

Portfolio overview – 31 July 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 – 31 July 2009

When investment managers talk about defensive companies they are usually referring to those that produce everyday essentials – companies such as Kraft (the maker of Vegemite), Pepsi or Woolworths. These businesses enjoy very stable earnings as no matter what happens to the economy, people will continue to eat and buy the everyday necessities that these companies provide. Additionally, many of these kinds of companies have diversified international exposures – so if things are bad in New Zealand or Australia, their other operations will pick up the slack.

To this list of traditional, defensive sectors NZ Funds also adds the bonds issued by blue-chip technology companies. This may seem an unusual choice given the experiences of the dot-com bubble and the resulting tech crash in 2000/2001. However, since that time the technology industry has experienced years of consolidation and the number of companies has halved. This consolidation has three important implications for bond investors.

First, the companies that remain are no longer one-product businesses. They are large, financially secure businesses providing diversified technology solutions across sectors such as financial management, procurement, project management, human resources, supply chain automation and customer relationship management.

Second, companies such as Kraft or Woolworths now use (information) technology as a core component of their businesses because it enables operating models that are much leaner and more responsive. This has shifted technology spending to a need rather than a want.

Finally, the combination of these two factors has resulted in the industry charging structure moving to a software license model where ongoing payments (rents) are required. This license structure, combined with the fact that their software is embedded at the heart of businesses, means that cash flows are generally stable and predictable.

For this reason the Portfolio has more than 10% of its corporate bond exposure allocated to technology companies such as the ones below:

Bond Insight: Technology sector bonds

Oracle (rated A) – Oracle is one of the world's largest software businesses and is a provider of large-scale database solutions. 50% of the company's US\$22 billion in revenue is generated from software licenses (rental payments). Just as importantly, the gross margin on these rental payments is approximately 90%.

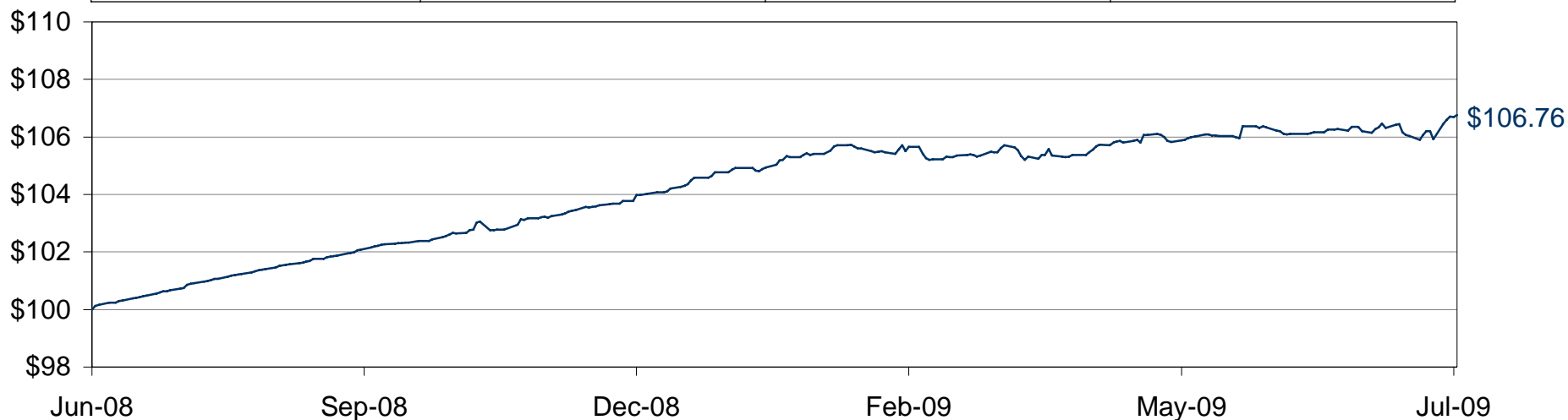
IBM (rated A+) – IBM is a truly global business with clients in 170 countries and a workforce of 380,000 people. In 2008 the business generated US\$18 billion in cash (after operating expenses), it held US\$13 billion in cash and had net debt of US\$21 billion.

Microsoft (rated AAA) – This is a company that needs little introduction as its products are a daily feature in our lives. Until recently, Microsoft debt was not available as they had no borrowings. At the end of 2008 the company raised US\$3.75 billion of debt – an amount which is dwarfed by the US\$31 billion of cash and short-term investments on the company's balance sheet.

Core Income Portfolio

Performance since 25 June 2008 to 31 July 2009

Performance attribution	One month	Three month	Six month
Positive	Corporate credit spreads	Credit; interest rate hedge	Interest rates
Neutral	n/a	Cash	Cash
Negative	Interest rate hedge	Medium-term interest rates	n/a



One-month return	Three-month return	Six-month return	1-year return	Since inception of strategy pa
0.38%	0.64%	0.99%	5.63%	6.13%

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 31 July 2009

Portfolio summary

Number of securities	53*
Weighted average running yield (approximately)	5.8%**
Weighted average credit rating	A

Sector	Portfolio value	Proportion of portfolio	Maturity date / Expected average life date	S&P rating	Yield to maturity***
Bank deposits / Bank bills	\$5,435,422	9.4%	Sep-09	A1+	3.5%
New Zealand / Australian corporate bonds	\$12,321,519	21.2%	Oct-13	A-	7.1%
Global corporate bonds	\$20,890,843	35.9%	Jun-18	A-	7.4%
New Zealand / Australian government-guaranteed bonds	\$12,982,624	22.3%	Nov-12	AAA	5.0%
Residential mortgages	\$5,119,569	8.8%	Jun-11	AA	12.2%
Loans	\$1,374,925	2.4%	-	NR	7.5%
Total	\$58,124,903	100.0%			

Interest rate swaps, notional value ~ \$19m.

*The Portfolio often holds more than one security under a given issuer. The 'number of securities' takes this into account. **The 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. ***The yield to maturity is stated before the deduction of management, custodial and trustee fees.

Core Income Portfolio

Complete portfolio as at 31 July 2009

Portfolio summary						
Number of securities	54*					
Weighted average running yield (approximately)	5.7%**					
Weighted average credit rating	A					
Sector / Security	Portfolio value	Proportion of portfolio	Maturity date / Expected average life date	S&P rating	Yield to maturity***	
Bank deposits / Bank bills		9.4%				
Westpac (Bank deposits)****	\$1,305,770	2.2%	Current	A1+	2.5%	
ANZ (Bank bills)	\$945,278	1.6%	Oct-09	A1+	2.9%	
Westpac (Bank bills)	\$944,510	1.6%	Oct-09	A1+	2.9%	
ASB (Bank bills)	\$915,246	1.6%	Oct-09	A1+	2.9%	
BNZ (Bank bills)	\$677,248	1.2%	Sep-09	A1+	2.9%	
Kiwibank (Bank bills)	\$647,369	1.1%	Sep-09	A1+	2.9%	
New Zealand / Australian corporate bonds		21.2%				
Woolworths	\$2,771,757	4.9%	Nov-11	A-	6.5%	
Fonterra	\$2,705,116	4.7%	Mar-15	A+	7.4%	
Telstra Corporation	\$2,210,591	3.8%	Nov-12	A	7.2%	
Vector	\$2,176,786	3.7%	Oct-14	BBB	7.3%	
Watercare	\$1,399,328	2.4%	May-14	AA	7.1%	
Bank of New Zealand	\$1,057,942	1.8%	Mar-14	AA	6.8%	
Global corporate bonds		35.9%				
Vodafone	\$2,629,831	4.5%	Jan-13	BBB+	6.9%	
Oracle Corp	\$1,431,515	2.5%	Jul-19	A	7.0%	
Citigroup	\$1,363,423	2.3%	May-12	A-	9.4%	
McDonalds	\$1,217,621	2.1%	Feb-39	A-	7.9%	
Kraft Foods	\$1,133,828	2.0%	Nov-11	BBB	5.8%	
Pfizer	\$1,035,990	1.8%	Mar-39	AA	8.0%	
IBM Corp	\$995,056	1.7%	Oct-18	A+	6.9%	
Time Warner Cable	\$966,469	1.7%	Apr-19	BBB	8.0%	
EDF SA	\$921,745	1.6%	Jan-16	AA-	6.4%	
AT&T Inc	\$865,352	1.5%	Feb-19	A	7.3%	
GlaxoSmithKline PLC	\$862,577	1.5%	May-18	A+	7.1%	
Comcast	\$848,312	1.5%	May-18	BBB+	7.4%	
Shell International	\$845,521	1.5%	Mar-14	AA+	5.4%	
Goldman Sachs	\$843,039	1.5%	Apr-18	A+	7.9%	
Microsoft Corp	\$809,415	1.4%	Jun-19	AAA	6.6%	
Fiserv	\$742,856	1.3%	Nov-12	BBB	6.7%	
Merrill Lynch	\$704,921	1.2%	Apr-18	A	9.2%	
CME Group	\$589,889	1.0%	Feb-14	AA-	5.9%	
Mozaic	\$566,844	1.0%	Dec-16	BBB-	9.1%	
Simon Property Group^	\$543,951	0.9%	Mar-12	A-	6.8%	
Computer Associates Inc	\$533,667	0.9%	Dec-14	BBB-	8.8%	
Bank of America	\$439,019	0.8%	Oct-16	A	8.4%	
New Zealand / Australian government guaranteed bonds		22.3%				
Westpac	\$5,571,968	9.6%	May-12	AAA	4.7%	
Commonwealth Bank of Australia	\$3,547,421	6.1%	Dec-13	AAA	5.5%	
BNZ	\$1,686,693	2.9%	Feb-14	AAA	6.0%	
ANZ	\$1,092,609	1.9%	Dec-10	AAA	3.6%	
National Australia Bank	\$1,083,932	1.9%	Jan-12	AAA	4.9%	
Residential mortgages		8.8%				
AMSNZ mortgage security (various issues)****	\$3,898,083	6.7%	May-10 to Mar-11	AA- to AAA	12.0%	
Sapphire New Zealand mortgage security (various issues)	\$1,221,486	2.1%	Jan-12 to Apr-14	AA	13.0%	
Loans		2.4%				
Private Loan Trust (Fidelity - 32 current loans)	\$1,374,925	2.4%	-	NR	7.5%	
Total	\$58,124,903	100.0%				

Interest rate swaps, notional value – \$19m.

*The Portfolio often holds more than one security under a given issuer. The 'number of securities' takes this into account. **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. ***The yield to maturity is stated before the deduction of management, custodial and trustee fees. ****Bank deposits includes cash and FX assets. *****Originated and serviced by AMSNZ, a subsidiary of GE Capital. ^This security has been purchased but not settled into the Portfolio. 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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