

Manager insight – 31 December 2009

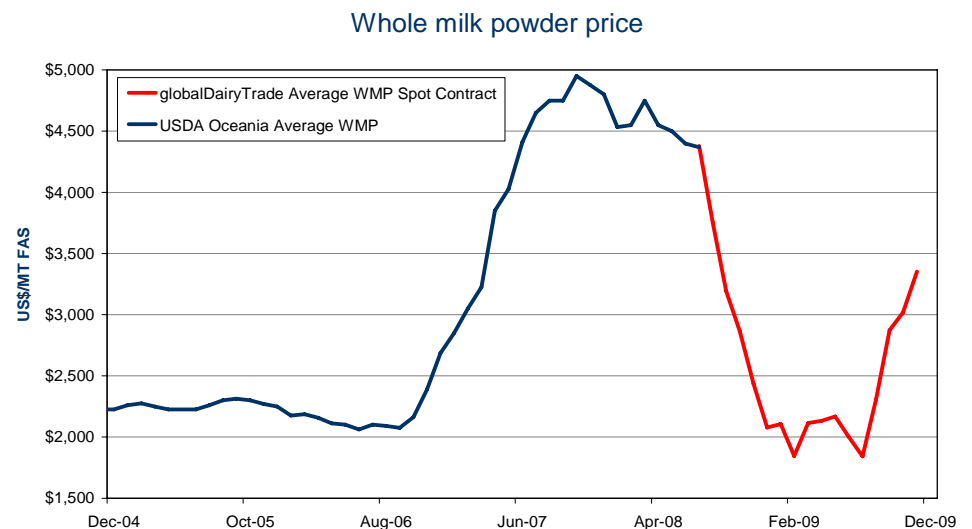
Bond insight: Fonterra

One of the key positions in the Portfolio is the Fonterra March 2015 bond. Given the recent strong performance of Fonterra's milk powder auctions, we thought it timely to provide an update. The Fonterra Group is the world's largest dairy exporter and is responsible for around one quarter of New Zealand's export earnings. Fonterra is the world's largest seller of globally traded dairy commodities and accounts for 40% of international dairy trade. As a co-operative, Fonterra is owned by the 10,500 dairy farmers that supply Fonterra with milk.

In the past few years Fonterra has experienced the extremes of the commodity cycle. As the accompanying chart shows, whole milk prices enjoyed a bull market run throughout 2007. Between September 2006 and their peak in October 2007, prices grew 139%. As the world fell into recession, dairy prices gave up all of these gains. By December 2008, prices were back to pre 2007 levels and the milk payout forecast was grim. In recent months, however, whole milk prices have grown strongly, reflecting increased confidence in the global economy. This has enabled Fonterra to increase its forecast payout to farmers to \$6.05 per kilogram of milk solids (kg/MS) for the 2009/10 season, a 33% increase on the initial forecast of \$4.55 kg/MS.

Volatility in prices is generally viewed as a negative as there is less certainty around the company's cash flows and profitability. However, Fonterra is better equipped than most to handle such volatility. This is because Fonterra sets the price it pays farmers for milk after determining its costs for the year. This is very positive for bondholders, as interest and principal payments rank ahead of payments to farmers.

The ability to set the payment to farmers provides Fonterra with a high degree of financial flexibility and underpins its strong credit rating (rated A+ by S&P and AA- by Fitch). This financial flexibility was well illustrated over the past financial year. Despite the difficult conditions, Fonterra was able to reduce its leverage from 58% as at 31 July 2008 to 52% as at 31 July 2009. Fonterra has plans for further reductions in leverage following recently approved changes to its capital structure. Farmers will be able to invest additional capital in Fonterra as they will now be able to hold shares valued at up to 120% of their milk production. A higher proportion of equity is always good news for existing bondholders who, at current prices, are enjoying a yield of 7.1% .



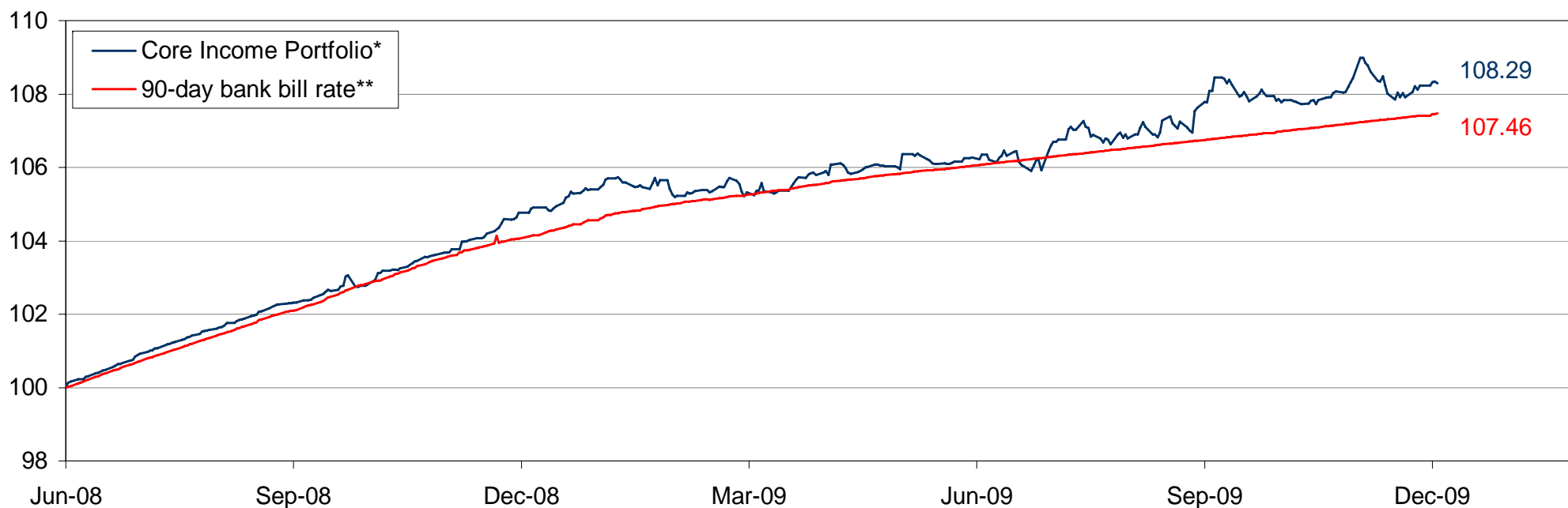
Source: USDA International Dairy Market News, globalDairyTrade.

Core Income Portfolio



Performance since 25 June 2008 to 31 December 2009 (Part 1)

CIP performance attribution	1 month	3 month	6 month
Positive	US corporate bonds; int. rate hedging	Credit; interest rate hedging	Credit; interest rate hedging
Neutral	NZ corporate bonds	NZ & Australian interest rates	Cash
Negative	NZ & US interest rates	US interest rates	Interest rates



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*	-0.64%	0.18%	1.81%	3.21%	-	-	-	5.38%	-1.06%
90-day bank bill rate**	0.22%	0.66%	1.31%	3.19%	-	-	-	4.86%	-0.18%

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

Performance since 25 June 2008 to 31 December 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

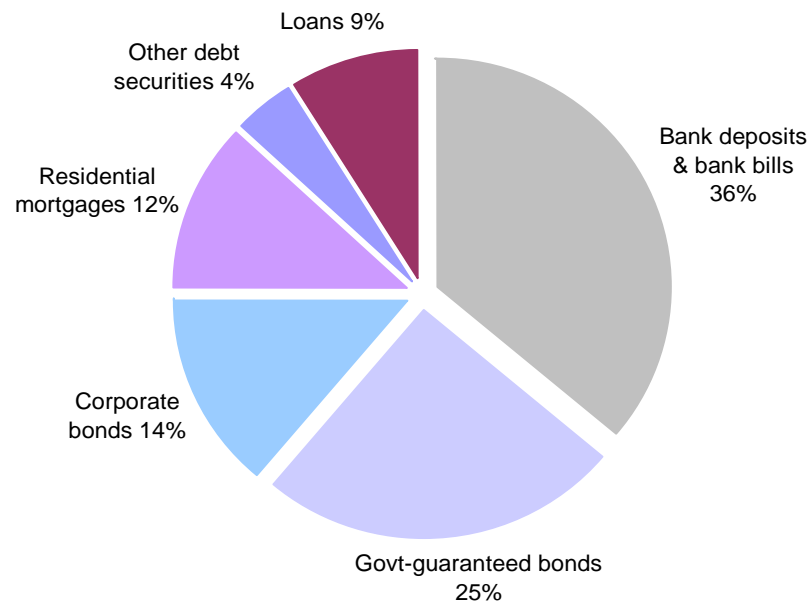
- ** The comparative index is based on the 90-day bank bill rate (sourced from Bloomberg). A fee of 0.20% pa has been deducted from the published rate to reflect the fact that bank bills are usually accessed by retail investors through a managed fund. The returns from this index should be higher than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

Maximum drawdown

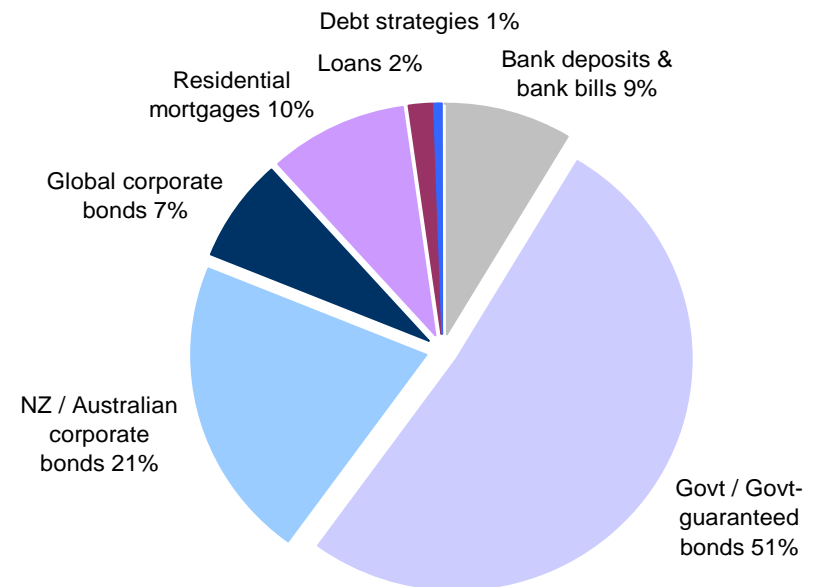
- x Returns should be looked at in conjunction with the level of risk associated with an investment. For this reason, we have included the 'maximum drawdown' for both the Portfolio and the comparison. Maximum drawdown is a measure of volatility and represents the largest cumulative decline experienced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

Asset allocations

January 2009



November 2009



Core Income Portfolio



Portfolio summary as at 26 November 2009

Portfolio summary

Number of securities	38 ¹
Yield	4.8% ²
Weighted average credit rating	AA-
Weighted average credit spread duration	1.8 years
Weighted average interest rate duration	3.8 years

Sector	Portfolio value	Proportion of portfolio	Expected maturity	S&P rating	Yield to maturity ³
Bank deposits / Bank bills	\$5,041,799	8.6%	Nov-09	A1+	2.5%
New Zealand / Australian corporate bonds	\$12,495,401	21.2%	Oct-13	A-	6.3%
Global corporate bonds	\$4,181,986	7.1%	Oct-12	BBB+	6.6%
Government/Government-guaranteed bonds	\$30,204,898	51.3%	Oct-16	AAA	5.0%
Residential mortgages	\$5,606,840	9.5%	Jun-11	AA	10.3%
Loans	\$1,027,422	1.7%	-	NR	7.3%
Debt strategies	\$358,633	0.6%			
Total economic exposure	\$58,916,980	100.0%			

Interest rate swaps, notional value ~ \$18m.

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 26 November 2009 (Part 1)

Portfolio summary

Number of securities	38 ¹
Yield	4.8% ²
Weighted average credit rating	AA-
Weighted average credit spread duration	1.8 years
Weighted average interest rate duration	3.8 years

Sector / Security	Portfolio value	Proportion of portfolio	Expected maturity	S&P rating	Yield to maturity ³
Bank deposits / Bank bills		8.6%			2.5%
Westpac (Bank deposits) ⁴	\$4,431,177	7.5%	Current	A1+	2.5%
BNZ (Bank bills)	\$155,973	0.3%	Dec-09	A1+	2.7%
Kiwibank (Bank bills)	\$155,973	0.3%	Dec-09	A1+	2.7%
ANZ (Bank bills)	\$155,701	0.3%	Dec-09	A1+	2.8%
ASB (Bank bills)	\$142,975	0.2%	Dec-09	A1+	2.7%
New Zealand / Australian corporate bonds		21.2%			6.3%
Fonterra	\$2,786,908	4.7%	Mar-15	A+	7.1%
Woolworths	\$2,610,979	4.4%	Nov-11	A-	5.5%
Telstra Corporation	\$2,360,373	4.0%	Nov-12	A	5.1%
Vector	\$2,204,477	3.7%	Oct-14	BBB+	7.4%
Watercare	\$1,443,589	2.5%	May-14	AA	6.8%
Bank of New Zealand	\$1,089,076	1.8%	Mar-14	AA	6.5%

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Core Income Portfolio

Complete portfolio as at 26 November 2009 (Part 2)

Sector / Security	Portfolio value	Proportion of portfolio	Expected maturity	S&P rating	Yield to maturity ³
Global corporate bonds		7.1%			6.6%
Vodafone	\$2,772,722	4.7%	Jan-13	BBB+	5.5%
Citigroup	\$1,409,264	2.4%	May-12	A-	8.9%
Government/Government-guaranteed bonds		51.3%			5.0%
US Treasury	\$17,617,550	29.9%	Sep-19	AAA	5.5%
Westpac	\$5,189,607	8.8%	Jan-12	AAA	3.8%
Commonwealth Bank of Australia	\$3,663,148	6.2%	Dec-13	AAA	4.7%
BNZ	\$1,715,234	2.9%	Feb-14	AAA	6.1%
National Australia Bank	\$1,014,582	1.7%	Jan-12	AAA	4.4%
ANZ	\$1,004,778	1.7%	Dec-10	AAA	3.4%
Residential mortgages		9.5%			10.3%
AMSNZ mortgage security (various issues) ⁵	\$4,299,504	7.3%	May-10 to Mar-11	AA- to AAA	9.2%
Sapphire mortgage security (various issues)	\$1,307,336	2.2%	Jan-12 to Jun-14	AA	13.8%
Loans		1.7%			7.3%
Private Loan Trust (Fidelity - 32 current loans)	\$1,027,422	1.7%	-	NR	7.3%
Debt Strategies		0.6%			
Interest rate swaps	\$358,633	0.6%			
Total economic exposure	\$58,916,980	100.0%			

Interest rate swaps, notional value ~ \$18m.

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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