



Government of the Punjab

Punjab Pension Fund



Dated: 17 January 2014

MONTHLY REVIEW OF INVESTMENTS

December 2013

FUND SIZE

- A summary of changes in fund size during FY14 is given in the following table:

Rs. millions (rounded to the nearest million)

	1 st July - 31 st December 2013
Beginning fund size (30 th June 2013)	17,585
Add: Contribution during the period	-
Less: Transfer to Reserve Pension Fund	-
Add: Gains during the period	1,021
Less: Expenses during the period	(13)
Ending fund size	18,593

The numbers exclude unrealized capital gains/losses

FUND'S PORTFOLIO

- The Fund's exposures to different investment types are summarized as under:

Amounts: Rs. millions (rounded to the nearest million)

#: as percentage of Total Fund Size

	30 Jun 2012		30 Jun 2013		31 st Dec 2013	
	Amount	%	Amount	%	Amount	%
PIBs	9,480	60.7	9,560	54.3	11,152	60.0
T-Bills	139	1.0	-	-	239	1.3
Short term bank deposits	5,349	34.3	5,928	33.7	5,315	28.6
National Saving Schemes	-	-	1,831	10.4	673	3.6
Corporate bonds/TFCs	501	3.2	246	1.4	609	3.3
Cash at bank	130	0.8	11	0.1	606	3.6
Other assets*	6	0.0	9	0.1	(1)	0.0
Total Fund Size	15,605	100.0	17,585	100.0	18,593	100.0

*Other assets include prepaid expenses for management of PPF and book value of fixed assets (motor cycles, computers etc.) of PPF.

- Long-term investments consist of PIBs and TFCs whereas short-term investments consist of T-bills, National Saving Schemes and bank deposits.
- PPF keeps switching exposure between T-bills, National Saving Schemes & short-term bank placements in pursuit of higher rates of return.



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FUND'S PERFORMANCE

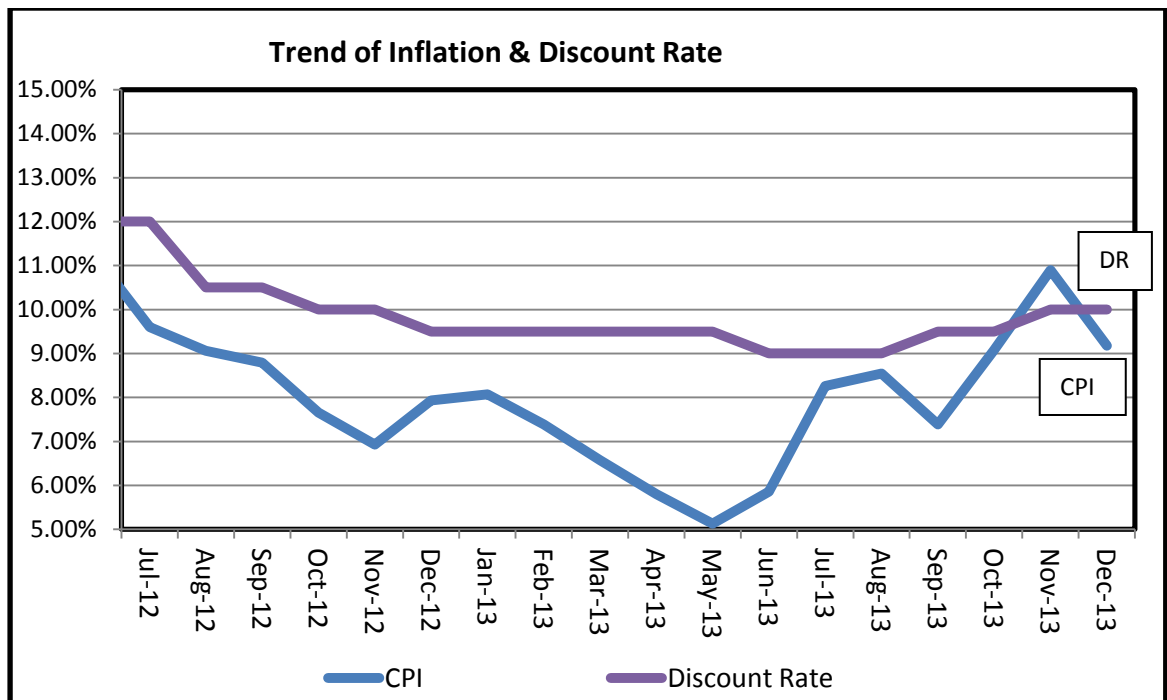
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period		Year End Discount Rate	CPI Inflation	Long-term Benchmark CPI Inflation + 3%
	Gross Return	Net Return*			
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%
Jul 2008 - Jun 2013 (CAGR)**	13.85%	13.67%	12.14%	11.17%	14.17%
July-December 2013	11.85%	11.70%			
December 2013	12.08%	11.78%			

*Net Return means the return after deducting expenses incurred on management of PPF

**CAGR means Compound Annualized Growth Rate

- In order to lock-in high yields for a long period of time, the Fund has invested a large proportion of its assets in long-term fixed-rate instruments consisting mainly of PIBs. At the end of Dec 13, 60% of total portfolio is invested in PIBs.
- During FY 13, the CPI Inflation rate had declined sharply, and the SBP reduced the policy rate by 3.0% cumulatively (from 12% to 9%). With the start of FY 14, the newly elected government announced considerable upward adjustments in electricity, gas and petroleum prices; as a result the CPI inflation has started to accelerate since May 2013 and peaked at 10.90% at the end of November 2013. In its recent Monetary Policy Statement (MPS), the SPB has revised discount rate by 50 basis points to 10.0% from 9.5%.





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- The investment strategy followed over the past few years i.e. investment in long-term fixed-rate instruments at attractive yields is paying off. Despite lower short term interest rates, PPF continues to earn an attractive rate of return over inflation because of its high yielding portfolio of PIBs. PPF also has a sizeable portion of its portfolio in liquid investments, in order to purchase more PIBs at attractive yield.

GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- We have constructed a liability index on the basis of next 30-year pension-related cash outflows projected by the Actuary of the Fund. The index captures the growth in the present value (computed at market rates of interest) of next 30-year liabilities.
- The following table summarizes the amount & growth of market value of Fund's assets vis-à-vis the amount & growth in present value of 30-year pension liabilities of GoPb:

Period	During the period		End of period		
	Growth		Market Value (Rs. billions)		Funding Ratio
	Fund's Assets	Liability Index	Fund's Assets (a)	30-yr Pension Liabilities (b)	(a)/(b)
FY 2008-09	15.00%	28.01%	3.5	575.9	0.60%
FY 2009-10	13.21%	9.41%	12.1	621.7	1.94%
FY 2010-11	10.81%	-2.88%	13.4	608.9	2.19%
FY 2011-12	16.86%	25.40%	15.6	757.1	2.06%
FY 2012-13	20.46%	38.96%	18.8	1052.1	1.79%
Jul-Dec FY14	0.19%	-10.29%	18.9	943.8	2.00%
Jul 2008 - Dec 2013 (CAGR)	13.77%	16.97%			

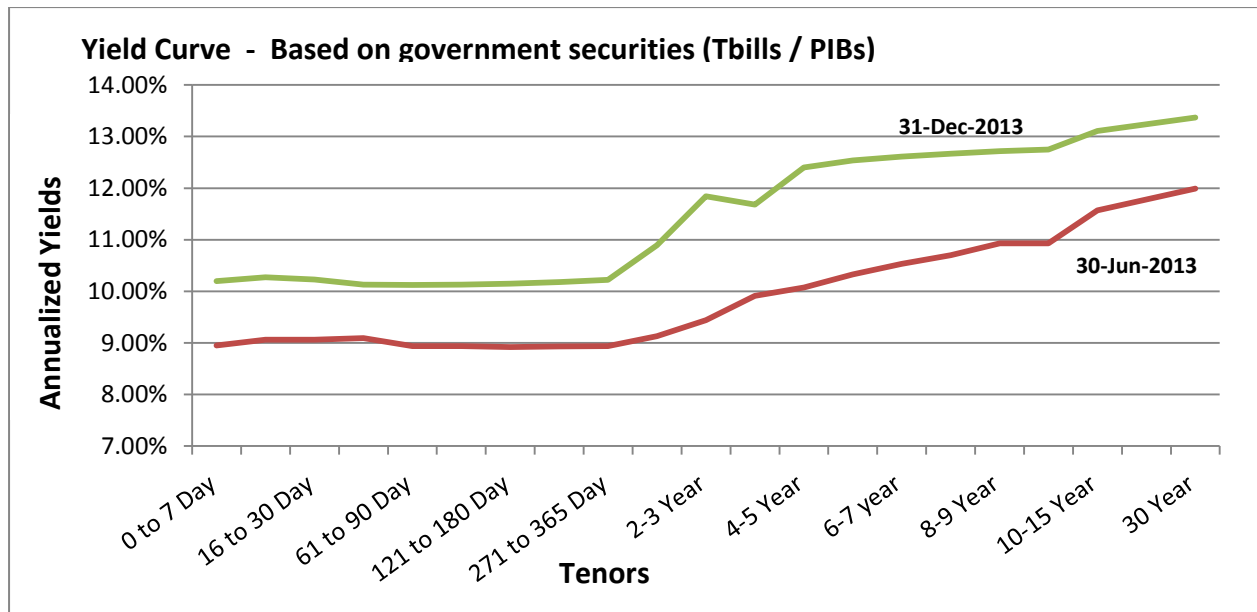
- Since the pension liabilities have very long maturities, their present value is highly sensitive to changes in interest rates.
- The present value of liabilities has a negative correlation with interest rates - it increases sharply when interest rates decrease and vice versa.
- The biggest market risk exposure of the pension liabilities is a decline in interest rates. It can sharply increase the requirement of funds to meet the same liabilities and thus lower the Funding Ratio of the pension plan.
- During the period July-December FY14, long term interest rates reversed with the expectations of resurge in inflation. The long-term interest rates (yield on 10-yr PIBs) which were below 11% at the end of FY13 have touched 13%; the shift in yield curve is shown in graph below. This has resulted in a decrease of 10.29% in present value of liabilities. Although Market value of Fund's assets could increase only by a 0.19% during the same period, but the larger decline in present value of liabilities has resulted in a significant improvement in funding ratio. This occurred because there is a substantial Duration Gap between the Fund's assets and its liabilities. Duration measures the sensitivity of present value of a series of cash flows to changes in interest rates. Despite investing a large proportion of Fund's assets in long-term fixed-rate bonds



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which have higher Durations, the overall Duration of Fund's assets is still much lower than the overall Duration of Fund's liabilities.



REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

GDP GROWTH

- Pakistan's economy is facing a cycle of low growth and high inflation since last several years. GDP growth during FY13 fell to 3.6 percent from 4.4 percent in FY12. Fundamental issues like energy shortages and worsening law & order situation did not allow the country to achieve its economic potential.
- Prospectus of a sustainable global economic recovery also weakened in the wake of a slowdown in US and a protracted recession in the euro area. Even the emerging economies, led by China, Brazil, India and Russia, are expected to experience a relative slowdown. This weak global economic situation has implications for the domestic economy as it results a grim outlook of exports and lower investment related foreign inflows.
- Recently, the modestly improving outlook for the global economy along with GSP status awarded to Pakistan by European Union is expected to brighten the export outlook of the country. However, resolution of the prevailing energy problems will be pivotal in order to get the full benefits of GSP status.
- The real investment to GDP ratio declined for the fifth consecutive year declined to 8.7% in FY13. A relentless increase in fiscal borrowings and a secular decline in both domestic and foreign investments, are not allowing the country to invest in order to increase its future productivity.
- IMF has projected that Pakistan's real GDP growth is estimated at 2.8 percent for the current financial year 2013-14.
- World Bank in its recent study warned that unemployment among the growing younger population is rapidly increasing and has become a most critical issue. In order to create sufficient number of job opportunities, Pakistan's GDP must grow at 5 to 6 percent for a foreseeable future on consistent basis.



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EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US \$

	Jul-Nov FY13	Jul-Nov FY14	Growth %
Current Account	(0.68)	(1.89)	(176)
Trade balance(Goods)	(6.65)	(7.27)	(9)
Trade balance (Services)	(0.56)	(1.10)	(95)
Remittances	5.98	6.41	7.1
Capital Account	0.06	0.07	35
Financial Account	0.32	(0.73)	(328)

- The Current Account posted a huge deficit of USD 1.89 billion during the first five months of FY14 as compared to deficit of USD 684 million during the same period last year. Last year's lower deficit was due to inflows of over USD 1.0 billion of Coalition Support Fund (CSF) from the US.
- Although the trade balance on services worsened by 95%, but 9% deterioration in trade deficit also remained the main factor for the situation due to its large quantum.
- Trade balance for the period deteriorated by 9% attributed to 3% surge in imports and a 1% decrease in exports.
- Services balance worsened by a massive 95%, mainly because of lesser amount of Coalition Support Fund inflows; and a 12% increase in import bill of services.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 7.1% during the July-November FY14 compared with the same period of last year.
- Capital and financial account, continued to deplete in the absence of any significant capital and financial inflows and high loan repayments to IMF. However, the likelihood of receiving higher financial inflows has increased given that a new IMF program has been approved for Pakistan in September 2013. This would not only ease pressure on foreign exchange reserves but also provide comfort to other international donors.
- The State Bank of Pakistan has projected that the external current account deficit is expected to remain USD 3 billion or 1.2% of GDP for FY14.

INFLATION

- A summary of consumer price inflation rates is given in the following table:

Period	CPI Inflation								
	CPI Overall (%)			CPI Food (%)			CPI Non-food (%)		
	YOY	MOM	12mma ¹	YOY	MOM	12mma	YOY	MOM	12mma
Oct-2013	9.1	2.0	7.2	9.8	1.7	7.7	8.6	2.2	6.9
Nov-2013	10.9	1.3	7.6	13.0	2.6	8.3	9.4	0.3	7.1
Dec-2013	9.2	-1.3	7.7	9.3	-3.3	8.5	9.1	0.2	7.1
12 month high	10.9	2.0	9.5	13.0	3.0	8.7	9.4	2.2	10.1
12 month low	5.1	-1.3	7.1	5.5	-3.3	7.1	4.1	0.1	6.9

¹12 month moving average Source: FBS, SBP.



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- CPI for the month of December 2013 declined to 9.2% as compared to 10.9% in November 2013. On MoM basis overall CPI declined by 1.3%, on the back of sharp decline in food prices.
 - Perishable food items were solely responsible for this MoM food deflation, although they have only 5% weightage in overall CPI basket but declined by a massive 26% on MoM basis.
 - The CPI is still on higher side when compared with the last year. This upward pressure in prices was expected because the government had increased electricity and fuel prices recently. Further, there is another phase of passing on of electricity & Gas prices on consumers as government agreed with the IMF. Currency depreciation will also cause increase in domestic prices despite no significant increase in commodity prices globally.
 - The Government has set an inflation target of 8 percent for FY14. However, the State Bank of Pakistan, in its recent Monetary Policy Statement of November 2013, projected that the inflation will remain between 10.5 to 11.5 percent for FY14.
- A summary of measures of core inflation is given in the following table:

Period	Core Inflation					
	NFNE ¹ (%)			Trimmed Mean ² (%)		
	YOY	MOM	12mma	YOY	MOM	12mma
Oct-2013	8.4	0.9	8.9	9.0	0.8	8.2
Nov-2013	8.5	0.4	8.8	9.2	0.4	8.2
Dec-2013	8.2	0.2	8.6	8.7	0.4	8.0
12 month high	10.0	1.5	10.6	9.9	1.2	10.4
12 month low	7.8	0.2	8.6	6.7	0.2	8.0

¹NFNE stands for non-food non-energy measure of core inflation Source: SBP

²Trimmed Mean measure of core inflation excludes 20% of the items in the CPI basket showing extreme changes in price

- NFNE inflation recoded increase of 8.2% on YoY and 0.2% on MoM basis, which states that general CPI is higher and volatile due to food and energy prices. Otherwise, on YoY basis, inflation is not as much higher in ex-food & energy items.
- Trimmed inflation also increased by 8.7% on YoY and 0.4% on MoM basis; it is also depicting more stable situation due to non-inclusion of outliers which is food segment.



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- The following table summarizes international commodity price inflation rates:

Period	Inflation Rates (%) as per the indices maintained by IMF								
	(Overall) Index of Fuel & Non-fuel Commodities			Commodity Fuel (Energy) Index			Index of Non-fuel Primary Commodities		
	YOY	MOM	12mma	YOY	MOM	12mma	YOY	MOM	12mma
Oct-2013	-0.7	-1.6	-1.8	0.7	-2.6	-2.4	-3.4	0.5	-0.5
Nov-2013	-0.8	-1.4	-1.7	0.3	-2.0	-2.0	-2.8	-0.1	-0.8
Dec-2013	0.9	2.4	-1.5	3.0	2.7	-1.4	-3.2	1.8	-1.4
12 month high	5.2	2.7	-1.5	7.0	4.2	-0.3	3.7	1.9	-0.3
12 month low	-9.1	-3.8	-4.9	-12.0	-4.1	-4.9	-4.3	-3.0	-7.8

Source: IMF

- Due to continued slowdown in economic growth around the world, commodity prices remained depressed. Although on YoY basis overall index increased by only 0.9%; however, in December 2013, overall index showed a MoM increase of 2.4%, mainly driven by rise in energy prices. The break-up shows that on MoM basis, fuel/energy related commodities recorded an increase of 2.7% whereas non-fuel commodities rose by 1.8%.
- The inflation figures are based on US dollar (and not Pak rupee) prices of commodities, therefore these figures need to be interpreted carefully. For instance, assuming a 10% depreciation of rupee against dollar, an inflation of 1% in dollar terms may actually mean inflation of 11% in rupee terms. However, the impact of currency depreciation on domestic prices is reflected with some time lag.

INTEREST RATES

- A summary of important interest rates is given below:

Period	Yield on 1-yr T-bill (% p.a.)		Yield on 10-yr PIB (% p.a.)		6-month KIBOR (% p.a.)	
	Month end	12mma	Month end	12mma	Month end	12mma
Oct-2013	9.67	9.39	12.56	11.79	9.57	9.41
Nov-2013	10.09	9.44	13.08	11.91	10.08	9.45
Dec-2013	10.22	9.51	12.75	12.02	10.15	9.52
12m high	10.22	10.77	13.08	12.35	10.15	10.87
12m low	8.94	9.35	10.80	11.51	9.08	9.40

Source: SBP, Reuters

- In its last Monetary Policy Statement dated 13 November 2013, the State Bank of Pakistan (SBP) increased the Discount Rate by 50 basis points to 10.0% from 9.5%.
- The inflation for the month of November was 10.9% which has declined to 9.2% in December 2013. As the current discount rate is 10% and CPI is 9.2% which shows a 0.8% real rates over inflation. The SBP is expected to announce its next Monetary



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Policy Statement in January 2014; we expect that the SBP will maintain the discount rate at 10%.

INVESTMENT STRATEGY

- PPF invested Rs. 1,550 million in PIBs in the last PIB auction held on 18th December 2013. The OIC is of the view that the inflation and interest rates scenario is likely to remain volatile and uncertain in foreseeable future. The CPI in November 2013 increased to 10.9% on YoY basis and 1.27% on MoM basis, but in December 2013, it sharply declined to 9.18% on YoY and 1.3% on MoM basis. The liquid portion of Fund's portfolio will be used to capitalize on any opportunity to lock in securities at higher returns if rates go up; however, in an upward interest rates scenario, the Fund may not be able to post a decent real return over inflation.
- If inflation and interest rates remain low, the high yielding PIB portfolio will help to earn an attractive spread over inflation.
- If inflation and interest rates increase, the Fund will have the opportunity to further build high-yielding long-term bond portfolio by investing part of its short term funds.

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