Core Income Portfolio

NZFUNDS

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.

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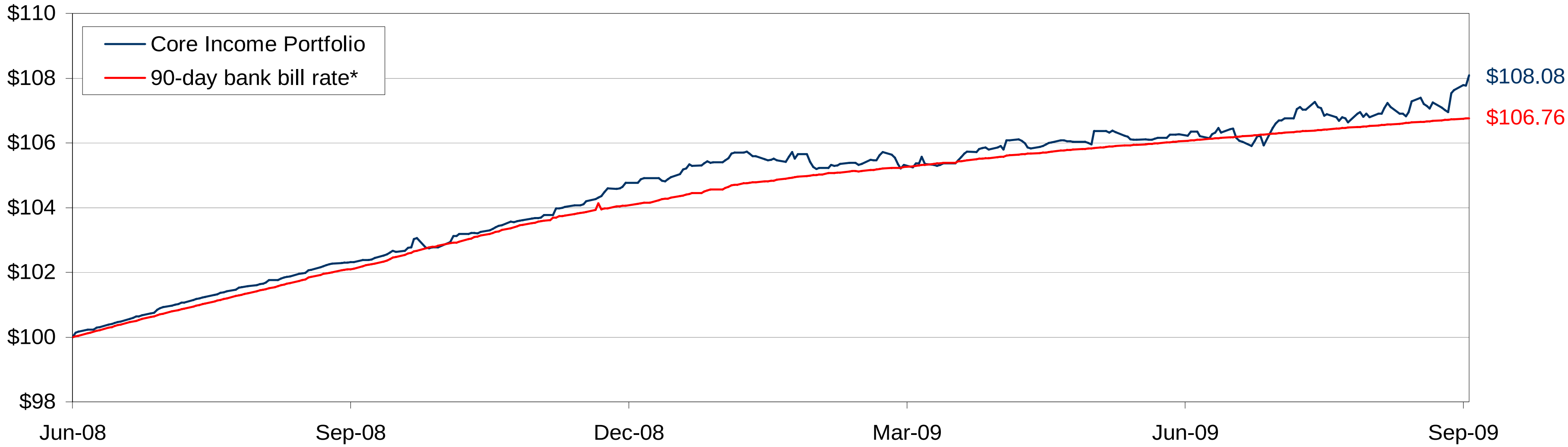
Performance since 25 June 2008 to 30 September 2009

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.

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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

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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%

[1]The Portfolio often holds more than one security under a given issuer. The 'number of securities' takes this into account. [2]The 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. [3]The yield to maturity is stated before the deduction of management, custodial and trustee fees. [4]Bank deposits includes cash and FX assets. Note: Rounding may affect the subtotals and totals.

Core Income Portfolio

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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.

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

Notes

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.