the Fund should preferably make long-term fixed-rate investments whose maturity is as close as possible to the maturity of pension liabilities. With fixed-rate investments the rate of return on the assets of the Fund will be less vulnerable to the fluctuations in the market rate of interest.

OUTLOOK FOR FY2017-18

Inflation:

- FY2016-17 started with low inflation rate which remained within the range of 3%-4% during the year. The YOY CPI for the FY2016-17 has clocked at 3.93%. Inflation has decelerated mainly due to the sharp decline in global oil prices, global economic slowdown, soft outlook on commodity prices and stable exchange rate.
- As far as inflation outlook for FY2017-18 is concerned, CPI has bottomed out and reversal in imminent. Supply side conditions are good as all major crops have performed well in current fiscal year as compared to last year. Short term oil projections do not suggest any major change. Major upside pressure will be exerted by external sector as widening current account and trade deficit will put pressure on rupee. However, CPI will remain within Government's target of 6%. SBP has also projected CPI between 4.5% to 5.5% for FY2017-18 (Source: March-17 SBP Report: "The State of Pakistan's Economy").

Interest rates:

- During the FY2016-17, the SBP has maintained its policy rate due to lower inflation and favorable macroeconomic indicators. It seems that interest rates have almost bottomed out and are not expected to go down further. CPI remained below expectations and continued to hover around 4%. Agriculture and large scale manufacturing have performed well during current fiscal year. Imports are on the rise due to CPEC related investments and plant up-gradation under export package. Exports have shown dismal performance despite favorable export package. Pakistan has witnessed decline in foreign remittance for the first time owing to recession in gulf countries and imposition of new taxes on expatriates. Composite effect of aforementioned factors has put

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external sector under pressure. This trend could lead to balance of payment crisis if trend in export is not reversed. Demand side has shown positive signs as world economy has shown growth signs which will lead to higher export figures in current fiscal year. Based on aforementioned reasons, we expect an interest rate hike in later half of FY2017-18.

INVESTMENT STRATEGY

- Operational Investment Committee of the Fund is currently following a strategy of investing in short duration instruments and is not taking exposure in long term instruments at currently prevailing lower yields. At the end of June 2017, the Fund has around 59% of its exposure in fixed rate PIBs, Special Saving and Regular Income Accounts.
- Going forward, despite sharp decline in market yields, PPF's portfolio is well-positioned to post a decent margin over CPI.

AUDITORS

The Government of Punjab appointed M/S KPMG Taseer Hadi & Co., Chartered Accountants, as Auditors of the Fund for the year ended 30 June 2017. Auditors have submitted financial statements of the Fund for the year ended 30 June 2017.

TRUSTEE

The Management Committee has appointed M/s Central Depository Company of Pakistan Limited as Trustee of the Fund under Rule 18 of the Punjab Pension Fund Rules 2007. After signing of the Trust Deed custody of all the assets of the Fund rests with the Trustee. The Trustee has submitted its report for the year ended 30 June 2017 to the Management Committee under Rule 22(h) of the Punjab Pension Fund Rules 2007.

ACKNOWLEDEMENT

The Management Committee takes this opportunity to thank its members for valuable contributions to the Fund.

The Management Committee also wishes to place on record its appreciation for the hard work and dedication shown by the employees of the Fund.

Aisha G. Pasha

(Dr. Aisha Ghaus Pasha)
Minister of Finance, Government of Punjab/
Chairman, Punjab Pension Fund

Place: Lahore
Dated: 13 September 2017