

Portfolio overview – 30 September 2009

Needs category objective

- Anticipated expenditure to meet living or lifestyle expenses over a two to five year period.

Investment objective

- Achieve higher returns than bank deposits over the minimum investment time frame.

Key features

- Designed specifically to meet the objective of the Near Term Spending Needs category.
- Invests in a diversified range of income-producing investments, including: cash, government-guaranteed bonds and debt securities such as corporate bonds, mortgage-backed bonds and interest rate exposures.
- Ability to select assets from a global universe.

Risk management

- Utilises NZ Funds' risk management strategy to manage risks associated with changes in interest rates and credit spreads.
- Diversified to ensure clients are not unduly exposed to any one sector or type of income-producing investment.
- Portfolio construction places equal emphasis on risk management (downside protection) and generating returns.
- Portfolio manager manages individual investment risks by conducting in-depth fundamental research on each investment held.

Return enhancement

- Ability to select the most attractive assets on offer from a wider universe (not just Australasia but also the United States and Europe).
- As managers, we recognise that during some periods all investments can suffer as part of a wider market malaise. NZ Funds' risk management strategy aims to identify these periods and actively manage market exposures to seek to preserve clients' capital during these stages of the cycle.

Manager insight – 30 September 2009

The Portfolio returned 1.11%¹ for the month of September and 3.02%¹ for the year to date. The stronger performance during the month reflects the combination of tighter (ie better) credit spreads for the Portfolio's corporate credit positions and residential mortgage-backed securities. Also beneficial to the Portfolio was a move lower in fixed-term interest rates.

Investment Grade – what does this mean in practise?

This month we want to provide insight into one the terms that is commonly used in relation to corporate bonds – the classification 'investment grade'.

Investment grade is a generic term for corporations that have a credit rating from a recognised agency of BBB- or better. Companies with a credit rating of BB+ or less are considered to be 'below investment grade' or 'high yield' securities. There are many factors that determine whether a company achieves an investment-grade rating, however, one of the most important is the level of debt. The measure most often used to access this is the ratio of debt to earnings (as measured by Debt/EBITDA). There is no hard and fast rule but typically companies with a ratio of Debt/EBITDA of less than 4x are considered to be investment grade. Those with debt in excess of 4x EBITDA are considered to be below investment grade. The table opposite details the average ratio of Debt/EBITDA for investment-grade companies in the United States, grouped by sector. This shows that even within the investment-grade universe, the degree of debt can vary significantly

across sectors. Companies operating in sectors such as technology, pharmaceuticals and (United States) telecoms are on average robust businesses which operate with relatively little debt. At the other end of the spectrum are sectors such as chemicals and building materials which have much higher levels of Debt/EBITDA. As a result, the companies in these sectors are more at risk of having their ratings downgraded from investment grade to below investment grade.

This is one of the reasons NZ Funds has chosen to have significant holdings in corporate bonds issued by companies that operate in the telecoms, pharmaceuticals and technology sectors and has avoided any exposure to the chemical or building materials sectors.

Sector	Debt / EBITDA
Chemicals	4.4x
Utilities	3.7x
Building materials	3.4x
Food & beverage	3.1x
Telecoms - non US	2.9x
Paper & packaging	2.8x
Food, drug & retail	2.7x
Cable, TV & media	2.6x
Non-food retail	2.0x
Consumer products	2.0x
Metals & mining	1.9x
Telecoms - US	1.9x
Pharmaceuticals	1.7x
Capital goods & manufacturing	1.5x
Energy	1.2x
Technology	1.1x

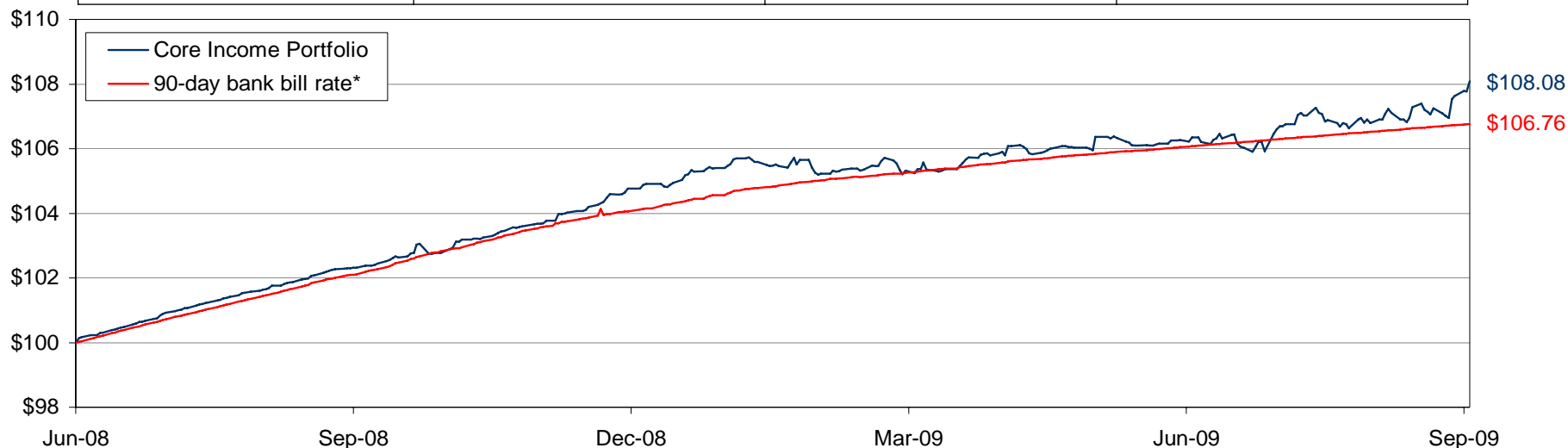
Source: JP Morgan

¹ Returns are stated after Portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns.

Core Income Portfolio

Performance since 25 June 2008 to 30 September 2009

Performance attribution	1 month	3 month	6 month
Positive	US interest rates and credit	Credit; interest rate hedge	Credit
Neutral	Cash	Cash	Cash
Negative	NZ interest rates	Medium-term interest rates	NZ interest rate hedging



Period	1 month	3 month	6 month	1 year	2 year pa	Since inception of strategy pa
Portfolio	1.11%	1.63%	2.58%	5.56%	-	6.33%

*Source: Bloomberg. 90-day bank bill rate adjusted for assumed portfolio management fee of 0.20% pa. Returns are stated after Portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns. Strategy implemented on 25 June 2008.

Core Income Portfolio



Portfolio summary as at 30 September 2009

Portfolio summary

Number of securities	40*
Weighted average credit spread duration (yrs)	2.7
Weighted average interest rate duration (yrs)	2.5
Weighted average running yield (approximately)	5.1%**
Weighted average credit rating	AA-

Sector	Portfolio value	Proportion of portfolio	Maturity date / Expected average life date	S&P rating	Yield to maturity***
Bank deposits / Bank bills	\$4,857,282	8.3%	Oct-09	A1+	2.6%
New Zealand / Australian corporate bonds	\$12,383,859	21.1%	Oct-13	A-	6.5%
Global corporate bonds	\$10,120,244	17.3%	Sep-15	A-	7.1%
Government / Government-guaranteed bonds	\$24,432,230	41.7%	Jul-16	AAA	5.1%
Residential mortgages	\$5,483,020	9.3%	Jun-11	AA	12.0%
Loans	\$1,374,809	2.3%	-	NR	7.8%
Total	\$58,651,443	100.0%			

Interest rate swaps, notional value ~ \$19.5m.

*The Portfolio often holds more than one security under a given issuer. The 'number of securities' takes this into account. **The weighted average running yield is stated after the deduction of management, custodial and trustee fees. The running yield is not the actual return of the Portfolio, nor is it a projection or forecast. Rather, it is an estimate of the pre-tax income stream generated from investing in the Portfolio. The Portfolio return consists of yield and capital gains and losses. Therefore, the Portfolio's return could be less than the Portfolio's yield. Details of the yield calculation are available on request from NZ Funds. ***The yield to maturity is stated before the deduction of management, custodial and trustee fees.

Core Income Portfolio



Complete portfolio as at 30 September 2009 (Part 1)

Portfolio summary

Number of securities	40 ¹
Weighted average credit spread duration (yrs)	2.7
Weighted average interest rate duration (yrs)	2.5
Weighted average running yield (approximately)	5.1% ²
Weighted average credit rating	AA-

Sector / Security	Portfolio value	Proportion of portfolio	Maturity date / Expected average life date	S&P rating	Yield to maturity ³
Bank deposits / Bank bills		8.3%			2.6%
Westpac (Bank deposits) ⁴	\$3,338,207	5.7%	Current	A1+	2.5%
ANZ (Bank bills)	\$377,410	0.6%	Oct-09	A1+	2.7%
Westpac (Bank bills)	\$306,645	0.5%	Oct-09	A1+	2.7%
Kiwibank (Bank bills)	\$306,645	0.5%	Oct-09	A1+	2.7%
ASB (Bank bills)	\$268,904	0.5%	Oct-09	A1+	2.7%
BNZ (Bank bills)	\$259,469	0.4%	Oct-09	A1+	2.7%
New Zealand / Australian corporate bonds		21.1%			6.5%
Fonterra	\$2,789,403	4.8%	Mar-15	A+	7.1%
Woolworths	\$2,608,488	4.4%	Nov-11	A-	5.8%
Telstra Corporation	\$2,249,275	3.8%	Nov-12	A	5.8%
Vector	\$2,204,972	3.8%	Oct-14	BBB	7.4%
Watercare	\$1,442,818	2.5%	May-14	AA	6.8%
Bank of New Zealand	\$1,088,904	1.9%	Mar-14	AA	6.5%

¹The Portfolio often holds more than one security under a given issuer. The 'number of securities' takes this into account. ²The running yield is stated after the deduction of management, custodial and trustee fees. The running yield is not the actual return of the fund, nor is it a projection or forecast. Rather, it is an estimate of the pre-tax income stream generated from investing in the Portfolio. The Portfolio return consists of yield and capital gains and losses. Therefore, the Portfolio's return could be less than the Portfolio's yield. Details of the yield calculation are available on request from NZ Funds. ³The yield to maturity is stated before the deduction of management, custodial and trustee fees. ⁴Bank deposits includes cash and FX assets. Note: Rounding may affect the subtotals and totals.

Core Income Portfolio



Complete portfolio as at 30 September 2009 (Part 2)

Sector / Security	Portfolio value	Proportion of portfolio	Maturity date / Expected average life date	S&P rating	Yield to maturity ³
Global corporate bonds		17.3%			7.1%
Vodafone	\$2,639,879	4.5%	Jan-13	BBB+	6.1%
Citigroup	\$1,406,641	2.4%	May-12	A-	8.9%
Pepsico	\$1,264,641	2.2%	Nov-18	AA	6.9%
Pfizer	\$1,132,749	1.9%	Mar-19	AA	7.0%
Telecom Italia	\$1,058,409	1.8%	Oct-15	BBB	6.7%
Time Warner Cable	\$914,552	1.6%	Apr-19	BBB	7.9%
AT&T Inc	\$752,637	1.3%	Feb-19	A	8.3%
CME Group	\$551,362	0.9%	Feb-14	AA-	5.8%
Merrill Lynch	\$399,373	0.7%	Apr-13	A	6.9%
Government / Government-guaranteed bonds		41.7%			5.1%
US Treasury	\$12,019,749	20.5%	May-20	AAA	5.5%
Westpac	\$5,180,751	8.8%	Jan-12	AAA	4.2%
Commonwealth Bank of Australia	\$3,499,844	6.0%	Dec-13	AAA	5.3%
BNZ	\$1,711,574	2.9%	Feb-14	AAA	6.1%
ANZ	\$1,009,698	1.7%	Dec-10	AAA	3.7%
National Australia Bank	\$1,010,613	1.7%	Jan-12	AAA	4.8%
Residential mortgages		9.3%			12.0%
AMSNZ mortgage security (various issues) ⁵	\$4,261,917	7.3%	May-10 to Mar-11	AA- to AAA	11.7%
Sapphire New Zealand mortgage security (various issues)	\$1,221,103	2.1%	Jan-12 to Jun-14	AA	13.0%
Loans		2.3%			7.8%
Private Loan Trust (Fidelity - 32 current loans)	\$1,374,809	2.3%	-	NR	7.8%
Total	\$58,651,443	100.0%			

Interest rate swaps, notional value ~ \$19.5m.

³The yield to maturity is stated before the deduction of management, custodial and trustee fees. ⁵Originated and serviced by AMSNZ, a subsidiary of GE Capital. Note: Rounding may affect the subtotals and totals.

For further information or to request a copy of the relevant Investment Statement, please contact New Zealand Funds Management Limited.

Past performance is not necessarily an indication of future returns.

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