Dated: 06 December 2013

MONTHLY REVIEW OF INVESTMENTS
November 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)

	1st July - 30th November 2013
Beginning fund size (30th June 2013)	17,585
Add: Contribution during the period	-
Less: Transfer to Reserve Pension Fund	-
Add: Gains during the period	842
Less: Expenses during the period	(9)
Ending fund size	**18,418**

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**		**30th Nov 2013**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
PIBs	9,480	60.7	9,560	54.3	9,478	51.5
T-Bills	139	1.0	-	-	6,990	37.9
Short term bank deposits	5,349	34.3	5,928	33.7	-	0.0
National Saving Schemes	-	-	1,831	10.4	1,244	6.8
Corporate bonds/TFCs	501	3.2	246	1.4	604	3.3
Cash at bank	130	0.8	11	0.1	100	0.5
Other assets*	6	0.0	9	0.1	2	0.0
Total Fund Size	**15,605**	**100.0**	**17,585**	**100.0**	**18,418**	**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

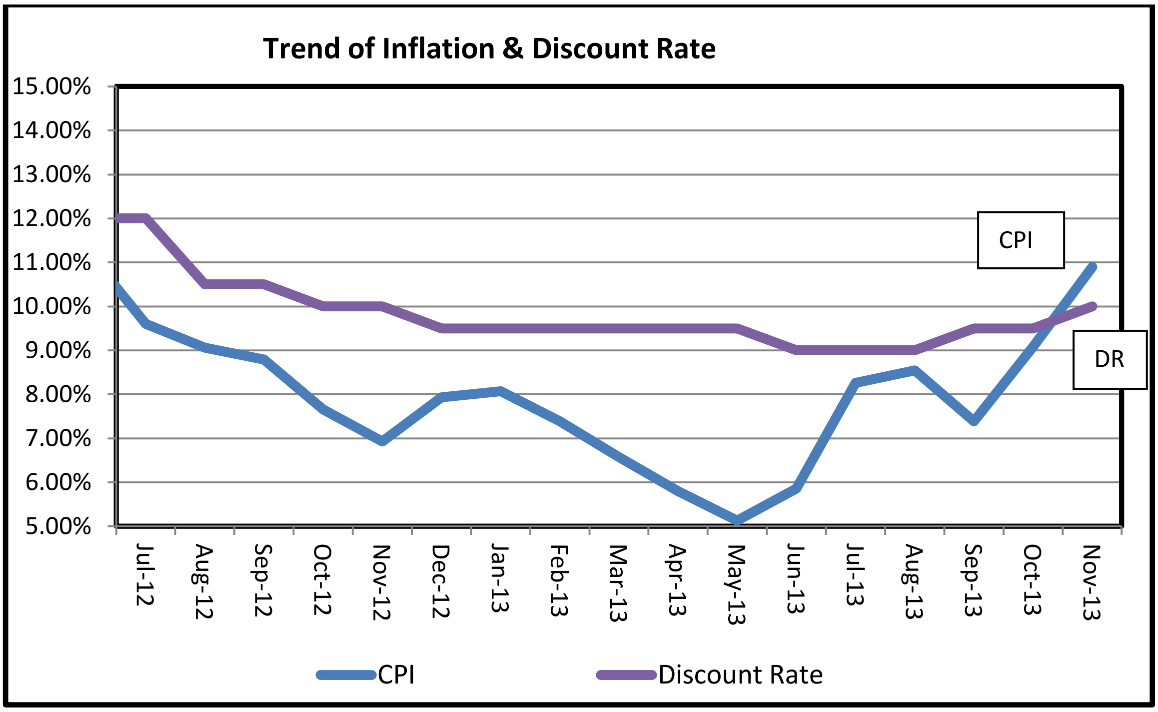
- Time Weighted Return (TWR) earned by PPF is summarized as under:

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-November 2013	11.80%	11.68%			
November 2013	11.75%	11.62%			

*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.
- In FY 13, CPI Inflation rate had declined sharply and SBP reduced the policy rate by 3.0% cumulatively (from 12% to 9%). However, the new government announced considerable upward adjustments in electricity, gas and petroleum prices. Further sales tax rate also has been increased; all these steps are expected to increase inflation in coming months. The YoY inflation has already started to accelerate since May 2013. In its recent Monetary Policy Statement (MPS), the SPB has revised discount rate by 50 basis points to 10.0% from 9.5%. The next MPS is expected to be announced in January 2014, and there are expectations of further increase in discount rate.



- 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 interest rates, PPF continues to earn an attractive rate of return 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.

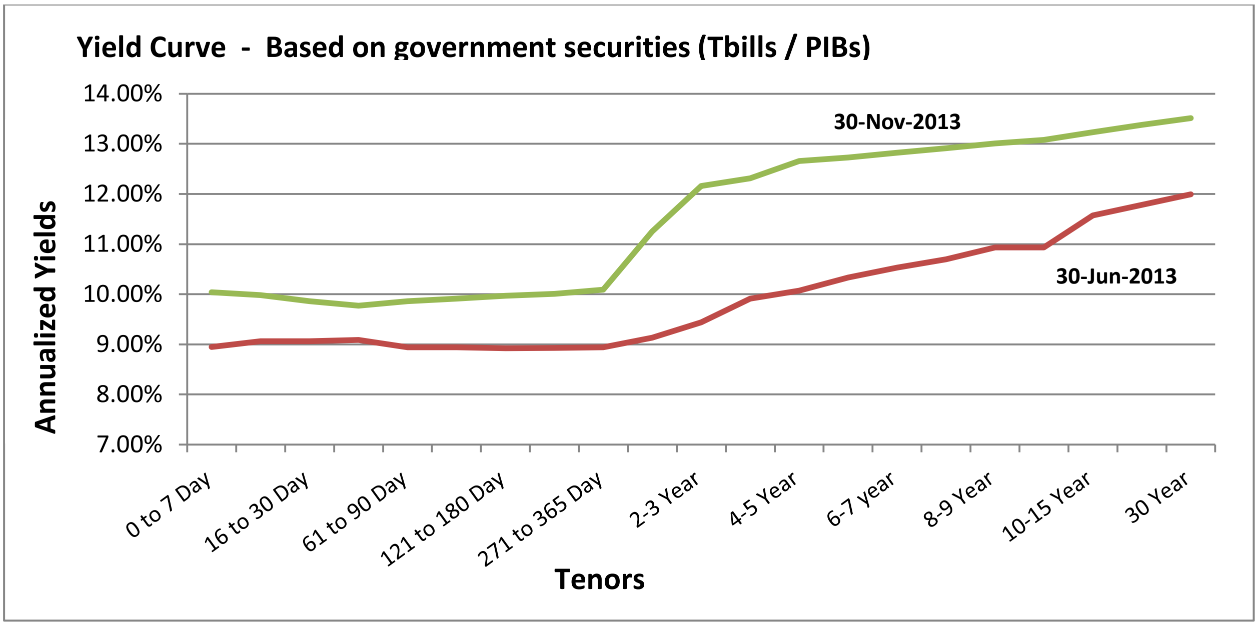
GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- 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:

	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-Nov FY14	-1.28%	-12.66%	18.6	918.9	2.02%
Jul 2008 – Nov 2013 (CAGR)	13.69%	17.25%			

- 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-November 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 crossed 13%; the shift in yield curve is shown in graph below. This has resulted in a decrease of 12.66% in present value of liabilities. Although Market value of Fund's assets also declined by 1.28% during the same period, the decline in present value of liabilities is much higher than decline in market value of assets, which 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 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 likely 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.
- 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 2.5 percent for the current financial year 2013-14. However, the government of Pakistan has projected 4.4 percent GDP growth rate for the same period.
- 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 growth 5 to 6 percent for a foreseeable future on consistent basis.

EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US $

	Jul-Oct FY13	Jul-Oct FY14	Growth %
Current Account	**0.01**	**(1.37)**	**(9857)**
Trade balance(Goods)	(5.25)	(6.02)	(15)
Trade balance (Services)	(0.21)	(0.76)	(260)
Remittances	5.28	4.96	6.3
Capital Account	**0.04**	**0.06**	**40**
Financial Account	**0.59**	**(0.48)**	**(181)**

- The Current Account posted a huge deficit of USD 1.37 billion during the first quarter of FY14 as compared to surplus of USD 14 million during the same period last year. Last year's current account surplus was due to inflows of over USD 1 billion of Collation Support Fund (CSF) from the US.
- Although the trade balance on services worsened by 260%, but a 15% deterioration in trade deficit was main responsible for the situation due to its large quantum.
- Trade balance for the period deteriorated by 15% attributed to 6% surge in imports and a merely 1% increase in exports.
- Services balance worsened by a massive 260%, mainly because of lesser amount of Collation Support Fund inflows; and a 10% increase in import bill of services.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 6.3% during the July-October 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 flows 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:

	CPI Inflation								
Period	**CPI Overall (%)**			**CPI Food (%)**			**CPI Non-food (%)**		
	YOY	**MOM**	**12mma[1]**	**YOY**	**MOM**	**12mma**	**YOY**	**MOM**	**12mma**
Sep-2013	7.4	-0.3	7.1	7.9	-1.5	7.3	7.0	0.6	7.0
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
12 month high	10.9	2.0	9.7	13.0	3.0	8.8	9.4	2.2	10.4
12 month low	5.1	-0.3	7.1	5.5	-1.5	7.1	4.1	0.1	6.9

[1]12 month moving average Source: FBS, SBP.

- CPI for the month of November 2013 recorded at 10.9% on YoY basis, which is its 15 month high, as compared to the same period of last year. On MoM basis overall CPI surges by 1.3%, on the back of sharp rise in food prices.
- Perishable food items were solely responsible for this high MoM food inflation, although they have only 5% weightage in overall CPI but surged by 12% on MoM basis.
- 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 electricity & Gas prices on consumers as government agreed with 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, State Bank of Pakistan, in its recent Monetary Policy Statement, projected inflation 10.5 to 11.5 percent for FY14.

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

	Core Inflation					
Period	**NFNE[1] (%)**			**Trimmed[2] (%)**		
	YOY	**MOM**	**12mma**	**YOY**	**MOM**	**12mma**
Sep-2013	8.7	0.6	9.0	7.6	0.6	8.3
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
12 month high	10.0	1.5	10.6	9.9	1.2	10.4
12 month low	7.8	0.3	8.8	6.7	0.2	8.2

[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 8.5% on YoY and 0.4% on MoM basis, which states that general CPI is higher due to food and energy prices. Otherwise inflation is not as much higher in ex-food & energy items.
- Trimmed inflation also increased by 9.2% on YoY and 0.4% on MoM basis; it is also 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
Aug-2013	0.1	1.2	-1.7	1.0	2.4	-2.1	-1.5	-1.2	-0.6
Sep -2013	-1.0	-0.3	-1.7	0.7	0.6	-2.4	-4.3	-2.2	-0.3
Oct-2013	-0.7	-1.6	-1.8	0.7	-2.6	-2.4	-3.4	0.5	-0.5
12 month high	5.2	2.7	-1.7	7.0	4.2	2.9	4.5	2.2	-0.3
12 month low	-9.1	-3.8	-4.9	-12.0	-4.1	-4.9	-4.3	-3.0	-10.7

Source: IMF

- Due to continued slowdown in economic growth around the world, commodity prices showed a nominal decline both on YoY & MoM basis in October 2013. The break-up shows that on MoM basis, fuel/energy related commodities recorded a decrease of 2.6% whereas non-fuel commodities recorded an increase of 0.5%.
- 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 1% in dollar terms may actually mean inflation of 9% 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
Sep-2013	9.71	9.35	12.96	11.66	9.51	9.40
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
12m high	10.09	10.98	13.08	12.44	10.08	11.08
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 August was 9.1% which has increased to 10.9% by November end. SBP also predicted in November's MPS that inflation for FY14 will remain 10.5 to 11.5 percent. Due to higher inflation projection, expectations of further rate increase have been built in secondary market yields. We expect another 50 basis points increase in discount rate in next MPS due in January 2014.

INVESTMENT STRATEGY

- Current portfolio of the Fund is based on the expectations that inflation and interest rates will increase. Our expectations of reversal in inflation have also started realizing as CPI reversed since start of FY14. 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 as rates go up; however, in an upward interest rates scenario, the Fund may not be able to post a decent real return over inflation.

(Muhammad Sajid)
Sr. Research Analyst
Punjab Pension Fund

(Aquil Raza Khoja)
General Manager
Punjab Pension Fund