

FUND SELECT

An Investment Guide to Mutual Funds
(Special Bulletin November 14, 2008)

Highlights

TFC's Valuation: An Authentic Dilemma

On November 5, 2008, the Securities and Exchange Commission of Pakistan (SECP) directed all Asset Management Companies (AMCs) to re-price all debt securities including TFCs and Sukuks held by collective investment schemes (Mutual Funds).

The overnight re-pricing of TFCs/Sukuks had significant adverse impact on the Net Asset Values (NAVs) of Income/Money Market Funds. Faysal Saving Growth Fund is the only Income/Money Market which managed to shield its NAV from this event. The fund did not have any exposure towards this asset class.

Moreover, some recently launched funds did not have any major exposure towards TFCs/Sukuks because these funds are in the process of building their investment portfolios and thus could not be effected by this action of SECP. Moreover, Pakistan Cash Fund which takes exposure only in T-bills and PIBs also remained unaffected from this major event.

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All figures given in the report are verified from respective AMCs or FMRs. However, for any further clarification regarding database & return calculations please send your queries to the following:

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TFC's Valuation: An Authentic Dilemma

Prevailing Liquidity Shortage

Since the beginning of the FY08-09, the financial sector of the country is witnessing massive liquidity shortage. In order to address this issue, the SBP has reduced CRR (Cash Reserve Requirement) by 400pbs in last couple of months which proved out to be an icing on the cake for Big Banks, nevertheless, this did not have any material impact on smaller banks and Non-Banking Financial Institutions (NBFCs). Due to prevailing liquidity shortage and absence of buyers for debt instruments, price discovery of TFCs/Sukuks and other debt instruments have become a difficult task. Owing to this fact, TFCs/Sukuks prices quoted on the MUFAP's (Mutual Fund Association of Pakistan) website were not reflective of true market value of these debt instruments.

Rising TFC Exposure

After freezing of redemption and issuance of equity-linked funds, heavy redemption pressure was witnessed by Income/Money market funds. Panic runs on Income/Money Market Funds significantly reduced cumulative asset under management and consequently increased the weight-ages of TFCs/Sukuks in their investment portfolios. During October 2008, total asset under management of Income/Money Market Funds reduced to Rs104.07bn from Rs137.86bn a month earlier, showing a decline of 24.51%MoM.

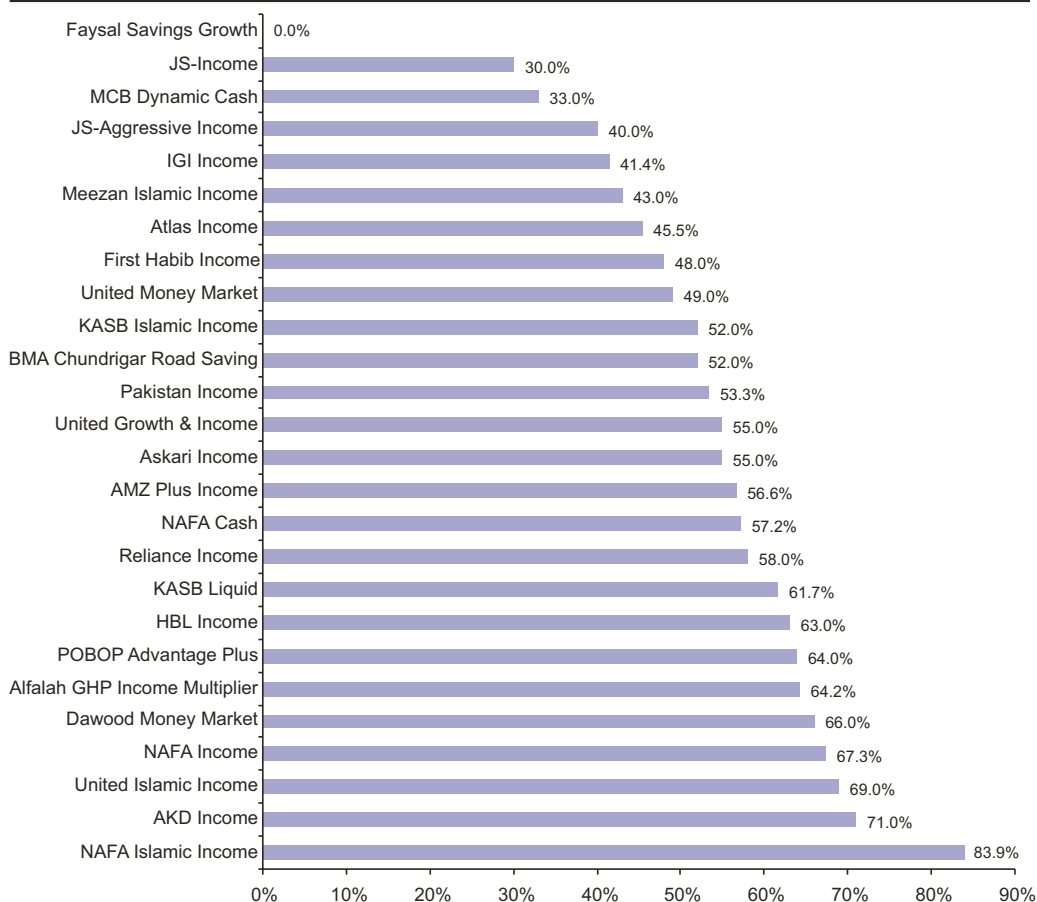
Open End Income/Money Market Funds			(PKR bn)
	Fund Sizes as at 30 Sep, 08	Fund Sizes as at 31 Oct, 08	%Chg MoM
AKD Income Fund	2.27	1.25	-44.96%
AMZ Plus Income Fund	3.00	1.50	-50.00%
Askari Income Fund	6.69	4.93	-26.35%
Atlas Income Fund	5.15	2.90	-43.69%
Dawood Money Market Fund	2.60	2.05	-21.03%
HBL Income Fund	4.46	3.06	-31.45%
KASB Liquid Fund	7.99	5.42	-32.14%
KASB Islamic Income Fund	0.94	0.89	-5.63%
MCB Dynamic Cash Fund	15.95	11.78	-26.18%
Meezan Islamic Income Fund	5.29	5.01	-5.40%
NAFA Cash Fund	21.03	14.34	-31.83%
Pakistan Income Fund	5.84	3.62	-38.01%
Reliance Income Fund	1.07	0.95	-10.99%
United Growth & Income Fund	14.37	12.11	-15.71%
United Money Market Fund	7.53	6.37	-15.47%
JS Income Fund	11.96	9.81	-18.00%
IGI Income Fund	2.68	1.742	-35.00%
Faysal Savings Growth Fund	4.53	4.03	-10.87%
First Habib Income Funds	1.96	1.69	-13.78%
Alfalah GHP Income Multiplier Fund	1.76	1.27	-27.82%
BMA Chundrigar Road Saving Fund	3.29	2.80	-14.79%
NAFA Islamic Income Fund	0.91	0.67	-27.10%
POBOP Advantage Plus Fund	1.85	1.71	-7.57%
United Islamic Income Fund	2.20	1.75	-20.45%
Pakistan Cash Management Fund	0.147	0.14	-2.04%
NAFA Income Fund	1.47	1.52	3.20%
JS Aggressive Income Fund	0.90	0.76	-15.02%
Total	137.86	104.07	-24.51%

Source: IGI Fund Select

* Above do not include funds launched after July 01, 2008

As a result of significant decline in fund sizes, average industry exposure towards TFCs/ Sukuks has increased significantly. Since TFCs/Sukuks prices were not reflective of true value, NAV calculated by Income / Money Market Funds were also not reflective of actual net worth of the total asset value. Considering this fact, one of the key criteria among our seven stringent criteria to evaluate Income/Money Market Funds (layout in previous couple of issues of Fund Select Monthly Bulletin) was total exposure of the Funds in TFCs/Sukuks. We had discouraged funds having exposure of more than industry average towards this asset class.

TFCs/ Sukuk Exposure as a % of NAV as on Oct 31, 2008



Source: IGI Fund Select

TFC Re-pricing by SECP

Addressing the earlier mentioned issue, on November 5, 2008, the Securities and Exchange Commission of Pakistan (SECP) directed all Asset Management Companies (AMCs) to re-price all debt securities including TFCs and Sukuks held by collective investment schemes (Mutual Funds). In the recently issued circular no. 26/2008, the SECP directed all AMCs that all debt securities to be valued after applying following discounts on face value for calculating the Net Asset Value (NAV). However, if the valuation resulting from this works out to be higher than the price quoted by MUFAP, then the price quoted by MUFAP shall prevail.

Entity or Issuer Rating	Percentage of Discount to face Value	
1	AAA	5.0%
2	AA+	7.5%
3	AA	10.0%
4	AA-	12.5%
5	A+	15.0%
6	A	17.5%
7	A-	20.0%
8	All others	30.0%

The overnight re-pricing of TFCs/Sukuks had significant adverse impact on the Net Asset Values (NAVs) of Income/Money Market Funds. Faysal Saving Growth Fund is the only Income/Money Market which managed to shield its NAV from this event. The fund did not have any exposure towards this asset class. This depicts that the Fund has implemented a very prudent investment strategy. Some recently launched funds did not have any major exposure towards TFCs/Sukuks because these funds are in the process of building their investment portfolios and thus could not be effected by this action of SECP. Moreover, Pakistan Cash Fund which takes exposure only in T-bills and PIBs also remained unaffected from this major event.

Impact of TFCs re-pricing on the NAV of Income/Money Funds

Name of Fund	Category	Repurchase Price (5 Nov 2008)	Repurchase Price (10 Nov 2008)	% Change
AMZ Plus Income Fund	Income	102.7415	91.7379	-10.71%
Alfalah GHP Income Multiplier Fund	Income	53.5288	48.1586	-10.03%
Askari Income Fund	Income	102.4800	93.1900	-9.07%
AKD Income Fund	Income	47.6871	46.3287	-2.85%
Atlas Income Fund	Income	505.8600	467.1200	-7.66%
BMA Chundrigar Road Saving Fund	Income	10.4134	9.5251	-8.53%
Dawood Money Mkt. Fund*	Income	103.9285	72.0986	-30.63%
Faysal Saving Growth Fund	Income	101.5300	101.5200	-0.01%
HBL Income Fund	Income	101.4800	93.4700	-7.89%
First Habib Income Funds	Income	101.4200	95.1000	-6.23%
IGI Income Fund	Income	104.2200	97.5800	-6.37%
KASB Liquid Fund	Money Market	101.6400	91.1100	-10.36%
KASB Islamic Income Fund	Income - Islamic	101.2000	92.8000	-8.30%
NAFA Cash Fund	Income	10.1535	9.4430	-7.00%
NAFA Islamic Income Fund	Islamic - Income	10.2099	8.7162	-14.63%
NAFA Income Fund	Income	10.1318	9.2165	-9.03%
Meezan Islamic Income Fund	Income - Islamic	50.5900	46.8500	-7.39%
MCB Dynamic Cash Fund	Income	101.2205	97.2278	-3.94%
POBOP Advantage Plus Fund	Income	52.3388	46.3296	-11.48%
PakOman Advantage Islamic Income fund	Income - Islamic	50.1329	49.9660	-0.33%
Pakistan Income Fund	Income	50.6400	47.3000	-6.60%
Pakistan Cash Fund	Income	50.2200	50.3000	0.16%
Reliance Income Fund	Income	52.2158	47.4081	-9.21%
United Growth & Income Fund	Growth Units	98.0068	91.0502	-7.10%
	Income Units	101.0379	93.8662	-7.10%
United Money Market Fund	Class 'A'	100.8076	94.0880	-6.67%
	Class 'C'	99.7995	93.1471	-6.67%
United Islamic Income Fund	Growth Units	100.0500	91.0600	-8.99%
	Income Units	101.0700	91.9800	-8.99%
JS – Income Fund	Income	102.4500	98.7800	-3.58%
JS - Aggressive Income Fund	Income	101.5900	97.5800	-3.95%

Source: IGI Fund Select

Fallacy in Recent Re-pricing

Despite the fact that the crucial step taken by SECP was the need of the time, nevertheless, we believe that the methodology used to re-price TFCs/Sukuk was not very prudent. In the recent re-pricing, SECP has given weightage to credit rating only. Apart from credit rating, following are few key factors which need to be considered to value TFC/Sukuk.

- Fixed or Floating Returns.
- Duration (time to coupon re-pricing and time to maturity of the issue)
- Embedded Call / Put Option.
- Listed or Unlisted.
- Secured or Unsecured.

All aforesaid factors are key attributes to value TFC/Sukuks but all of these were ignored in recent revaluation of TFCs/Sukuks by SECP. For example, United Bank Limited has four TFC issues. All four issues are rated AA by JCR-VIS. According to the re-pricing methodology of SECP, all these issues are to be valued at Rs90 (discount of 10% to be applied on the face value) or to be valued at prices quoted by MUFAP, if the re-valued price by SECP works to be higher than that of MUFAP.

An illustration: Key Highlights of TFCs issue by United Bank Limited

NAME OF ISSUER	UBL - 1	UBL - 2	UBL-3	UBL - 4
TENOR	8 YEARS	8 YEARS	8 YEARS	10 YEARS
INSTALLMENTS	Semi Annual	Semi Annual	Semi Annual	Semi Annual
RATING	AA	AA	AA	AA
RATING AGENCY	JCR-VIS	JCR-VIS	JCR-VIS	JCR-VIS
FACE VALUE PER SCRIP	5,000	5,000	5,000	5,000
ISSUE DATE	10-Aug-04	15-Mar-05	8-Sep-06	13-Feb-08
MATURITY DATE	10-Aug-12	15-Mar-13	8-Sep-14	13-Feb-18
PREVIOUS COUPON PAYMENT	10-Aug-08	15-Sep-08	8-Sep-08	13-Aug-08
NEXT COUPON PAYMENT	10-Feb-09	15-Mar-09	8-Mar-09	13-Feb-09
NATURE OF COUPON	Fixed	Fixed	Floating (6M Kibor)	Floating (6M Kibor)
BASE RATE	8.45%	9.49%	13.84%	13.00%
PREMIUM	Nil	nil	1.70%	0.85% for 1st five years and 1.35% for the remaining period
PRESENT EFFECTIVE RATE	8.45%	9.49%	15.54%	13.85%
PRICES AS PER MUFUP	87.50	88.83	101.11	93.29

Source: IGI Fund Select

Thus, UBL-1 and UBL-2 are to be valued at prices quoted by MUFAP; nevertheless, UBL-3 and UBL-4 are to be quoted at Rs90. Despite the fact that there is significant difference in effective yield of all these issues and UBL-3 appears to be the best among these, however, the recent re-pricing by SECP does not reflect this which depicts the major flaw in re-pricing methodology by SECP. In our view, all key attributes need to be considered and proper valuation methodology should have been implemented for re-valuing TFCs / Sukuks.

The Bottomline: An Investment Perspective

In our view, the recent huge decline in NAV of income/money market funds provides an outstanding investment opportunity to fresh investors to benefit from low base effect and earn outstanding returns in near future. Moreover, owing to rising interest rate scenario funds having more than 50% exposure towards liquid asset would eventually offer better returns going forward.

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I, **Tahir Hussein Ali**, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject, securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, relates to the specific recommendations or views expressed in this research report.

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