



Government of the Punjab
Punjab Pension Fund



Dated: 15 August 2013

MONTHLY REVIEW OF INVESTMENTS

July 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)

	July 13 - June 14
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	170
Less: Expenses during the period	(2)
Ending fund size	17,753

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 Jul 2013	
	Amount	%	Amount	%	Amount	%
PIBs	9,480	60.7	9,560	54.3	9,525	53.6
T-Bills	139	1.0	-	-	3,846	21.7
Short term bank deposits	5,349	34.3	5,928	33.7	2,108	11.8
National Saving Schemes	-	-	1,831	10.4	1,846	10.4
Corporate bonds/TFCs	501	3.2	246	1.4	249	1.4
Cash at bank	130	0.8	11	0.1	171	1.0
Other assets*	6	0.0	9	0.1	8	0.1
Total Fund Size	15,605	100.0	17,585	100.0	17,753	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

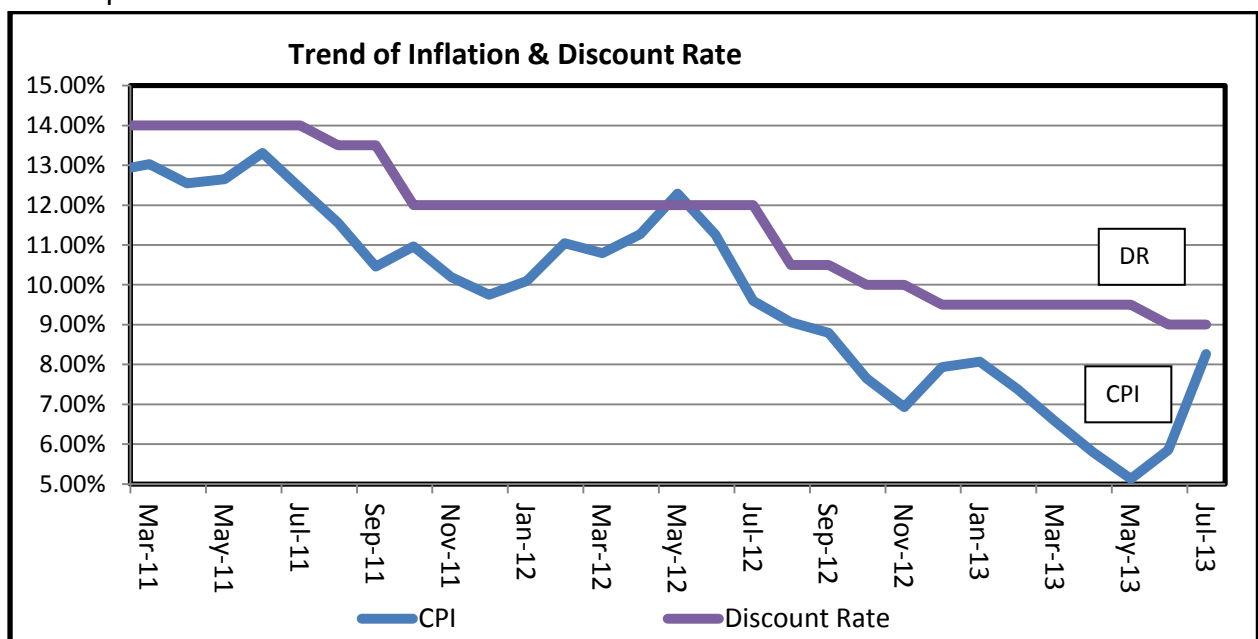
- Time Weighted Return (TWR) earned by PPF is summarized as under:

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 2013	12.02%	11.90%			

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

**CAGR means Compound Annualized Growth Rate

- Inflation rates over the last few years (FY 09 to FY 12) have been much higher than our long-term inflation expectations of 9%-10% p.a. Interest rates have also been higher than our long-term expectations.
- In order to lock-in high yields for a long period of time, the Fund invested a large proportion of its assets in long-term fixed-rate instruments consisting mainly of PIBs.
- In FY 13, CPI Inflation rate has declined sharply and SBP has reduced the policy rate by 3.0% cumulatively (from 12% to 9%) so far.
- The investment strategy followed over the past few years i.e. investment in long-term fixed-rate instruments at attractive yields, is now paying off. Despite lower interest rates, PPF continues to earn an attractive rate of return because of its high yielding portfolio of PIBs.





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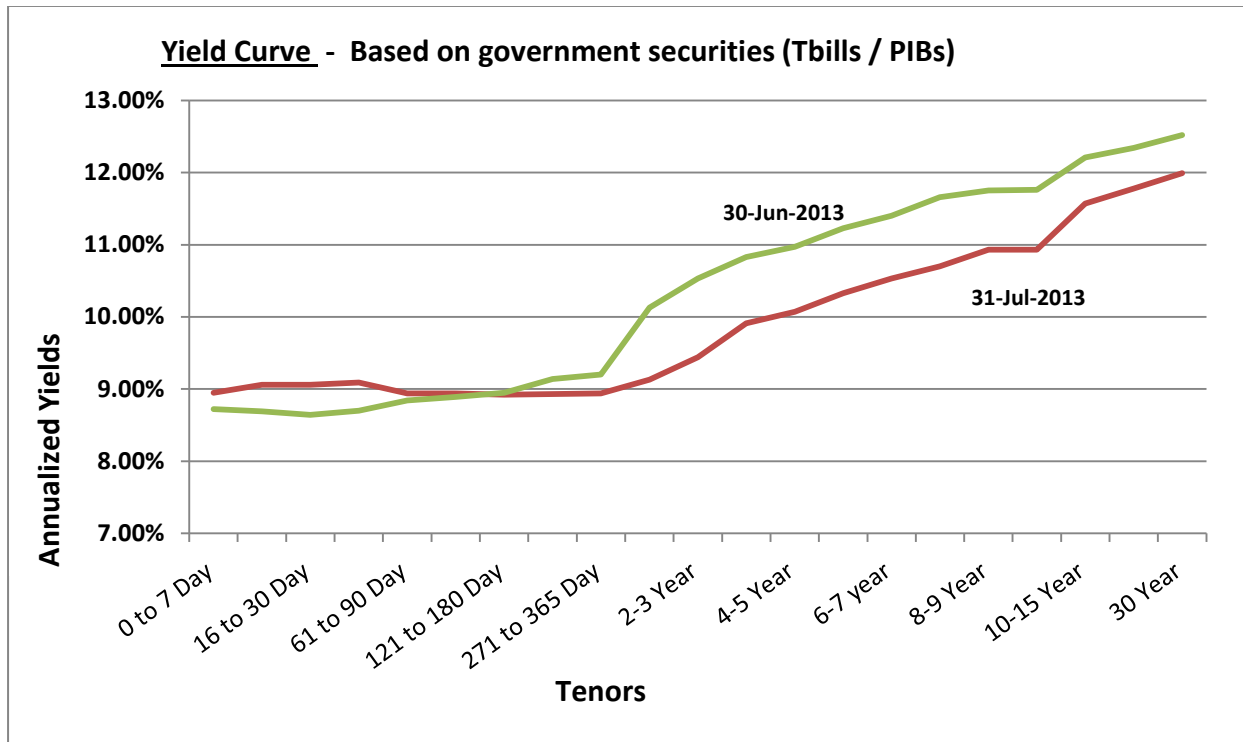


GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- 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 2008 - Jun 2013 (CAGR)	15.21%	18.83%			

- 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-June FY13, short-term interest rates (yield on 1-yr T-bills) have declined by around 3% whereas long-term interest rates (yield on 10-yr PIBs) have also declined by more than 2.0%. This has resulted in a sharp increase (37%) in present value of liabilities. Although Market value of Fund's assets also increased by 20.5% during the same period, the growth in market value of assets remained well short of the growth in present value of liabilities. This occurred because a substantial Duration Gap still remains 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

- GDP growth during FY13 fell to 3.6 percent in FY13 from 4.4 percent in FY12. Higher growth in industrial sector, as compared with last year, was insufficient to make up for the slowdown in services. Agriculture growth has remained almost unchanged during the year as compared with the last year.
- Analysis of the demand side shows that the Growth in FY13 was primarily driven by private consumption. Strong worker remittances, a vibrant informal economy and higher fiscal spending supported consumption growth during the year. On the other hand investment demand remained sluggish - a trend that has continued over the past several years. It is important to realize that over-dependence on consumption makes growth unsustainable, especially when a country's investment rate has been falling. During the recent years lower investment-to-GDP can be attributed to security concerns, energy constraints, and excess capacity with the manufacturing sector and lower appetite of commercial banks to lend to private sector. Public investment has also been overshadowed by subsidies.
- On external front, slower global economic growth weighed on Pakistan's exports and financial inflows.
- For FY14, the government has set a GDP growth rate target of 4.4%.



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GDP Growth Rates	FY 10	FY 11	FY 12	FY 13
A) Commodity Producing Sector	1.8%	3.3%	3.06%	3.42%
I. Agriculture	0.2%	2.0%	3.45%	3.35%
Crops	-4.2%	1.0%	2.9%	3.2%
Important Crops	-3.7%	1.5%	7.4%	2.3%
Other Crops	-7.2%	2.3%	-7.7%	6.7%
Cotton Ginning	7.3%	-8.5%	13.8%	-2.9%
Livestock	3.8%	3.4%	3.95%	3.68%
Fishing	1.4%	-15.2%	3.77%	0.65%
Forestry	-0.1%	4.8%	1.74%	0.13%
II. Industry	3.4%	4.7%	2.66%	3.49%
Manufacturing	1.4%	2.5%	2.13%	3.51%
Large Scale	0.4%	1.7%	1.18%	2.83%
Small Scale	6.3%	6.6%	6.52%	6.44%
Mining & Quarrying	2.8%	-4.4%	4.58%	7.58%
Construction	8.3%	-8.6%	3.16%	5.18%
Electricity & Gas Distribution	16.7%	66.4%	2.73%	-3.20%
B) Services Sector	3.2%	3.9%	5.34%	3.71%
Wholesale & Retail Trade	1.8%	2.1%	1.66%	2.52%
Transport Storage & Communication	3.0%	2.4%	8.91%	3.44%
Finance & Insurance	-3.3%	-4.2%	1.01%	6.64%
Ownership of Dwelling	4.0%	4.0%	4.00%	3.99%
General Government Services	8.0%	14.1%	11.1%	5.6%
Other Private Services	5.8%	6.6%	6.3%	4.0%
GDP at Factor Cost (A+B)	2.6%	3.7%	4.4%	3.6%

EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US \$

	FY-12	FY-13	Growth %
Current Account	(4.66)	(2.30)	51
Trade balance(Goods)	(15.77)	(15.06)	4
Trade balance (Services)	(3.19)	(1.14)	64
Income transfers (net)	(3.25)	(3.72)	(15)
Remittances	13.19	13.92	5.6
Capital Account	0.18	0.24	30
Financial Account	1.28	(0.08)	(106)
Net Errors & Omissions	(0.08)	(0.25)	
Overall Balance of Payments	(3.28)	(2.39)	27

Source: SBP

- The Current Account posted a 51 percent lower deficit in FY13. The deficit stood at USD 2.3 billion in FY13, compared with a huge deficit of USD 4.66 billion in the same period last year.



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- The development in current account was due to a combination of CSF inflows, steady growth in worker remittances and a contraction in the trade deficit. Of these, the impact of CSF inflows was the largest.
- Trade balance for the period improved by 4% due to 2% decline in imports and zero increase in exports. Services balance improved significantly due to receipt of CSF.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 5.6% during the year FY13 compared with the same period of last year.
- Capital and financial account almost dried during the period under review; and posted a surplus of only US\$ 158 million against a surplus of US\$ 1.46 billion in FY12. Although net foreign investment improved somewhat compared to last year, it was the fall in foreign borrowings that led to the overall deterioration in the financial account.
- The overall Balance of Payments remained negative USD 2.39 billion.

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
May-2013	5.1	0.5	7.8	6.5	1.1	7.3	4.1	0.1	8.2
Jun-2013	5.9	0.7	7.4	7.9	1.1	7.1	4.4	0.5	7.5
Jul- 2013	8.3	2.0	7.3	9.2	3.0	7.1	7.6	1.3	7.3
12 month high	9.1	2.0	10.6	9.2	3.0	10.0	9.7	1.5	10.9
12 month low	5.1	-0.4	7.3	5.3	-1.3	7.1	4.1	-0.4	7.3

¹12 month moving average Source: FBS, SBP.

- CPI showed a reversal during the very first month of FY14 and settled at 8.3% YoY in July 2013. On MoM basis it stood at 2.02%, highest during the last three years.
- Both Food and Non-Food segments are contributing towards higher inflation; although contribution from food segment is much higher both on YoY and MoM basis.
- The surge in inflation is due to Ramzan impact on food prices, and low base effect of last year. We expect there can be seen some upward pressure in prices as the government has increased electricity and fuel prices recently; their impact is yet to be realized.
- The Government has set an inflation target of 8 percent for FY14.



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- A summary of measures of core inflation is given in the following table:

Period	Core Inflation					
	NFNE ¹ (%)			Trimmed ² (%)		
	YOY	MOM	12mma	YOY	MOM	12mma
May-2013	8.1	0.3	9.9	6.7	0.3	9.1
Jun-2013	7.8	0.4	9.6	6.8	0.6	9.0
Jul-2013	8.2	1.5	9.3	7.8	1.2	8.8
12 month high	10.8	1.5	10.8	10.6	1.2	11.1
12 month low	7.8	0.2	9.3	6.7	0.2	8.8

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

- Both measures of core inflation have also showed upward trend in prices both on YoY & MoM basis.

- 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
May-2013	-3.2	0.2	-4.6	-4.7	0.4	-4.9	-0.3	-0.2	-3.6
Jun-2013	5.2	-0.1	-3.1	7.0	-0.3	-3.3	2.1	0.4	-2.3
Jul-2013	3.3	2.6	-1.9	6.4	4.2	-1.9	-2.3	-0.3	-1.5
12 month high	5.2	4.4	2.4	7.0	7.9	9.9	4.5	2.2	-1.5
12 month low	-9.1	-3.8	-4.9	-12.0	-4.2	-4.9	-11.4	-3.0	-11.2

Source: IMF

- Despite continued slowdown in economic growth around the world, commodity prices showed a sharp increase of 2.6% on a MoM basis, solely contributed by petroleum prices. The break-up shows that on MoM basis, fuel/energy related commodities recorded a sharp increase of 4.2% whereas non-fuel commodities recorded deflation of 0.3%.
- 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 3.3% in dollar terms may actually mean inflation of 13.3% in rupee terms. Further, the impact of currency depreciation on domestic prices is reflected with some time gap.



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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
May-2013	9.31	9.94	10.80	11.82	9.58	10.07
Jun-2013	8.94	9.69	10.93	11.62	9.09	9.82
Jul-2013	9.20	9.47	11.76	11.51	9.06	9.57
12m high	10.34	11.86	12.10	12.82	10.51	11.94
12m low	8.94	9.47	10.80	11.51	9.06	9.57

Source: SBP, Reuters

- Although short term interest rates (yields on 1 year T-bills) have been declining in line with the reduction in discount rate. However, despite the 50 basis points cut in discount rate, the yield on 10 year PIBs remained firm in the range of 11.5% which reflects that market is expecting resurgence in inflationary pressure.

INVESTMENT STRATEGY

- Current portfolio of the Fund is based on the expectations that inflation and interest rates have bottomed out and no further decline in discount rate is expected. Our expectations of reversal in inflation have also started realizing as CPI reversed in July 2013. We expect this trend to persist in coming months. 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 & interest rates remain low, the high yielding PIB portfolio will provide an attractive spread above inflation.
- If inflation and interest rates increase, the Fund will have the opportunity to further build its high-yielding long-term bond portfolio by diverting part of its short-term liquid investments.

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