



Government of the Punjab
Punjab Pension Fund



Dated: 13 March 2014

MONTHLY REVIEW OF INVESTMENTS

February 2014

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 2013 - 28 th February 2014
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	1,375
Less: Expenses during the period	(18)
Ending fund size	18,942

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		28 th Feb 2014	
	Amount	%	Amount	%	Amount	%
PIBs	9,480	60.7	9,560	54.3	12,640	66.7
National Saving Schemes	-	-	1,831	10.4	1,385	7.3
Corporate bonds/TFCs	501	3.2	246	1.4	620	3.3
Short term bank deposits	5,349	34.3	5,928	33.7	-	-
T-Bills	139	1.0	-	-	4,241	22.4
Cash at bank	130	0.8	11	0.1	54	0.3
Other assets*	6	0.0	9	0.1	2	0.0
Total Fund Size	15,605	100.0	17,585	100.0	18,942	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

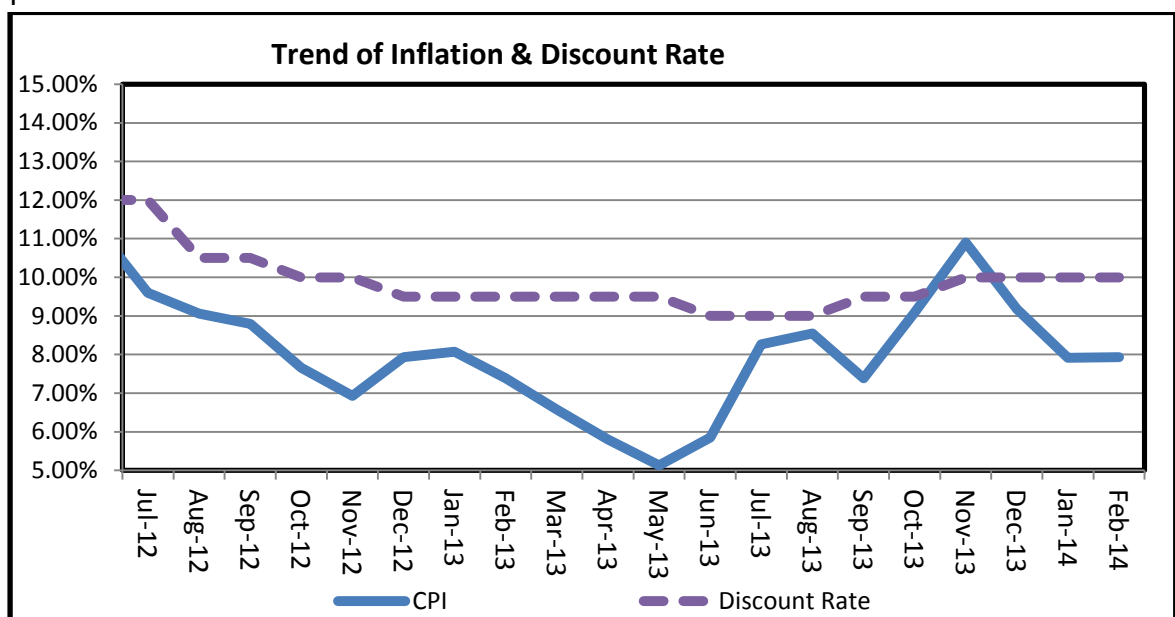
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period		Year End Discount Rate	YOY 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%		11.17%	14.17%
July-February 2014	11.98%	11.82%			
February 2014	12.44%	12.25%			

*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 Feb-14, 66.7% of total portfolio is invested in PIBs.
- During FY 13, YOY 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 had started to accelerate since May 2013 and peaked at 10.90% at the end of November 2013. After touching double digit inflation in Nov 2013, CPI sharply declined and recorded a 7.9% increase in Feb 2014. We expect that inflation for the full year FY14 will remain in single digit. We don't expect any further hike in discount rate by State Bank of Pakistan during the remaining part of FY14.





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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.

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		Funding Ratio (a)/(b)
	Fund's Assets	Liability Index	Fund's Assets (a)	30-yr Pension Liabilities (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-Feb FY14	2.18%	-7.86%	19.2	969.4	1.98%
Jul 2008 - Feb 2014 (CAGR)	13.74%	16.44%			

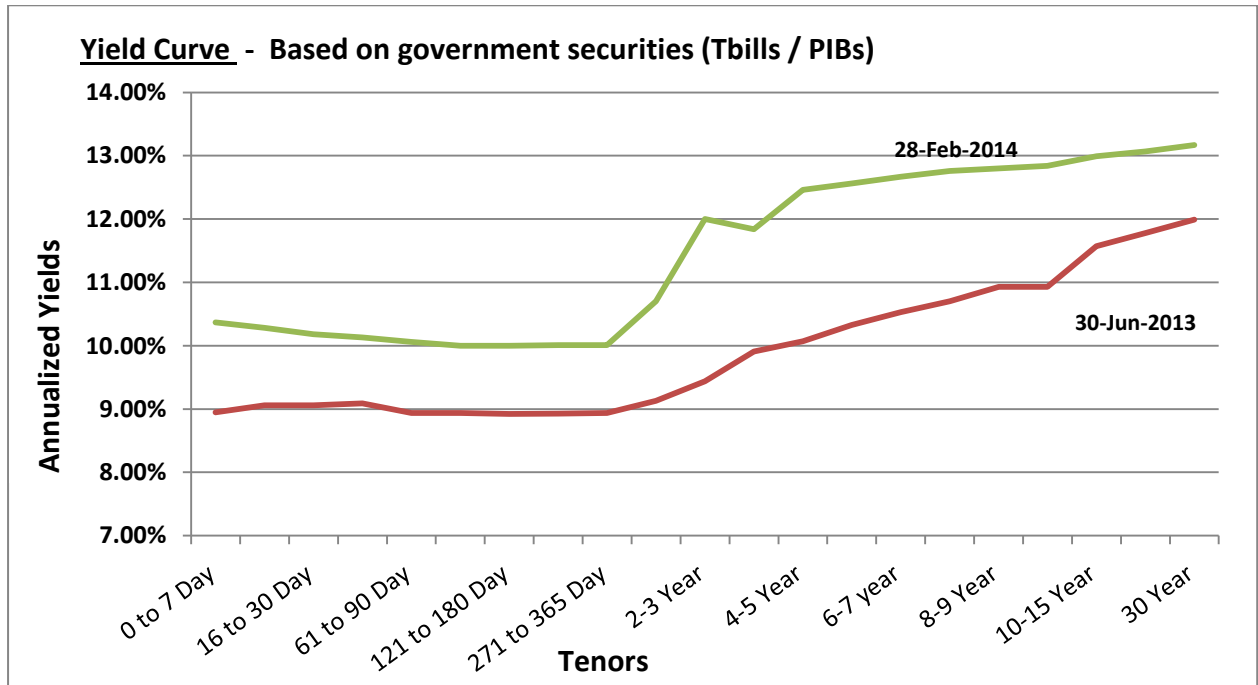
- Since the pension liabilities have very long maturities, their present value is highly sensitive to changes in interest rates.
- The present value of liabilities has a negative correlation with interest rates - it increases sharply when interest rates decrease and vice versa.
- The biggest market risk 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-February FY14, long term interest rates reversed with the expectations of resurgence in inflation, and higher demand of government borrowings. Recently, the inflation has come quite under control since last couple of months; however, government borrowings are still on higher side. 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 7.86% in present value of liabilities. Although Market value of Fund's assets could increase only by a 2.18% 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-



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rate bonds 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.
- 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.
- GDP growth rate for the first quarter of FY14 is claimed at 5% by the Finance Ministry which is surprisingly positive. The SBP, in its 1Q report FY14, raised questions about the sustainability of the trend and conditioned the growth prospectus on the implementation of structural reforms in the fiscal and energy sectors.
- IMF in its recent review report on Pakistan observed that Pakistan's economy is showing signs of improvement and the GDP growth rate is expected to reach about 3.1 per cent for FY-14 compared to the earlier estimates of 2.8 per cent.



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EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US \$

	Jul-Jan FY13	Jul-Jan FY14	Growth %
Current Account	(0.44)	(2.06)	(366)
Trade balance(Goods)	(9.22)	(9.72)	(5)
Trade balance (Services)	(0.29)	(1.76)	(511)
Remittances	8.21	9.03	10.1
Capital Account	0.13	0.18	40
Financial Account	0.38	(0.25)	(165)

- The Current Account posted a deficit of USD 2.06 billion during the first seven months of FY14 as compared to deficit of only USD 441 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.
- The month of February 2014 alone witnessed a deficit of USD 464 million, as opposed to surplus of USD 283 in December 2013, mainly because of 8% decline in exports and 10% lower remittances on MoM basis.
- The sharp deterioration in trade balance on services of USD 1.47 billion remained the main factor for the situation. The trade balance deficit also added towards increasing deficit.
- The SBP forecasts that the country will have a current account deficit of USD 3 billion or 1.2% GDP in the current fiscal year as compared to \$2.5 billion (1% of GDP) recorded in the preceding fiscal year. However, healthy export prospectus and stable fuel & commodity prices may keep the deficit lower than projected by SBP.
- Capital and financial account, continued to remain under pressure 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 as the government is progressing on reforms agenda agreed with IMF and making efforts to attract inflows from various sources.

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
Dec-2013	9.2	-1.3	7.7	9.3	-3.3	8.5	9.1	0.2	7.1
Jan-2014	7.9	0.5	7.6	7.2	0.0	8.4	8.4	0.9	7.2
Feb-2014	7.9	-0.3	7.7	7.6	-1.0	8.4	8.2	0.2	7.2
12 month high	10.9	2.0	8.9	13.0	3.0	8.5	9.4	2.2	9.4
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 during the month of February 2014 remained unchanged from preceding month of January 2014 at 7.9% on YoY basis. On MoM basis overall CPI decreased by 0.3% as opposed to increase of 0.5% in preceding month.
- Food index did show a deflation on MoM basis due to sharp decline of 6.58% in Perishable food items. On YoY basis, food inflation also remained relatively lower mainly due to fall in prices of potatoes, onions, tomatoes, tea and sugar. The non-food inflation is also softening since last couple of months.
- 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 January 2014, projected that the inflation will remain between 10 to 11 percent for FY14.
- We are of the view that the Government's efforts to achieve the exchange rate stability along with lower fuel & commodity prices in international market will bode well for inflationary outlook and CPI is expected to remain in single digit for the whole year 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
Dec-2013	8.2	0.2	8.6	8.7	0.4	8.0
Jan-2014	8.1	1.0	8.5	8.2	0.6	7.9
Feb-2014	7.8	0.2	8.3	8.1	0.2	7.9
12 month high	9.0	1.5	10.4	8.4	1.2	9.9
12 month low	7.8	0.2	8.3	6.7	0.2	7.9

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 is also on declining trend and ended at below 8% on YoY and 0.2% on MoM basis, which states that decline in general CPI is broad based.
- Trimmed inflation is also following the trend witnessed in all other measures of inflation and stood at 8.1% on YoY and 0.2% on MoM basis in February 2014.
- 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
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
Jan-2014	-3.9	-2.1	-1.8	-2.8	-2.7	-1.4	-6.0	-1.0	-2.2
12 month high	5.2	2.6	-1.5	7.0	4.2	-1.4	2.1	1.8	-0.3
12 month low	-9.1	-3.8	-4.9	-12.0	-4.1	-4.9	-6.0	-3.0	-6.5

Source: IMF



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- Due to continued uncertainty in economic growth prospectus around the world, commodity prices remained depressed. Overall index declined by 3.9% on YoY basis and 2.1% on MoM basis. The break-up shows that on MoM basis, fuel/energy related commodities recorded a decrease of 2.7% whereas non-fuel commodities declined by 1.0%.
- 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, a deflation of 4% in dollar terms may actually mean inflation of 6% 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
Dec-2013	10.22	9.51	12.75	12.02	10.15	9.52
Jan-2014	10.01	9.58	12.81	12.12	10.19	9.59
Feb-2014	10.01	9.62	12.84	12.18	10.17	9.64
12m high	10.22	10.37	13.08	12.18	10.19	10.47
12m low	8.94	9.35	10.80	11.51	9.08	9.40

Source: SBP, Reuters

- In its last Monetary Policy Statement announced by the State Bank of Pakistan (SBP) in January 2014, SBP kept the discount rate unchanged at 10 percent. Short term interest rates (1-year T-Bills yields) are in line with Discount Rate while long term rates (10Y PIB yields) are on higher side and offering a significant spread of around 3% over short term yields
- Going forward, we do not expect any hike in discount rate in the remaining part of FY-14 as the inflation expectations are tamed. However, long term yields will largely be determined by demand & supply situation.

INVESTMENT STRATEGY

- PPF invested another Rs. 1.2 billion in long term PIBs (10 Years) during February 2014. The OIC is of the view that the inflation and interest rates scenario is likely to remain stable to downward in foreseeable future. In consistent with its inflation and interest rates view, the OIC of PPF is following a strategy to lock in maximum allowed exposure in PIBs at attractive yields.

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