

Dear Investor,

On behalf of the Board of Directors, I am pleased to present **Pakistan Income Fund** accounts review for the quarter ended March 31, 2022.

Economy and Money Market Review

Political turmoil in the country has taken the central stage in past few weeks where we witnessed ruling party coalition government lost majority in the National Assembly and overthrown by opposition led coalition. In the backdrop of weak economic environment, the transition resulted in significant volatility in equity, fixed income and exchange rate markets. In heightened political environment, markets will increasingly focus on efforts of the new government on policies and measures taken to stabilize the economy.

The fiscal year (July – June) started on strong note with government's renewed focus on reviving growth through several incentives in fiscal year 2022 (FY22) budget to spur growth. This was in addition to lagged impact of monetary easing and incentives on capital investment at lower rates (TERF), which further supported to growth premise. However, the sharp recovery in domestic demand, coupled with rising international commodity prices, led to a strong pick-up in imports and a commensurate increase in the current account deficit. The start of Russia Ukraine conflict inflicted additional misery as international commodities prices spiked up further to multi-year high.

The country posted a current account deficit of USD 12.1bn in 8MFY22 compared to a surplus of USD 1.0bn in the corresponding period last year. This was the largest CAD since FY18, when country witnessed a deficit of USD 10.6bn in first eight months of the fiscal year. The deterioration came in primarily on the back of higher imports which grew by 49.1% in 8MFY22 compared to export growth of 28.1%. Trade Deficit increased by 70.2% to USD 27.3bn compared to USD 16.0bn in same period last year. The unprecedented increase in imports mainly came from historic high prices of our commodity basket including crude oil, palm oil, coal coupled with one time vaccines imports. As per our estimates, prices contributed more than two-third of the increase in import bill.

Foreign exchange reserves of central bank saw a decrease of USD 5.3bn on account of higher current account deficit and debt repayments. Pakistan was also unable to timely roll over commercial loan of USD 2.2bn from China which put further pressure on reserves. In addition, a USD 900mn penalty payment to settle Reko Dik case further dragged the reserves to 22 months' low of USD 11.3bn, implying an import cover of hardly a couple of months. These outflows coupled with widening current account deficit led PKR to lost ground against USD by 14.1% since start of the fiscal year.

Inflation remained a concern as rising commodities continued to create challenges for policy makers. Headline inflation represented by CPI averaged 10.7% in 9MFY22 compared to 8.4% in 9MFY21. The rise mainly came from higher food prices, elevated energy costs (both electricity and fuel) and second round impact of PKR depreciation, which keeps the prices of imported commodities high. Core inflation as measured by Non Food Non Energy also depicted an upward trend as it increased to 9.5% in March 2022 compared to 6.9% in June 2021. The SBP increased policy rate by a cumulative 525bps to 12.75% in the fiscal year to counter inflationary pressures and slow aggregate demand.

On the fiscal side FBR tax collection increased by 29.1% in 9MFY22 to PKR 4,382bn compared to PKR 3,394bn during same period last year. This exceeded the target of 4,134bn by 248bn. The improved tax collection was primarily on the back of higher custom duty and sales tax collected on import stage.

Secondary markets yields have increased significantly in 9MFY22 as SBP started the monetary tightening cycle. The recent depreciation in rupee along with persistently high commodity prices

will add pressure to inflation and we expect average inflation numbers to remain elevated in medium term. Bond yields for tenors of 3 years, 5 years and 10 years witnessed a rise of 2.4%, 2.1% and 1.4%, respectively during the period.

FUND PERFORMANCE

During the period under review, the fund generated an annualized return of 8.64% as against its benchmark return of 9.91%.

At period end, the fund was 10.1% in TFCs and 52.7% in Cash. Weighted average maturity of the fund stood at 2.0 years.

The Net Assets of the Fund as at March 31, 2022 stood at Rs. 4,922 million as compared to Rs. 9,595 million as at June 30, 2021 registering a decrease of 48.70%.

The Net Asset Value (NAV) per unit as at March 31, 2022 was Rs. 57.8041 as compared to opening NAV of Rs. 54.2828 per unit as at June 30, 2021 registering an increase of Rs. 3.5213 per unit.

Economy & Market – Future Outlook

The ongoing Russia – Ukraine war has kept international commodity prices at elevated levels which have exacerbated fears about the import bill and external outlook going forward. In addition, due to political pressure the government resorted to the populist move to absorb the hike in international energy prices and keep petroleum prices unchanged. This have undermined the structural reform process and put the IMF program on hold. Going forward the new government will have to engage with the IMF and find the right balance of growth and external account sustainability.

We estimate GDP to grow by 4.5% this year, slightly lower than the government target of 4.8%. We expect Agriculture, Industrial and Services sectors to grow by 4.5%, 4.1% and 4.5% respectively. Industrial sector growth is likely to remain robust but below government's target due to demand compression as a result of monetary tightening. Agriculture sector growth on the other hand is likely to exceed government estimates due to growth in wheat and cotton crop. The Covid vaccination roll out has been quite successful which is anticipated to unleash Services growth as this segment was the most affected by the pandemic.

The persistently elevated international commodities prices especially petroleum, palm oil, fertilizers and steel, has led to a strong pick-up in imports and a rise in the current account deficit, which we expect to close the year around USD 19.0bn (5.7% of GDP). This would be the largest current account deficit since fiscal year 2018, when the country posted CAD of USD 19.2bn (6.1% of GDP). Responding to a high CAD, we expect PKR to depreciate further to end the fiscal year near PKR 192 against a dollar.

Successful resumption of the IMF program will be a key prerequisite to keep the financial account in positive zone. The SBP is expected to continue to discourage unnecessary imports and use flexible market determined exchange rate and appropriate monetary policy setting to ensure sustainable external account position. The remittances along with bilateral and multilateral flows would also be crucial in managing our external position.

We expect Average FY22 and FY23 inflation to clock at 11.6% and 13.8% respectively assuming international oil stays above USD 100/bbl. The recent hike in commodity prices and the resultant currency depreciation is likely to keep inflation numbers elevated in near term. In the recent monetary policy held in April-22 SBP increased policy rate by 250bps to 12.25% due to significant uncertainty around outlook for international commodities and global financial condition as result of Russia Ukraine war. As per the SBP the recent rate hike increased forward looking interest rates to mildly positive territory. Thus we may be at the end of monetary tightening cycle.

From capital market perspective, particularly equities, the recent correction in stock prices have opened up valuation. The market has priced in interest rate increase and currency depreciation. Market cap to GDP ratio has declined to 13.4%, a discount of 69% from its historical average. Similarly, risk premiums are close to 6.0%, compared to historical average of 1.9% signifying deep discount at which market is trading. We believe a micro view of sectors and stock will remain important and investment selection should focus on companies which trade at a deep discount to their intrinsic value. The market is currently trading at PER of 5.7x, while offering a dividend yield of 8.3%.

For debt holders, we expect Money Market Funds to continue to seamlessly mirror policy rates throughout the year. On the other hand, government bonds yields may continue to remain at elevated levels given inflationary pressure. We remain cautious at the current levels of bond yields and would continue to monitor the data points to capitalize on opportunities.

Mutual Fund Industry Review

The Net Assets of the open end mutual fund industry increased by about 7.4% during the nine months to PKR 1,093bn. Total money market funds grew by about 11.9% since June 2021. Within the money market sphere, the conventional funds dominated with a growth of about 19.6% to PKR 341bn while Islamic funds declined by 0.2% to PKR 181bn. In addition, the total fixed Income funds increased by about 17.7% since June 2021, as the conventional income funds rose by 21.5% to PKR 153bn. Equity and related funds declined by 11.3% as market witnessed a decline in 9MFY22 eroding AUMS as concern over macroeconomic and geopolitical factors kept investors at bay.

In terms of the segment share, Money Market funds were the leader with a share of around 47.8%, followed by Income funds with a share of 26.4% and Equity and Equity related funds having a share of 24.3% as at the end of 9MFY22.

Mutual Fund Industry Outlook

The recent increase in interest rates would increase flows in the money market funds. The money markets funds by virtue of its short duration would be the ideal for investors with a short term horizon and low risk profile. However recent correction in stock prices have opened up valuations and long term investors would look to add equity exposure at these attractive levels. Our operations remained seamless and given our competitive edge due to aggressive investment in digital access and online customer experience, the environment provides an opportunity with growing number of investors available online.

ACKNOWLEDGMENT

The Board is thankful to the Fund's valued investors, the Securities and Exchange Commission of Pakistan and the Trustees of the Fund for their continued cooperation and support. The Directors also appreciate the efforts put in by the management team.

On behalf of Directors,

Muhammad Saqib Saleem
Chief Executive Officer
April 20, 2022

Nasim Beg
Director/Vice Chairman
April 20, 2022