

Manager insight – 31 October 2009

The Portfolio returned -0.23%¹ for the month of October and 2.79%¹ for the year to date. This small negative performance is primarily due to US 10-year interest rates moving higher during October.

Last month's 'Manager insight' discussed the issue of leverage and how it relates to an organisation's credit rating. Leverage can also help us assess credit worthiness when an organisation does not have a credit rating. A good example is the University of Canterbury bond that is currently being marketed.

Bond insight: University of Canterbury

The University of Canterbury has around 15,000 full-time students and 2,000 staff. In this year's Times Higher Education World Rankings the university was ranked in the world's top 200. In order to maintain and improve the quality of its research and education standards, the university is planning a substantial capital expenditure programme. In general, universities in New Zealand manage their capital expenditure requirements out of their annual Crown funding. Crown funding alone is not enough for the University of Canterbury to finance its planned capital expenditure programme. With the approval of the government's tertiary education monitoring agency, the Tertiary Education Commission, the university is seeking to raise up to \$100m by issuing bonds to the public.

The University of Canterbury has decided not to obtain a credit rating from a rating agency. Therefore it is up to individual investors to make an assessment of the university's ability to repay its debt. By looking at

some key credit metrics, it quickly becomes apparent that the university is well placed to service additional debt.

It is currently very lowly levered – its debt is less than 1x EBITDA, significantly less than the '4x or below' that is generally considered to be investment grade. As well as low leverage, other factors suggest that the university is of investment-grade quality. It has substantial, stable cash flows and a significant degree of government funding. In 2008, almost 50% of the university's funding came from the government. This substantial cash flow, in combination with the low leverage, means that the university has ample ability to meet the interest payments on its debt (interest cover is 60x). NZ Funds plans to add these bonds to the Portfolio.

	2008	2007
Key financials		
Total revenue	\$272m	\$258m
Net surplus	\$15.6m	\$13.9m
Total assets	\$797m	\$765m
Liquidity		
Net surplus/revenue	5.7%	5.4%
Interest cover	60.1x	64.2x
Leverage		
Debt/debt + equity	1.2%	1.4%
Debt/EBITDA	0.21x	0.25x

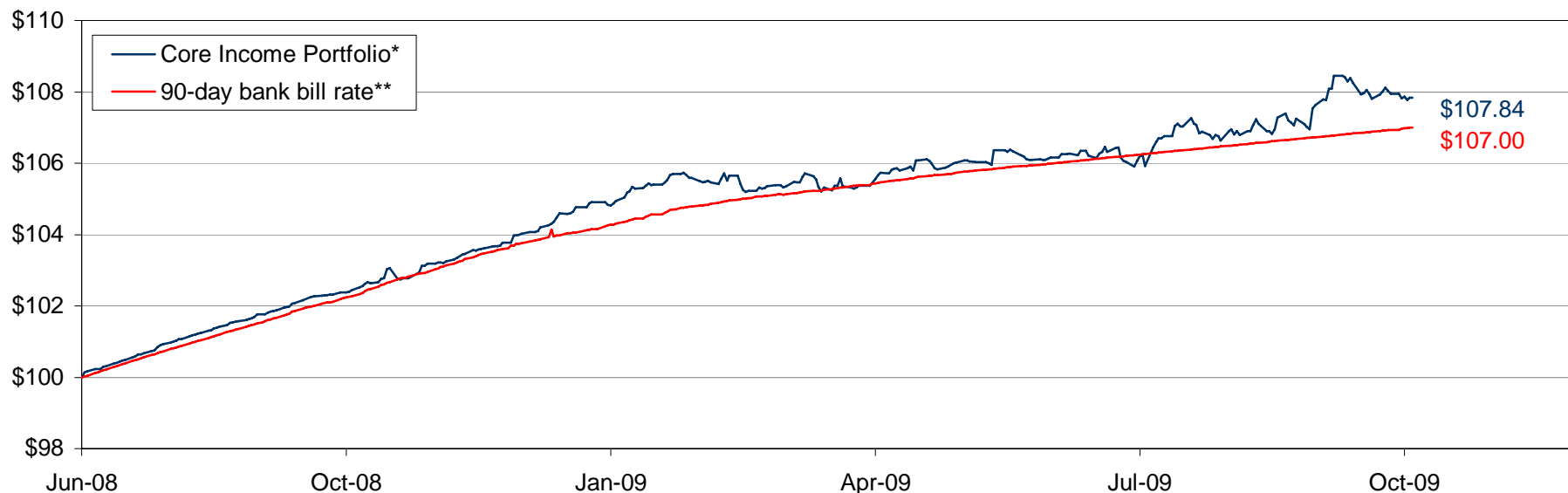
Source: University of Canterbury.

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 31 October 2009 (Part 1)

CIP performance attribution	1 month	3 month	6 month
Positive	NZ/Australian credit	Credit; interest rate hedge	Credit
Neutral	US credits; NZ rates	Cash	Cash
Negative	US interest rates	Medium-term interest rates	NZ interest rate hedging



Comparison	1 month	3 month	6 month	1 year	2 year pa	5 year pa	7 year pa	Since strategy inception pa	Maximum drawdownx
Portfolio*	-0.23%	1.02%	1.67%	4.51%	-	-	-	5.75%	-0.64%
90-day bank bill rate**	0.22%	0.65%	1.32%	3.94%	-	-	-	5.14%	-0.18%

IMPORTANT: Please refer to the slide that follows for the footnotes relating to this slide.

Performance since 25 June 2008 to 31 October 2009 (Part 2)

Core Income Portfolio

- * 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.

Comparative index

- ** The comparative index is based on the 90-day bank bill rate (sourced from Bloomberg). A fee of 0.20% pa has been deducted from the published rate to reflect the fact that bank bills are usually accessed by retail investors through a managed fund. The returns from this index should be higher than the returns from the NZX Call Index over longer periods of time.

Maximum drawdown

- x Returns should be looked at in conjunction with the level of risk associated with an investment. For this reason, we have included the 'maximum drawdown' for both the Portfolio and the comparison. Maximum drawdown is a measure of volatility and represents the largest cumulative decline experienced during the reporting period.

Core Income Portfolio

Portfolio summary as at 31 October 2009

Portfolio summary

Number of securities	45 ¹
Weighted average credit spread duration (yrs)	1.8
Weighted average interest rate duration (yrs)	2.6
Yield (approximately)	4.9% ²
Weighted average credit rating	AA-

Sector	Portfolio value	Proportion of portfolio	Maturity date / Expected average life date	S&P rating	Yield to maturity ³
Bank deposits / Bank bills	\$4,770,179	8.2%	Oct-09	A1+	2.5%
New Zealand / Australian corporate bonds	\$12,340,348	21.2%	Oct-13	A-	6.6%
Global corporate bonds	\$4,074,312	7.0%	Oct-12	BBB+	7.0%
Government / Government-guaranteed bonds	\$29,800,703	51.2%	Oct-16	AAA	5.2%
Residential mortgages	\$5,584,050	9.6%	Jun-11	AA	10.0%
Loans	\$1,375,098	2.4%	-	NR	7.3%
Debt strategies	\$306,414	0.5%			
Total	\$58,251,103	100.0%			

Interest rate swaps, notional value ~ \$19.7m. Futures notional value ~ \$15.1m

¹ The Portfolio often holds more than one security under a given issuer. The 'number of securities' takes this into account. ² The yield is stated after the deduction of management, custodial and trustee fees. The 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 (also calculated on a pre-tax and fees basis). 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. Note: Rounding may affect the subtotals and totals.

Core Income Portfolio

Complete portfolio as at 31 October 2009 (Part 1)

Portfolio summary

Number of securities	45 ¹
Weighted average credit spread duration (yrs)	1.8
Weighted average interest rate duration (yrs)	2.6
Yield (approximately)	4.9% 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		8.2%			2.5%
Westpac (Bank deposits) ⁴	\$4,325,739	7.4%	Current	A1+	2.5%
ANZ (Bank bills)	\$126,835	0.2%	Nov-09	A1+	2.9%
Kiwibank (Bank bills)	\$111,162	0.2%	Nov-09	A1+	2.8%
ASB (Bank bills)	\$111,162	0.2%	Nov-09	A1+	2.8%
BNZ (Bank bills)	\$95,281	0.2%	Nov-09	A1+	2.8%
New Zealand / Australian corporate bonds		21.2%			6.6%
Fonterra	\$2,766,347	4.7%	Mar-15	A+	7.2%
Woolworths	\$2,592,464	4.5%	Nov-11	A-	5.7%
Telstra Corporation	\$2,277,390	3.9%	Nov-12	A	5.6%
Vector	\$2,188,879	3.8%	Oct-14	BBB	7.5%
Watercare	\$1,433,498	2.5%	May-14	AA	6.9%
Bank of New Zealand	\$1,081,770	1.9%	Mar-14	AA	6.7%

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Core Income Portfolio

Complete portfolio as at 31 October 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		7.0%			7.0%
Vodafone	\$2,673,391	4.6%	Jan-13	BBB+	5.9%
Citigroup	\$1,400,921	2.4%	May-12	A-	9.1%
Government / Government-guaranteed bonds		51.2%			5.2%
US Treasury	\$17,379,692	29.8%	Sep-19	AAA	5.6%
Westpac	\$5,150,424	8.8%	Jan-12	AAA	4.1%
Commonwealth Bank of Australia	\$3,559,597	6.1%	Dec-13	AAA	4.9%
BNZ	\$1,702,034	2.9%	Feb-14	AAA	6.3%
National Australia Bank	\$1,005,665	1.7%	Jan-12	AAA	4.7%
ANZ	\$1,003,290	1.7%	Dec-10	AAA	3.6%
Residential mortgages		9.6%			10.0%
AMSNZ mortgage security (various issues) ⁵	\$4,294,328	7.4%	May-10 to Mar-11	AA- to AAA	9.0%
Sapphire New Zealand mortgage security (various issues)	\$1,289,722	2.2%	Jan-12 to Jun-14	AA	13.6%
Loans		2.4%			7.3%
Private Loan Trust (Fidelity - 32 current loans)	\$1,375,098	2.4%	-	NR	7.3%
Debt Strategies		0.5%			
Interest rate swaps	\$396,125	0.7%			
Futures	-\$89,711	-0.2%			
Total	\$58,251,103	100.0%			

Interest rate swaps, notional value ~ \$19.7m. Futures notional value ~ \$15.1m

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.

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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