Government of the Punjab
Punjab Pension Fund

Dated: 13 February 2014

MONTHLY REVIEW OF INVESTMENTS
January 2014

FUND SIZE

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

Rs. million (rounded to the nearest million)

	1st July - 31st January 2014
Beginning fund size (30th June 2013)	17,585
Add: Contribution during the period	-
Less: Transfer to Reserve Pension Fund	-
Add: Gains during the period	1,206
Less: Expenses during the period	(15)
Ending fund size	**18,776**

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		31st Jan 2014	
	Amount	%	Amount	%	Amount	%
PIBs	9,480	60.7	9,560	54.3	11,722	62.4
National Saving Schemes	-	-	1,831	10.4	1,373	7.3
Corporate bonds/TFCs	501	3.2	246	1.4	615	3.3
Short term bank deposits	5,349	34.3	5,928	33.7	-	-
T-Bills	139	1.0	-	-	4,406	23.5
Cash at bank	130	0.8	11	0.1	656	3.5
Other assets*	6	0.0	9	0.1	4	0.0
Total Fund Size	**15,605**	**100.0**	**17,585**	**100.0**	**18,776**	**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.

FUND'S PERFORMANCE

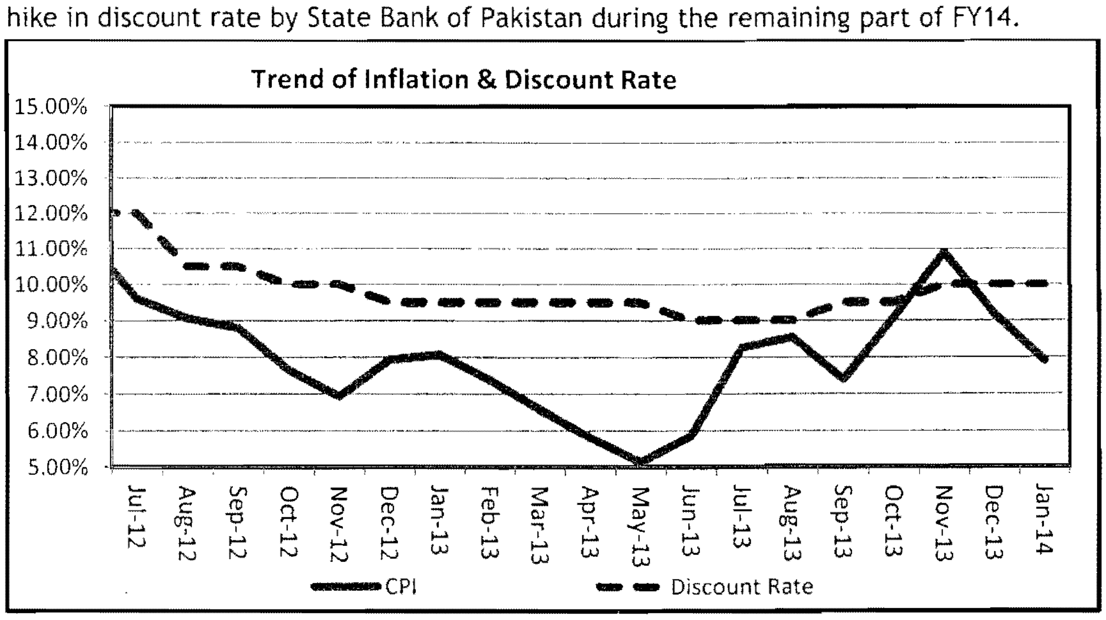
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period				Long-term Benchmark
	Gross Return	Net Return*	Year End Discount Rate	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%
Jul 2008 - Jun 2013 (CAGR)**	13.85%	13.67%	12.14%	11.17%	14.17%
July-January 2014	11.92%	11.76%			
January 2014	12.31%	12.14%			

*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 Jan-14, 62.4% 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 from May 2013 and peaked at 10.90% at the end of November 2013.After touching double digit inflation in Nov 2013, CPI sharply declined to below 8% in January 2014. We expect that inflation for the full year FY14 will remain 9-10%.We also don't expect any further hike in discount rate by State Bank of Pakistan during the remaining part of FY14.



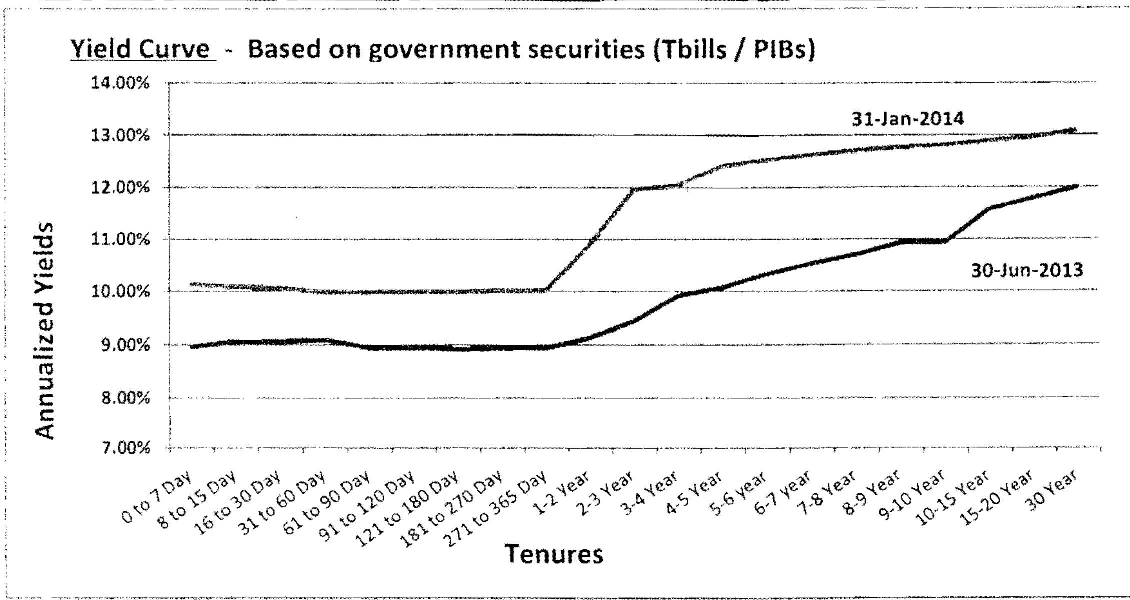
- The investment strategy followed over the past few years i.e. investment in long-term fixed-rate instruments at attractive yields is paying off. Despite lower short term interest rates, PPF continues to earn an attractive rate of return over inflation because of its high yielding portfolio of PIBs.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

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:

	During the period		End of period		
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-Jan FY14	1.46%	-7.82%	19.1	969.8	1.97%
Jul 2008 - Jan2014 (CAGR)	13.80%	16.69%			

- 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.
- In the first half of FY14, long term interest rates went up with the expectations of resurge in inflation, and higher demand of government borrowings. The long-term interest rates (yield on 10-yr PIBs) which were below 11% at the end of FY13touched13% by Oct 2013; the shift in yield curve is shown in graph below. This has resulted in a decrease of7.82% in present value of liabilities. Although Market value of Fund's assets could increase only by a 1.46% 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 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 for 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.
- 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.

EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US $

	Jul-DecFY13	Jul-DecFY14	Growth %
Current Account	**(0.08)**	**(1.59)**	**(1814)**
Trade balance(Goods)	(7.91)	(8.30)	(5)
Trade balance (Services)	(1.43)	(0.05)	(2945)
Remittances	7.79	7.12	9.5
Capital Account	**0.14**	**0.10**	**38**
Financial Account	**0.02**	**0.56**	**(97)**

- The Current Account posted a deficit of USD 1.59 billion during the first half of FY14 as compared to deficit of only USD 83 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.

- However, Current Account (CA) for the month of December 2013 alone witnessed a surplus of USD 285 million, as opposed to deficit of USD 572 in November 2013, on the back of 28% increase in exports and 22% rise in home remittance on MoM basis.
- The sharp deterioration in trade balance on services of USD 1.38 billion remained the main factor for the CA deficit. The deficit in trade balance of goods also worsened the CA.
- The SBP forecasts that the country will have a current account deficit of USD 3billion 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:

	CPI Inflation								
Period	CPI Overall (%)			CPI Food (%)			CPI Non-food (%)		
	YOY	MOM	12mma'	YOY	MOM	12mma	YOY	MOM	12mma
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
Jan-2014	7.9	0.5	7.6	7.2	0.0	8.4	8.4	0.9	7.2
12 month high	10.9	2.0	9.2	13.0	3.0	8.5	9.4	2.2	9.8
12 month low	5.1	-1.3	7.1	5.5	-3.3	7.1	4.1	0.1	6.9

'12 month moving average
Source: FBS, SBP.

- CPI during the month of January 2014further declined for the second consecutive month to 7.9% as compared to 9.2% in December 2013. On MoM basis overall CPI increased by0.5% as opposed to decline of 1.3% in preceding month.
- Food index did not show any increase on MoM basis due to sharp decline of 4.4% 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.
- On the other hand, non-food inflation remained intact both on MoM and YoY basis. Non-food index increased mainly due to revision in "Housing water, electricity, gas and fuel" sub-index which was up by 1.3 percent on monthly basis to take the yearly number at 9.3 percent. This kind of movement is observed every quarter due to quarterly revision of house rent index.

- 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 11percent 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
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
Jan-2014	8.1	1.0	8.5	8.2	0.6	7.9
12 month high	9.6	1.5	10.5	9.2	1.2	10.2
12 month low	7.8	0.2	8.5	6.7	0.2	7.9

[1]NFNE stands for non-food non-energy measure of core inflation Source: SBP
[2]Trimmed Mean measure of core inflation excludes 20% of the items in the CPI basket showing extreme changes in price

- NFNE inflation recoded increase of 8.1%on YoY and 1.0% on MoM basis, which shows that general CPI has remained volatile due to food and energy prices.
- Trimmed inflation also increased by 8.2% on YoY and 0.6% on MoM basis; which is also depicting more stable situation due to non-inclusion of outliers which is food segment.

- 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

- 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
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
Jan-2014	10.01	9.58	12.81	12.12	10.19	9.59
12m high	10.22	10.57	13.08	12.27	10.19	10.67
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. 675 million in PIBs during January 2014. The OIC is of the view that the inflation and interest rates are expected to remain on lower side in foreseeable future. The OIC plans to further build its PIB portfolio in coming PIB auction to lock in the prevailing attractive rates. The OIC also plans to sell floating rate WAPDA TFCs from its portfolio in order to create more room for building up longer term fixed rate PIBs.

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