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PAKISTAN ON THE GATEWAY TO MSCI'S EMERGING MARKETS CATEGORY:

SHINING EQUITIES CONTINUE TO LEAD THE INVESTMENT ARENA

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Turning the Leaf: Entering the Second half of 2016

More than three years into the PML-N regime already, the country has witnessed various highs and lows. Higher GDP growth rate, strengthening relations with China, re-classification of Pakistan into MSCI Emerging Markets Index, successful Zarb-e-Azab operation and efforts for restoration of peace in Karachi have all fared well for the country's capital markets. While economic progress and stability are in sight, only the turn into the second half of 2016 will tell if tranquility will prevail and gyrations of capital markets end.

Highlights of this Issue

Strategy: Suit Your Investing Style

After almost four years of investing in fixed income and the equity market, the three investors featured in our March 2013 issue have by now steadily made healthy returns that not only covered inflation but increased their wealth substantially. We will first see how their investment values have fared before we go ahead with this year's market movements and expectations.

Politics: Protests to Political Unity

The current government has successfully completed its first three years in office. Despite failing to achieve aggressive growth targets, and marred by controversies, it seems that the government will stay for a full five-year term and ensure a democratic transition. Now, the PML-N government has also added new feathers of Pakistan's MSCI reclassification & energy reforms to its crown. The impact of negatives has been overshadowed by start of major projects under CPEC, a promising GDP and a decent National Budget, hard core resistance over Drone attacks by Army Chief and improvement in law and order situation.

Economy: Beginning of Glad Tidings

While failing to meet the FY16 GDP growth target of 5.5% and also not reaping the benefits of the low commodity prices, the government is continuing to work for the China Pakistan Economic Corridor as its savior. With power projects of over 13,000MW progressing largely as scheduled, it appears that Pakistan's energy woes will soon be over and sectors suffering from energy shortages will soon be able to show their potential. The government has finally decided to focus on the agriculture and textile sectors in the FY17 budget, the growth target for next year is again set at an ambitious 5.7%. Low interest rates have managed to simulate consumer demand, as is evident from rising construction activity in the country. Moreover, as commodity prices bottom out, the upcoming year may see a moderately higher inflation level.

Equity: A Bet Worth Taking

MSCI's reclassification decision to classify Pakistan as Emerging market has put the PSX on the global radar as it will attract investments from Emerging Market funds across the globe. The MSCI Emerging Markets Index is tracked by global funds worth more than USD 1.7 trillion, as a result of which the PSX is expected to see foreign flows of USD 500-600 million in the coming years. Reclassification could unlock equity value as Pakistan offers higher discount (~30%) and dividend yield (~5.6%) compared to other emerging markets. Pakistani's equities also present a unique blend of positive developments that are yet to be priced in, including investments under the China Pakistan Economic Corridor, ending of energy demand deficit, improving security scenario, and a gradually improving regulatory framework that is bridging the gap between the PSX and its international counterparts.

Brexit- Just a Temporary Slide!

Brexit may keep the stock markets volatile in the short-term but overall, it will not have much of an impact on Pakistan. An emerging economy like Pakistan has drivers in the current situation which will provide a cushion for absorbing the impact caused by Brexit on exports to and remittances from the UK.

Investment Avenues: Equities for the Long Run!

Comparisons of all available investment avenues reveal that equity returns outshine all others asset classes in the long term. The return of Meezan Islamic Fund (MIF), the flagship fund of Al Meezan has surpassed KSE-100 return and provided its investors optimum risk adjusted returns.

Fixed Income: Stabilizing Interest Rates

As SBP resumed its monetary easing stance in second half of FY 2016, after three consecutive Monetary Policies with unchanged discount rate and slashed the Policy Rate by another 0.25% bringing it down to 5.75% via its MPS announced on May 21, 2016. However, the discount rate appears to be stabilizing around the current levels as it is mainly dependent on direction of oil prices (which apparently are stabilizing in the range of USD 40-50 per barrel). Going forward, commodity and agri market price trends will determine the size and timing of the next interest rate move.

Gold: As Good As GOLD!

The recent surge in gold price has proved that Gold can play a pivotal role in an active investment strategy. With low correlation with other investment avenues such as equities, fixed income securities and currencies, gold makes an attractive investment case. Gold price has been linked to uncertainty, and the current global economic scenario is uncertain when it comes to growth prospects. With major economies holding their interest rates at record lows, and as uncertainty regarding the future of equities continues to pile up, investors are looking at gold to protect their capital.

Path of Action: Make Money on Rough Tides

With the volatility in international markets led by weakening of commodity markets, historically low interest rates and the recent Brexit event, returns on equity met can be expected to be around 15-18% for the next 3-5 years.

Strategy

Suit Your Investing Style

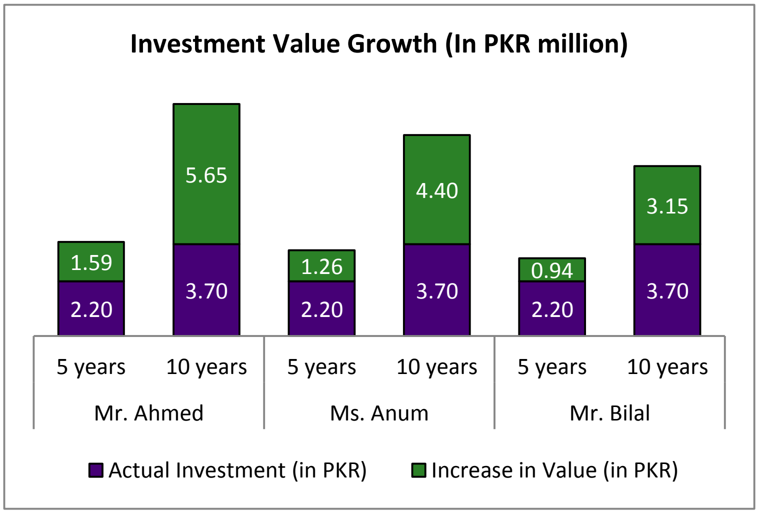
Heading into FY17, let's see how we have performed since we introduced our three hypothetical investors in our issue of "Market March – Enroute to Elections (March 2013)". In the last issue, "Fruits of longevity", we discussed how well Mr. Ahmed, Ms. Anum and Mr. Bilal had fared from our proposed investment allocations after completing twenty months of investment (from 1st March 2014 – 30th Oct 2015). Now let us see, moving ahead, how the portfolios have performed given the actual equity and fixed income fund returns from March 01, 2014 – June 30, 2016.

Recalling the profile of the three investors introduced earlier, the three investors have different psychographic profiles and are falling in different levels of risk tolerance buckets. The proportion of equity and fixed income investments are made according to the risk and return profile. The detail of the profile and the corresponding returns of each investor for the period of 28 months since we started tracking the investment are given below in the table.

Investor	Portfolio Category	Investor Profile	Actual Investment 1st March 2014 to 30th June 2016	Investment Value (30th June 2016)	Annualized Return	Total Return
Mr. Ahmed	Aggressive	- Age 27 - Fresh graduate with first job - High risk tolerance - Invests 75% in equity and 25% fixed income	Rs. 700,000 (Rs. 25,000 every month)	853,871	16.85%	**43.82%**
Ms. Anum	Balanced	- Age 42 - Savings for children's education and future needs - Moderately high risk tolerance - Invests 50% in equity and 50% in fixed Income	Rs. 700,000 (Rs. 25,000 every month)	818,554	13.26%	**33.72%**
Mr. Bilal	Conservative	- Age 57 - Father of three - Moderate risk tolerance - Invests 25% in equity and 75% in fixed Income	Rs. 700,000 (Rs. 25,000 every month)	783,236	9.65%	**23.99%**

Note: *Returns have been calculated using actual Karachi Meezan Index Fund -30 (KMI-30) and Meezan Sovereign Fund (MSF) using GIPS method.*

Looking at the above returns and the profiles of investors, we can observe that while each of them is contributing the same amount every month, Mr. Ahmed who has a high risk tolerance, consequently with high equity exposure earned the highest return in the last twenty seven months. The 2nd highest return was received by Ms. Anum following the balanced portfolio and a much more than risk free return was earned by Mr. Bilal with a conservative portfolio taking his risk aversion in account.



Expected future Portfolio Growth

Assuming the three investors follow the same strategy and same amount of monthly investments for 10 years ahead from now, we can expect great differential in returns in 10 years. The differential of returns is increasing as we are moving from 5 to 10 years.

Note: Al Meezan tries to maintain a prudent stance on the stock market expectations in its communication to investors; hence, relatively conservative returns are used in the projection

Protests to Political Unity

The incumbent government has successfully completed its first three years in office. Despite failing to achieve aggressive growth targets, and marred by controversies, it seems that the government will stay for a full five-year term and ensure a democratic transition. Now, the PML-N government has also added the feather of Pakistan's MSCI reclassification to its crown. The impact of negatives has been overshadowed a bit by start of major CPEC's projects, a promising GDP and a pro-farmer agricultural budget, hard core resistance over drone attacks by the military and major improvement in law and order situation.

Panama Leaks

The leaks by Panama based Law firm Mossack Fonseca exposed the offshore wealth of hundreds of politicians, businessmen, celebrities and other affluent personalities across the globe. It included names of the family members of current PM. The opposition members called for formulation of a JIT for investigating the issue. References against the PM have been filed by opposition parties with threats of nationwide protests after Eid-ul-Fitr unless the government moves swiftly to constitute the JIT along with ToRs in line with the opposition members' wishes.

Restoration of peace in Karachi

The Karachi operation that has been part of Army Chief's priority projects has entered into its second phase as law enforcement agencies increase their pace of raids arresting troublemakers.

Growing Indo-Pak conflict- Pathankot incident

Inquiries in the Pathan Kot incident have been concluded and India's National Investigation Agency (NIA) has found no linkage of Pakistan's government with the incident hence giving it a clean chit. The incident happened with the start of 2016 just after Modi paid a surprise visit to PM Nawaz Sharif on his grand daughter's wedding. Pakistan's policy remains rooted in containment of tensions and reducing untoward incident on the Line of Control (LOC)

Torkham Border Clash – India's Proxy War?

The deadly clashes between Pakistani and Afghan forces at the Torkham border stirred public emotions and anger on both sides of the Durand Line. This renewed the anti-afghan refugee sentiment among the Pakistani people. The clashes are seen as a result of increased Indian investment and influence in Afghanistan, especially in areas along the Pak-Afghan border. The Afghan leadership has reacted as the voice of India's foreign policy against Pakistan, calling out Pakistan for harboring and exporting terrorism to its neighbors. With diplomatic efforts from both sides, peace was however restored along the border. Such clashes in the future will ensure that the Pak Army is engaged on three major fronts – on the LOC with India where tensions keep fluctuating, in the north as Zarb-e-Azb continues against terrorists, and along the Durand Line.

Arrest Of Kulbushan Yadav

The Pakistani Intelligence has long accused India of waging proxy wars, and supporting anti-state elements in Pakistan – the arrest of Kulbushan Yadav, an Indian Naval Intelligence Officer in Baluchistan added credibility to Pakistan's claims. Mr. Yadav confessed to having contacts with Baloch separatists and terrorists and to fuelling sectarian violence inside Pakistan. Besides Yadav, a number of Afghan intelligence agents have also been arrested from the Pakistani territory in Balochistan as well as Khyber-Pakhtunkhwa. However, the Pakistani government seems reluctant to capitalize on these arrests to gain favor against India in the international community.

The Failed F-16 Deal

The stoppage of subsidization of the F-16s sale to Pakistan by the US Congress has cast a dark shadow upon Pak-US relations, at least in the short term. The Congress made this move on the pretext that Pakistan is not taking appropriate action against the famed Haqqani network. The US is also against imprisonment of Dr Shakeel Afridi, the man who helped US intelligence in taking down Osama Bin Laden.

Violation of sovereignty

The Pakistani government criticized the US on violating Pakistan's sovereignty when US carried out a drone attack inside Pakistan's border in Baluchistan, killing Taliban Chief Mullah Akhtar Mansour. Pakistan claimed that the US deliberately sabotaged the Pak-Taliban peace process.

On the Way to Consistent Stability

CPEC- The Game Changer

China and Pakistan have signed MOUs for projects worth U$46bn under CPEC. Initial prioritized pipeline of investments under CPEC envisages an overall investment of $34bn in energy and $10bn in transport infrastructure. With the implementation of these bulk projects during the next 2-3 years, an estimated 13,880 MW of electricity will be added to the national grid by 2018, which will be more than sufficient to overcome the current deficit of 6,000MW. Local component of this investment is expected to bolster GDP growth by 0.5pps, effectively taking GDP growth rate near 6% over the next three years. With energy woes on the backburner after implementation of these projects, industrial growth is expected to increase sharply along with increased output from existing industries.

Power Projects	# of Plants	Capacity (MW)	Cost (US$ Mn)
Priority	16	10,400	21,486
Actively Promoted	8	6,645	12,927
Total	24	17,045	34,413
Transport	**#of Projects**	**Length (Km)**	**Cost (US$ Mn)**
Roads	2	832	6,100
Railroads	2	1,736	3,690
Total	**4**	**2,568**	**9,790**
Gwadar Projects	8		793
Others	2		44
Grand Total			**45,040**

Inflation outlook

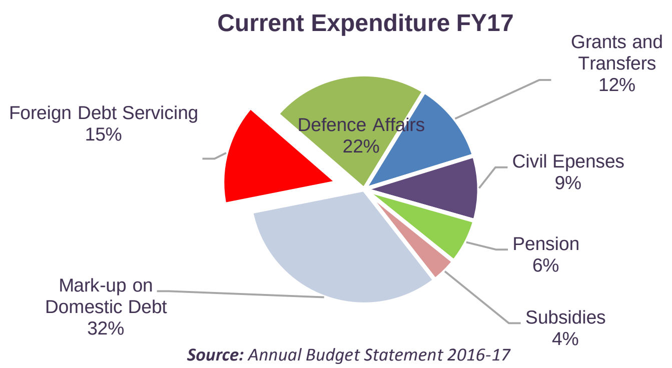
Supported by the fall in global commodity prices, CPI inflation was recorded at 2.82% during July-May FY16, hovering around its lowest level in around 13 years. During June, CPI fell to 3.19% after rising for seven consecutive months till April. Rising inflation indicates growth in aggregate demand and construction activities, along with uptick in private sector credit offtake. As oil prices start to rebound, recovering more than 70% from recent low of $28/bbl in January 2016 to $49/bbl in June 2016, other commodities are also starting to follow suit. Rising fuel prices, steadily improving consumer demand, and new tax measures are all expected to keep inflation at higher levels in the upcoming year.

IMF Overlords to be replaced by Leeching Creditors?

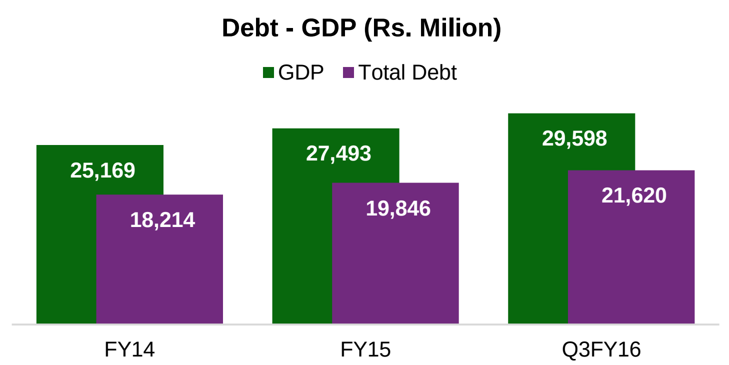
In its most recent discussions with the government in May 2016, the IMF attested to Pakistan's growing economy, backed by the CPEC, improving energy dynamics, and strengthening revenue collection. IMF's last review will be concluded in September, 2016 followed by the 12th and last disbursement of $500mn under the Extended Fund Facility (EFF) Program. The Finance Minister has asserted on multiple occasions that Pakistan will not go for another IMF program after September. If this is indeed the case, the Government will have to fill the nearly $2bn gap from other sources.

Piling Debt Concerns – Overplayed?

The government has decided to raise around $7.9bn ($8.3bn in FY16) in external resources in FY17, out of which $7.7bn are foreign loans ($7.9bn in FY16). GOP intends to fill the IMF gap by issuing $750mn Sukuk Bond and raising $2bn from foreign commercial banks. These loans will further add to the $500mn debt raised in FY16 at the controversially expensive rate of 8.25%. During FY16, almost $4.2bn was spent on foreign debt servicing (12.1% of the total current expenditure), whereas in FY17, the debt servicing amount is forecasted to pile up to $5.4bn, almost 15% of the forecasted current expenditure. Pakistan will have no option but to achieve its aggressive growth targets to meet its creditors' dues. Although Pakistan's total debt has increased by around Rs. 2bn, by the end of the 3rd quarter of FY16, Pakistan's total debt as percentage of GDP was at 73%, almost 1% up from FY15.



Source: *Annual Budget Statement 2016-17*

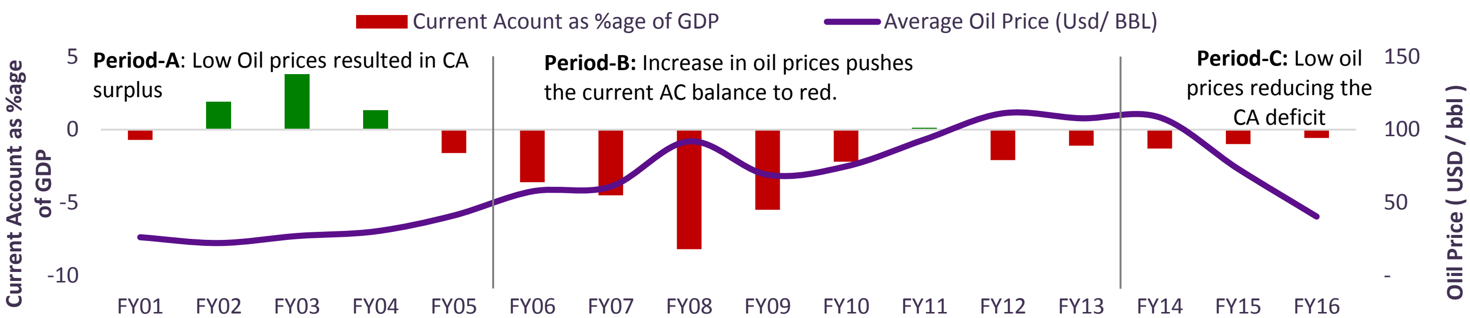


Discount Rate – Low As It Can Go

In the monetary policy announced in May 2016, the government decided to further lower the discount rate by 25bps, bringing it down to 5.75%. Although the growth in Private Sector Credit (PSC) was less than expected, flows to PSC were up 82% to Rs. 311.7 billion till June 2016. As structural bottlenecks are eliminated, the appetite for credit in the private sector will improve, leading to economic growth. On the other hand, growth in PSC could face resistance from rising interest rates as inflation recovers to its pre-oil crash levels.

Oil prices, impact on current account and outlook

The oil slump that began in FY15, made its low in January 2016, and since then crude has been in a steady upward trend. Being a net importer of oil, Pakistan was expected to be a major beneficiary, however events did not pan out as planned. Low agri-product prices, falling textile and food exports and rising machinery imports capped the potential benefits of this slump. Now, as oil starts to recover, Pakistan will have to undertake active measures to ramp up its exports to limit its current account deficit. Luckily, the government has taken measures in the proposed budget to boost its export oriented sectors (textile industry was awarded zero-rating on raw material), this, coupled with improving security and energy supply dynamics and rising inflows of foreign investment indicate that greener pastures might turn up in our own backyard.

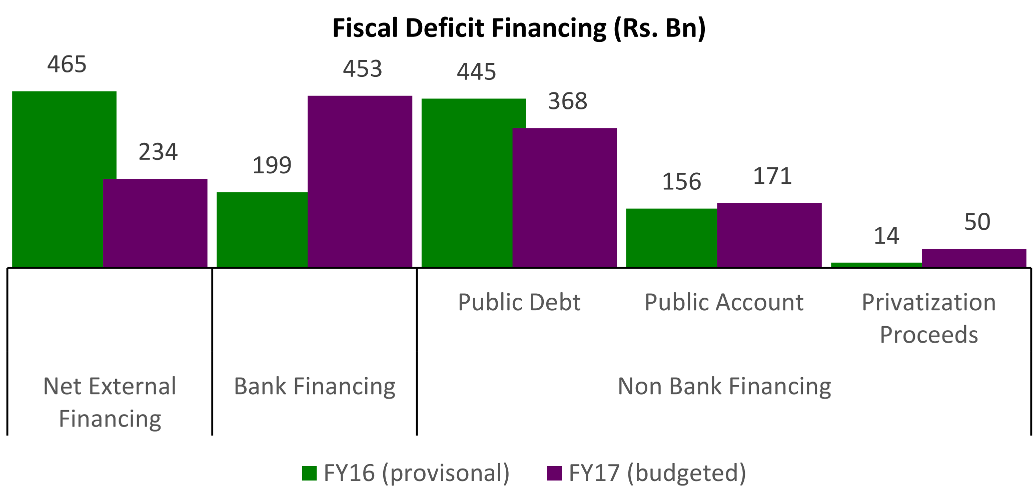


Budget 2016-17- Light at the end of the tunnel?

The proposed Finance Bill was met with mixed reactions from the business community. Praised by some industries that were supported, while censured by others, the budget was largely a repackaged version of last year's budget, with slightly aggressive growth targets. Benefits given to the agriculture and textile sectors stand out, as the government realized its folly of not focusing on its main cash crop – cotton, which in turn also adversely affected the textile sector. To support farmers, sales tax on Urea was reduced from 17% to 5%, along with a subsidy of Rs. 36 billion on Urea and Rs. 10 billion on DAP. To boost exports, textile, being one of the five main export oriented sectors, making almost 50% of total exports, was awarded zero-rated status. Import of machinery for textile manufacturing was made duty free, the rate on Export Refinance Facility was reduced from 3.5% to 3% and the DLTL scheme was continued for FY17 to make the textile sector more competitive in the export markets.

Fiscal Deficit:

Fiscal deficit was recorded at 3.4% of GDP during Jul-Mar FY16 compared to 3.6% in Jul-Mar FY15. During FY17, the projected deficit of Rs. 1.27tn is expected to be 3.8% of GDP. Compared to FY16, where bulk of the deficit was financed by external sources, in FY17 bank financing of Rs. 453bn will finance 35% of the deficit. In FY16, the government was unable to finalize privatization of Pakistan Steel Mills and PIA, leading to lower proceeds from privatization compared to the budgeted amount of Rs. 50bn, the amount budgeted in FY17 is again set at Rs. 50bn.



Equity

A Bet Worth Taking

Pakistan has resurfaced among Emerging markets

As part of its Annual Market Classification Review 2016, MSCI reclassified Pakistan from Frontier to Emerging markets with a 0.19% weight in the Emerging Markets Index. Pakistan was removed from MSCI's Emerging markets category at the end of December 2008 due to deteriorating investment environment. Until May 2009 Pakistan remained a standalone Index, after which it was reclassified as a Frontier Market. Now, almost seven years later, Pakistan has regained its position in the Emerging Markets category.

The development will put Pakistan's equity market on the larger radar as it will attract investments from Emerging Market funds from across the globe. The MSCI Emerging Markets Index is tracked by global funds worth more than USD 1.7 trillion, according to Bloomberg. Although the weight of the Pakistani market is small in the Index, the size of funds tracking Emerging Markets is much higher than those tracking Frontier Markets and is expected to bring about foreign flows of USD 500-600 million to Pakistan in the coming years. Moreover, Pakistan is currently trading at a ~30% discount to other countries in the Emerging markets pool, making it relatively more attractive. The additional inflows would not only unlock equity value but also increase market turnover, making it an investor's paradise.

Impact of Budget critical for stock specific picks

The government announced its budget for FY2017 where total budget outlay has been increased by 9.9%. The theme of the budget has been to encourage overall investment in the economy and exports by way of providing incentives to manufacturers, applying zero rating on export based sectors, measures to facilitate farmers such as lower fertilizer and tractor prices and encouraging company listing by way of tax incentives. The government aims to increase revenue by way of increasing indirect taxes and tax burden on non-filers. Overall, the budget will have positive effects on the different sectors of the equity market. Our assessment is that the budget is positive for Cements, Fertilizers, Power, textiles and Telecom sectors. However, it is neutral to positive for Pharmaceuticals, neutral to negative for chemicals, neutral for Food producers, Oil & Gas marketing, Refineries, Automobiles and steel sectors but negative for the banking sector.

The Regulator's blessings

With Pakistan being on route to be included amongst emerging markets, the SECP has been active in establishing best practices in the equity markets at par with international standards and conducive for local and foreign investors alike. To this end, the commission has taken certain steps and proposed many others in order to encourage market volumes, increase efficiency in the administration, maintenance and governance of the market, to facilitate and encourage foreign investment and to ensure transparency and reliability of the trading done by brokers. The steps include the integration of Karachi Stock Exchange, Lahore Stock Exchange and Islamabad Stock Exchange into 'Pakistan Stock Exchange' and proposals to widen scrip circuit breakers and introduce market based trading halts, eliminate requirement of spot trading prior to book closure date and standardization of technology based systems.

The measures taken and proposed will not only improve the efficiency of the market systems and bring them in line with best practices, but they will also signify the all-important commitment and intent from the regulator to attract investment in the equity market over the longer term. We expect even more similar measures to be introduced that would put Pakistan's equity market alongside its international counter parts.

Monetary Policy – Still room for easing?

In its latest monetary policy, the State Bank reduced its policy rate by another 25 basis points, taking cumulative decline to 4.25% since November 2014. Despite the recent uptick in oil prices and inflation readings, the Central Bank still showed comfort over price levels and foreign exchange reserves. Foreign exchange reserves are estimated to increase over 4 months of import cover, fueled by healthy foreign remittances, a contained current account deficit and multilateral and bilateral flows. On the back of improving energy and security conditions, industrial activity and service sector have shown remarkable expansion in the current fiscal year. With these macroeconomic factors improving in tandem, a rate cut has been announced by the central bank after almost eight months of unchanged monetary policy. The rate cut will definitely bear well for the equity market as stocks become more attractive.

It remains a question whether further easing can be expected, however, the recent cut signals to investors that the Central Bank remains comfortable on macroeconomic developments, which lays the ground for further rate cuts in the coming months if the commodity prices remain on lower side.

Political tides – will the government be able to weather the storm?

The Panama papers leaked evidence of offshore holdings by members of the current government. This revelation has intensified allegations of corruptions against the Prime Minister and his government by opposing parties. Opposing parties including the PTI and PPP are bidding to file a petition to disqualify Prime Minister Nawaz Sharif. To this end, the government and opposition have agreed to form a committee to establish the terms of reference for investigation in this matter. The opposition is blaming Government for using delaying tactics. Threat to the government's survival can create uncertainty in the equity market and make investors retreat to the sidelines. On the other hand, if the government is absolved of any such allegations, this would virtually ascertain the completion of its five year tenure and would set the path straight for the equity market. The outcome of this political tussle would be critical to the direction of the equity market.

Chinese Investment a boon

Projects under the China Pakistan Economic corridor worth as much as USD 46 billion and will provide energy, telecommunications and transportation infrastructure to Pakistan that would be completed in the coming years. The investment would benefit various sectors of the equity market such as Cement, Transport and Construction sectors. Not to mention the indirect benefits from additional income would sprawl to other sectors and increase economic growth.

Renewed Foreign Interest

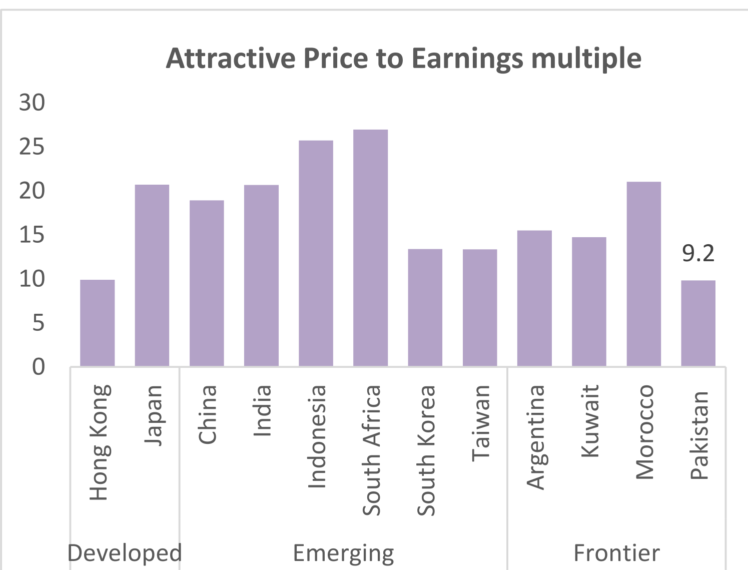
Blue chip companies have continued to show interest in local companies. Recent announcement of planned acquisition of up to 51% stake in Engro Foods stake for USD 470mn by FieslandCampina, a Netherlands based company is being looked as a game changer for the dairy landscape of Pakistan. Interest has also been witnessed in the home appliances sector where an appliances manufacturer from Turkey Arcelik has announced a 100% acquisition of Dawalance Pakistan for USD 258mn.

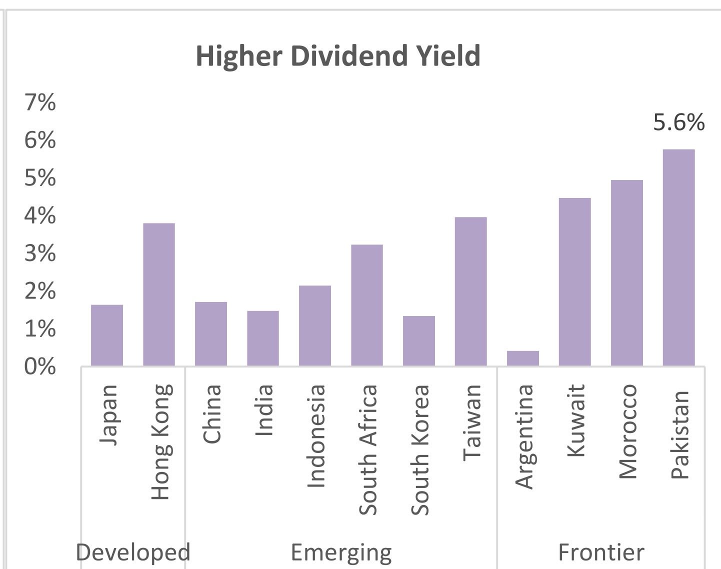
Superior Earning potential

The FY16-17 forward earnings yield for the KSE100 Index is 9% and offers a decent spread over the 12-month T-Bill yield of 4.0%. The dividend yield alone stands at 5.7%, which is comparable to the 6 month T-Bill yield of 5.85% and a policy rate of 5.75%. Additional growth from economic developments and investment in infrastructure and energy can result in even higher realized total returns!

Attractive Valuations

The KSE100 Index remains attractive among regional peers based on cheap multiples and fundamentals. The market currently trades at a forward P/E ratio of 9X, which is cheaper than most emerging and frontier markets. The Index also offers a trailing dividend yield of 5.7%, which is much higher than its regional counterparts.





Brexit Event

Just a Temporary Slide in equity market!

In an unexpected turn of events on June 23, 2016, the British voted in favor of leaving the European Union (EU) after 43 years of membership in the 28-state bloc. With the EU being the largest trade partner for the UK, the British economy is expected to slide on account of its exit from the EU as its relations with the remaining EU members could be stressed. Alongside, with UK's exit, a route could be paved for other major EU member economies to hold referendums to decide on continuation of their membership.

Gold Shining Bright

Up 30% Since the Start of 2016!

The uncertainty trickling down from the above mentioned situation led the way for a considerable decline witnessed in international markets as well as certain commodities when the results of the referendum held in the UK were announced. Precious metals like Gold obviously rallied as international investors rushed for safety under the anticipation of economic slowdown in the UK and the EU while commodities like oil and steel declined for the same reason.

Impact on Pakistan's Stock Market

Pakistan's Classification in MSCI Emerging Markets Category to Lead the Way for Stock Market!

- Foreign Investment Flows Expected to Continue

- Market Ready for another Boost!

With the Pakistani Stock market showing some volatility post the Brexit referendum results, the investors may be feeling pressured but it must be noted that this should not be treated as a panic situation. After touching an all-time high, this should be viewed as a logical breather taken by the market after closing at an all-time high post the MSCI development. The Foreign Investor Portfolio Investment is expected to continue flowing in on account of MSCI emerging market classification of Pakistan which shall provide the much needed boost to the stock market. Even though the maximum time for exiting is two years, EU leaders are pushing for Britain to exit as soon as possible; this could be concerning for the textile sector's exports to EU but given the pace at which the situation is settling in, considerable time is expected to pass by until the terms of exit are finalized and hence, the sector will have the time to readjust accordingly. International oil prices may also decline further in anticipation of slowdown in economic activity in the EU but it should be noted that lower oil prices are also a source of considerable benefit on a broader scale for Pakistan.

Brexit may keep the stock market volatile in the short-term but overall, it will not have much of an impact on Pakistan in economic terms. An emerging economy like Pakistan has drivers in the current situation which will provide a cushion for absorbing the impact caused by Brexit on exports to and remittances from the UK. The stock market has only shown a negative move in line with volatility of international markets and fall in international oil prices.

Positive developments - Key Drivers
· Inclusion of Pakistan once again in MSCI's emerging markets list
· Continued Monetary Softening
· Continued and fast paced ongoing development under CPEC
· Low/Stable international oil prices a blessing for the economy
· Pakistan's Stock Market Attractive among peers on the basis of P/E multiple
· Improving macro-economic fundamentals-strengthening forex reserves, declining deficits, falling inflation, etc
· Strong Corporate Profitability expected to continue

Outlook

The reclassification of Pakistan in the MSCI Emerging Markets category will serve to be a catalyst driving the market's performance during the new fiscal year. Also, the above mentioned key drivers, improving macroeconomic fundamentals and ongoing development under the China Pakistan Economic Corridor are expected to continue generating economic activity which shall in turn keep the equities strong and performing in the medium to long term. Commodities, especially precious metals like Gold are expected to continue rising as the volatility in the Global Economic landscape is expected to keep the demand for Gold strong.

Recommendation

Investors are advised to take advantage of this stock market correction. Customers with a risk taking ability and willingness are advised to take exposure to equities through professionally managed mutual funds like Meezan Islamic fund in order to take advantage of further upside expected to materialize in the stock market. As a result of re-rating of market and robust earnings growth, we expect the market to provide around a 15-18% return over the next one year. Investors interested in investing in Commodities and with a long-term time horizon are advised to take such exposure through Meezan Gold Fund as the precious metal is expected to continue performing going forward.

Investment Avenues

Equity- The Best Bet in the Long Run

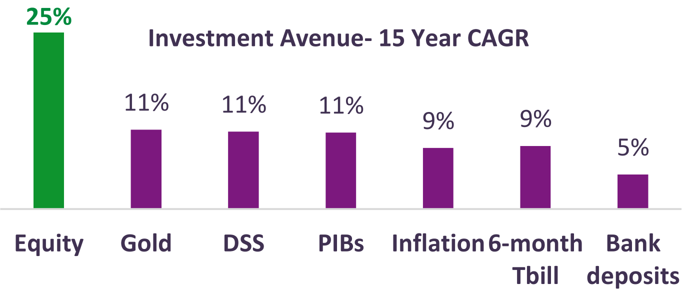
Equity investments are prone to short term market volatilities but the equity markets are often the best investment avenue for investors with a long term view. When we compare available investment alternatives as shown in the table below, we see that the KSE-100 provided the highest investment return over the last ten years, an annual compounded return of 25%.

Investment Avenues – 15 Years (% Returns)

Period	Equity (KSE-100)	Gold	Defense Saving	10 Year Govt. Bonds	Inflation	6-month T-bill	Bank Deposits
FY02	30	16	15	12	4	9	4
FY03	92	10	11	7	3	4	2
FY04	55	14	8	6	5	2	1
FY05	41	10	8	8	9	5	3
FY06	34	41	9	9	8	9	3
FY07	38	5	10	10	8	9	4
FY08	(11)	42	10	11	12	10	6
FY09	(42)	0	12	14	21	13	6
FY10	36	34	12	12	13	12	6
FY11	29	21	13	14	14	13	6
FY12	10	6	12	13	11	12	5
FY13	52	(23)	12	12	7	10	7
FY14	41	8	12	12	9	10	7
FY15	16	(12)	11	11	5	9	7
FY16	10	13	8	9	3	6	7
CAGR	**25**	**11**	**11**	**11**	**9**	**9**	**5**

Meezan Islamic Fund – From Legend to Legacy

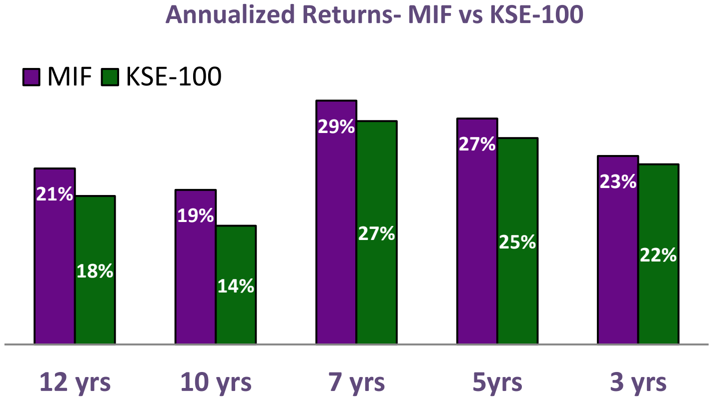
Meezan Islamic Fund (MIF) was launched in August 2003 as the first open-end mutual fund of Al Meezan. The objective of MIF is to invest in Sharia'h compliant equities while maximizing total return for investors by focusing on both capital gains and dividend income. Having completed 13 years of operations, MIF has to its credit the recognition of being the industry's largest private sector equity fund. With current Assets under Management (AUMs) of over PKR 30 Billion, MIF has accomplished remarkable performance in a short span as shown in the table.



Meezan Islamic Fund – Beating the market

Evaluating its performance, MIF has performed well not just industry's other equity funds, but its returns have outshined Pakistan's benchmark equity index of KSE-100 index. The graph to the right shows the fiscal year (FY) annualized returns of MIF vs KSE-100 as of June 30, 2016 for the past 3, 5, 7, 10, 12 years.

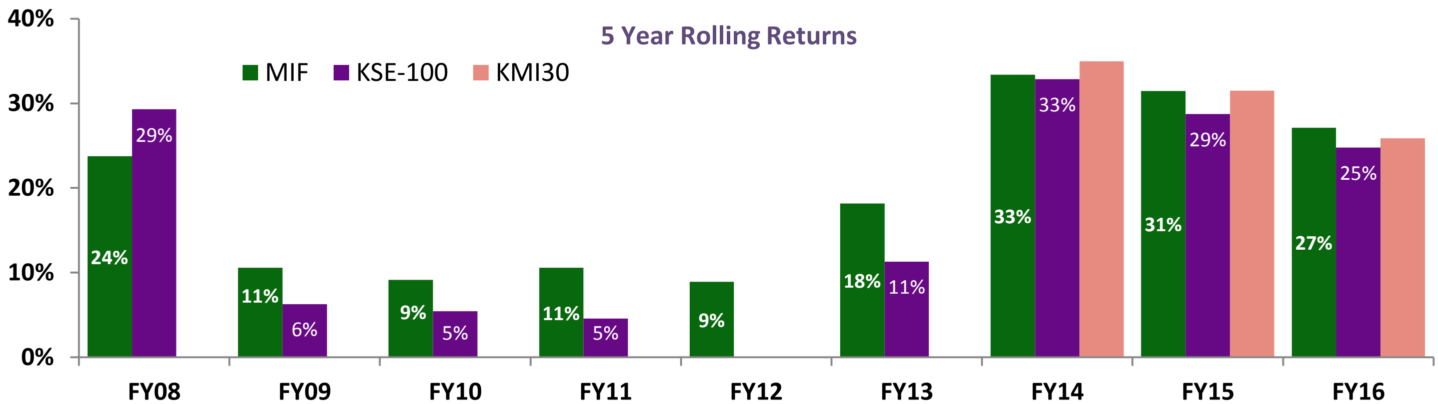
	PKR Return (%)		USD Return (%)	
	MIF	KSE-100	MIF	KSE-100
12 yrs	21	18	15	12
10 yrs	19	14	12	8
7 yrs	29	27	25	22
5 yrs	27	25	22	20



Compared to other viable investment avenues, equity has remained the desired investment avenue for many looking to invest over long time horizons and willing to withstand short to medium term volatility. It is worth noting from the chart above that MIF has consistently outperformed KSE-100 over the years.

Long term horizon – The Winning Strategy

Equity markets are usually volatile in the short run and Pakistani market even more so. This often strains the investors return potential. However, the stock market is resilient in the long run, and beats the short term volatilities. Furthermore, equity investments are subject to Capital Gains Tax (CGT), which is exempted for investors with a holding period of four years or more – Adding to the benefits of long term horizon. To justify the point made above, let's have a look at the graph below. The graph below shows five year rolling return of our fund, MIF and the local indexes. We see that the five year annual compounded return of MIF beats the return for that period of the local bourse for most of the years.



Grow your investment in Meezan Islamic Fund (MIF)

Assuming an investor made an initial investment of PKR 100,000 in MIF on the day the fund was launched in August 2013 and did not make any withdrawals, his investment would now have grown to PKR. 1,200,000 (as on June 30, 2016) earning him an annualized return of 21%. Over medium to long term, investment in equity is the best option to gain high returns. Even during less favorable market conditions, the research and fund management team at Al Meezan Investments ensures that the best equity picks are included in MIF portfolio which help it in sustaining its consistently high returns against all industry peers and available investment avenues.

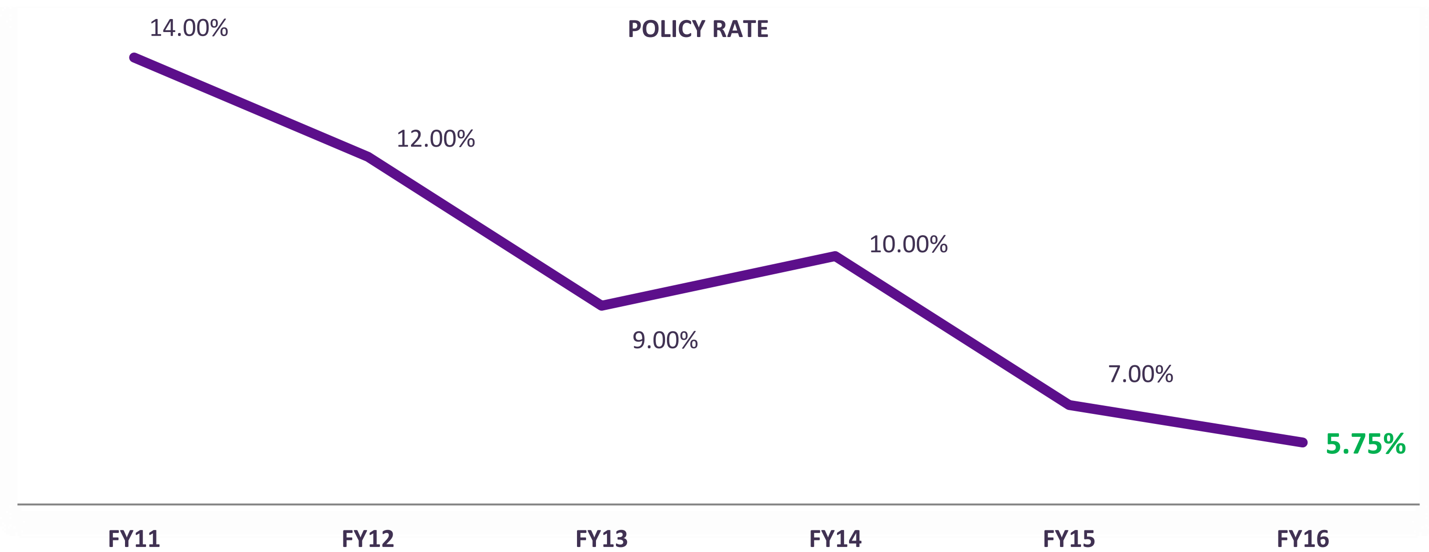
Stabilizing Interest Rates

Fixed Income: The Interest Rate Scenario!

The State Bank of Pakistan (SBP) has been continuing its monetary easing stance since 2011; consequently the discount rate (DR) has been brought down by 775 bps (more than halved), from 14% (in 2011) to 5.75% (at present). After three consecutive muted Monetary Policy Statements whereby the discount rate had been kept unchanged, the SBP surprisingly slashed the DR by another 0.25% via its last MPS which was carried out on May 21, 2016. The KIBOR and secondary market yields therefore, have also declined which is clearly reflective in the reduced returns of various fixed income investment avenues.

Considerably falling oil prices in the international market since the first quarter of FY'15 served to be a major impetus in melting the inflation and creating a wide real interest rate corridor, which coupled with other improving macroeconomic fundamentals like forex reserves at an all-time high, reduced budget deficits and improved tax collection, provided a cushion for the Central Bank to reduce the interest rates in order to stimulate the economy and increase private sector investment.

The monetary easing scenario can be observed from the below mentioned chart:



A quick review of changes in interest rates and yields over the monetary easing cycle mentioned above, can be seen in the following table:

	Before Monetary Easing (June 2011) (%)	Current Rates (June 2016) (%)	Difference from Last 5 Years (2011-2016) (%)
SBP Policy Rate	14.00	5.75	-8.25
GoP Securities			
6- Months T-Bills	13.76	6.09	-7.67
10-Year Pakistan Investment Bonds (PIBs)	14.07	7.70	-6.37
Ijarah Sukuks (3 year)	14.00	5.55	-8.45
Saving Schemes			
Special Saving Certificates - 3 years	14.00	6.80	-7.20%
Defense Saving Certificates - 10 years	13.55	7.70	-5.85
Corporate Instruments			
TFCs (AA- rated and above)	14.50	7.00	-7.50
Corporate Sukuks	15.70	6.50	-9.20
Bank Placement (AA Rated and above)	12.50	5.75	6.75

Changing expectation ahead!

In the medium term, international oil prices appear to be stabilizing due to which prospective inflation is expected to stay in check around its current low levels. Based on the low inflation, the real interest rate corridor is expected to stay intact hence interest rates are expected to stabilize around their current levels. Going forward, as the work on projects under China Pakistan Economic Corridor (CPEC) gains momentum, the foreign direct investment is expected to increase, thereby releasing the forex pressure on SBP and allowing it to maintain interest rates around current lower levels.

Hence, in the current scenario, the market appears to be concentrating around the expectation of unchanged interest rates in the upcoming bi-monthly Monetary Policy Statement.

Some respite in excess liquidity concern!

The Shariah compliant end of the money market, which has been facing an excess liquidity issue due to lack of investment avenues, experienced some respite when three fresh GoP Ijarah Sukuks (one floater and two fixed rate) of cumulative size of Rs. 314.38 billion were issued after the maturity of five GoP Ijarah (Ijarah IX to XIII), amounting to Rs. 234 billion. In addition to above, the Islamic OMOs/Bai Muajjal carried out by the Government also a played vital role in absorbing the excess liquidity of the market. However, such Islamic OMO facility is not available for mutual funds due to which Islamic income mutual funds are likely to continue facing an excess liquidity issue which is impacting the funds’ returns. Hopefully, the issuance of new Sukuks (both government and corporate) shall help the Islamic funds to deploy their excess liquidity.

As Good As GOLD!

Gold – A Unique Asset Class

Gold has traditionally been classified as an attractive investment alternative due to its distinctive characteristics. Its low correlation with other investment classes such as equities and bonds posits a strong case for portfolio diversification strategies.

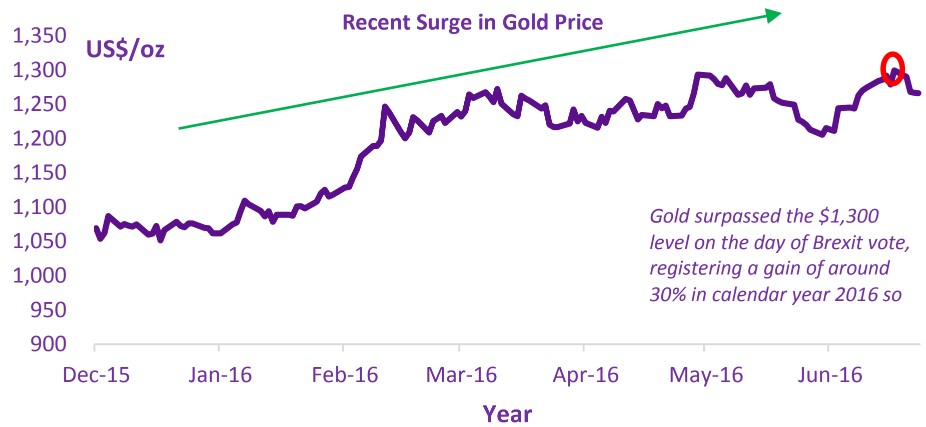
Investors' inclination towards gold has primarily been driven by the asset's wealth protection abilities. During turbulent times, gold serves as a "safe haven" by retaining its value and hedging against inflation as opposed to currencies which lose their value at the same time.

Apart from its wealth protection capabilities, gold is viewed as a long term asset in terms of savings. The general price trend of the commodity has always been northward. For this reason, many investors aim to cash in on the higher pay off on gold during their retirement years.

Saving is also triggered as a result of the social appeal of the metal. Households preserve gold for marriages of their children when it is customary to make gold jewelry. When it comes to subcontinent, demand for jewelry is unlikely to subside and given the finite supply of gold, a potential upside to its price can never be ruled out.

Leading Gains in 2016

The recent surge in gold price has proved that gold can play a pivotal role in an active investment strategy. The new calendar year has so far been promising for gold, as the asset has yielded almost 30% since the start of 2016.



Gold price has been linked to uncertainty, and the current global economic scenario is uncertain when it comes togrowth trajectory of major economies. The Federal Reserve, which recently conducted an interest rate hike, is still divided on further rate hikes due to concerns on economic growth and employment rates.

Similarly, Eurozone and Japan are holding their respective interest rate levels at record lows, causing investors to turn their attention to gold in the hope for better returns. Another factor that has aided gold recently is the recent turmoil in equity markets globally, stemming primarily out of slowdown in China. We also witnessed the recent referendum in favor for Brexit which rattled major economies of the world, causing British Pound to nosedive and gold to touch its highest level since March 2014.

Outlook

With interest rates across major economies expected to remain low and the possible adverse repercussions of Brexit already in sight, the layer of uncertainty has become increasingly thick. Amidst all this uncertainty, an opportunity is present to hedge such risk by investing in gold or avenues related to gold.

	Atlas Gold Fund	UBL Gold Fund	Meezan Gold Fund
Launch Date	July 2013	February 2013	August 2015
AUM Rs Mn (June 2016)	234	133	321

Al Meezan has provided investors with one such avenue in the form of Meezan Gold Fund (MGF). The industry's first and only Shariah compliant commodity fund provides investors a chance to take exposure to gold with an investment of as low as Rs. 5000. With its distinctive features, MGF has managed to surpass its counterparts to become the industry's largest commodity fund in just less than a year since its launch.

We strongly advise investors to capitalize on this opportunity and increase their allocation to gold. Such periodic increase in gold allocation would allow investors to secure returns that are otherwise not attainable with pure equity or fixed income investments, besides benefits of diversification.

Path Ahead

Make money on rough tides

Looking back at the first half of Year 2016; patchy times met serenity and the year fled by a swing. However, the positives fared wholesomely well for the country, which is on the track of recovery.

Entering the second half of 2016, we look back at nearly half a decade where KSE-100 index posted a return of 24% (5-year annualized return) whereas the discount rate stood at 10%. With discount rate down to single digits at 5.75%, returns on fixed income instruments have gone down. With the volatility in international markets led by anticipation of a US rate hike, weakening of commodity markets and dryness in foreign equity flows, we see returns on equity market to be around 15-18%.

2011-2015
KSE-100 return
(5yr annualized): 24%
Discount rate
(Average): 10%

Future: What to expect?
KSE-100 returns
(Medium term):15-18%
Discount rate
down to 42-year low at 5.75%

Equity - Still a bet worth taking in the long run

Why invest in Equity?

- ✓ Equities have outpaced returns on other investment classes
- ✓ History of quick recovery and reversal
- ✓ Provides high potential long-term returns

Outlook ahead

- ✓ The stock market remains resilient despite continued foreign selling
- ✓ With improving economic fundamentals, strong corporate profitability expectations, the market is expected to gain again
- ✓ In the current low interest rate environment, equities still are a good alternative for higher returns

Invest with Al-Meezan

- ✓ Our equity mutual funds which have once again shown healthy returns over calendar year 2015
- ✓ Meezan Islamic Fund (MIF) has posted a return of 15.35% CYTD 2015 (up to June 29, 2016)
- ✓ Investors with a longer-term investment horizon and low need for current income are advised to take/increase exposure to equities

Investors need to focus more on long-term plans that yield substantial returns through every boom and bust cycle. Moreover, a greater focus on research and analysis and prudent fund management aimed at reducing risk and protecting investments should be the priority. For such tailored and personalized investment advisory and allocation services, investors are advised to approach our professional investment advisors. Just dial 0800- HALAL (42525) or SMS "INVEST" to 6655, and one of our representatives will contact you promptly.