

MANAGER INSIGHT – 28 FEBRUARY 2010

The Portfolio returned -0.86%¹ in February. The performance for the month reflects the Portfolio's exposure to United States interest rates which moved higher and overshadowed the positive performance of a short position in the euro against the United States dollar.

2010: Portfolio construction

Last month's insight discussed how the Portfolio is being constructed to be a blend of three distinct strategies, each with different risk and return characteristics. The three strategies are: opportunistic returns, income generators and risk managed overlay strategies.

This month's insight will take a more in-depth look at the second of these strategies.

Strategy 2: Income generators

This strategy targets investments that produce either a high level of income or a regular return. The first type of securities that are capable of producing a high level of income are high-yield corporate bonds. These are bonds issued by companies with higher debt levels or more volatile earnings. An example is the Works Finance (NZ) Limited bonds that were previously held in the Portfolio. The United States has the largest and most actively traded high-yield bond market. It is also the market with the longest history. The last two points are important factors for the Portfolio as they allow an active risk management overlay to be developed and back-tested. History shows that investing in United States high-yield bonds has provided attractive returns.

Since 1987, these bonds have returned 8.8% per annum on average. However, passively investing would expose the Portfolio to a risk of significant drawdowns. The largest drawdown experienced was -35% (as occurred in early 2007/2008). In order to protect the Portfolio against this risk, NZ Funds has developed a risk management overlay that moves the Portfolio to cash during negative markets. This enables the Portfolio to benefit from the high income these bonds generate while reducing the risk that clients experience large drawdowns.

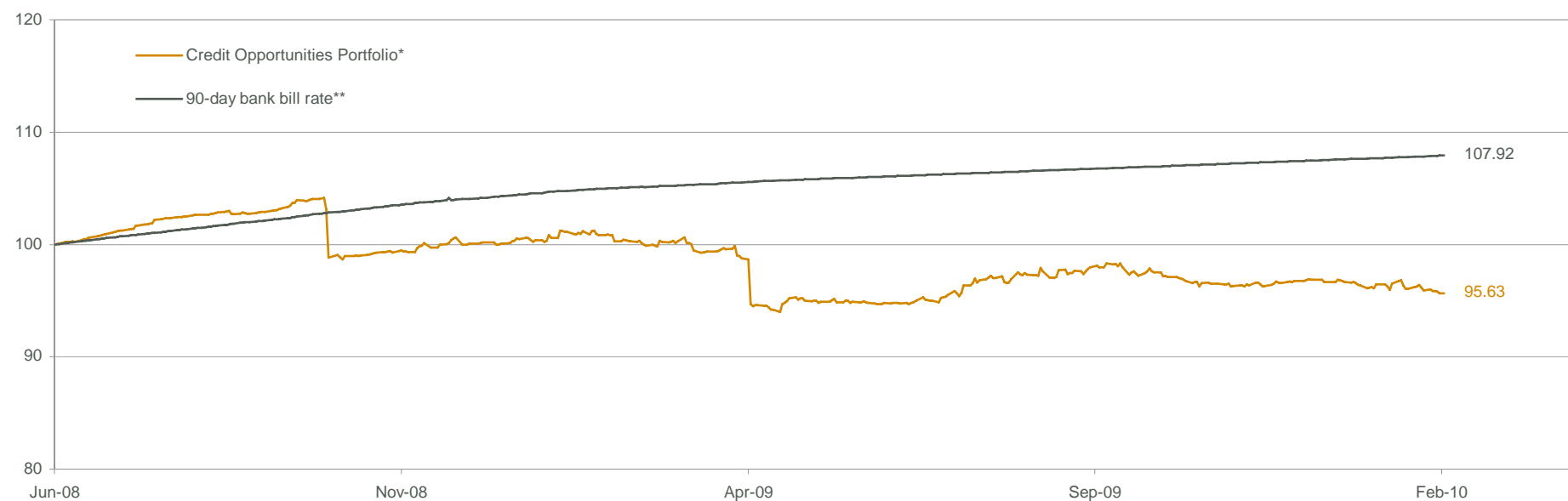
The second part of the income generators strategy is to complement higher-yielding assets with less volatile investments which provide a regular return. Investment-grade corporate bonds are the perfect solution to achieve this goal as history shows that they have produced returns of around 7.6% per annum. These returns are similar to those of high-yield bonds, but with less significant drawdowns. However, whilst investment-grade bonds experience less significant drawdowns, a risk management overlay is still required to protect the Portfolio during times of stress. Given the small size of the Portfolio, the allocations to both high-yield and investment-grade bonds will be achieved via a mix of directly held bonds and investments in Exchange Traded Funds (ETFs). This enables the Portfolio to achieve diversification and access NZ Funds' in-house corporate bond research.

In summary, the key enhancement of the income generators strategy is that it provides a core exposure to the attractive returns available from both high-yield and investment-grade corporate bonds, whilst ensuring that clients' capital is protected by an active risk management overlay.

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.

PERFORMANCE SINCE 25 JUNE 2008 TO 28 FEBRUARY 2010 (PART 1)

COP PERFORMANCE ATTRIBUTION	1 MONTH	3 MONTH	6 MONTH
Positive	Currency; credit	Distressed and inv. grade credit	Credit
Neutral	Cash	Government bonds	Cash
Negative	Interest rate hedging	Interest rate hedging	Interest rate hedging



COMPARISON	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	5 YEAR PA	7 YEAR PA	SINCE INCEPTION	MAXIMUM DRAWDOWN*
Portfolio*	-0.86%	-0.73%	-1.69%	-4.63%	-	-	-	-4.37%	-9.76%
90 day bank bill rate**	0.21%	0.64%	1.29%	2.75%	-	-	-	7.92%	-0.18%

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

PERFORMANCE SINCE 25 JUNE 2008 TO 28 FEBRUARY 2010 (PART 2)

Credit Opportunities 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. Due to the 'absolute return' nature of this Portfolio, cash is the most appropriate comparison.

Maximum Drawdown

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

COMPLETE PORTFOLIO AS AT 28 FEBRUARY 2010

PORTFOLIO SUMMARY

Number of securities	11 ¹
Yield	4.2% ²
Weighted average credit rating	A+
Weighted average credit spread duration	0 years
Weighted average interest rate duration	0.8 years

SECTOR / SECURITY	PORTFOLIO VALUE	PORTFOLIO ALLOCATION	EXPECTED MATURITY	S&P RATING	YIELD TO MATURITY ³
BANK DEPOSITS / BANK BILLS		34.8%			
Westpac (Bank deposits)	\$4,050,166	36.2%	Current	A1+	2.5%
ANZ (Bank bills)	\$146	0.0%	Apr-10	A1+	2.7%
ASB Bank (Bank bills)	\$114	0.0%	Apr-10	A1+	2.7%
Kiwibank (Bank bills)	\$104	0.0%	Apr-10	A1+	2.7%
FX Asset	-\$159,118	-1.4%	n/a	A1+	n/a
GOVERNMENT / GOVERNMENT-GUARANTEED BONDS		56.1%			
US Treasury	\$6,269,566	56.1%	Aug-19	AAA	6.1%
RESIDENTIAL MORTGAGES		2.6%			
Sapphire New Zealand mortgage security	\$289,899	2.6%	Jul-12	BB	20.0%
STRESSED ASSETS		0.8%			
CLO equity (4 securities)	\$94,336	0.8%	Dec-10	NR	0.0%
DEBT STRATEGIES		-0.6%			
Futures	-\$69,442	-0.6%	n/a	n/a	n/a
CURRENCY STRATEGIES		6.3%			
United States Dollar/Euro	\$705,443	6.3%	n/a	n/a	n/a
TOTAL ECONOMIC EXPOSURE⁴	\$11,181,215	100.0%			

¹ The Portfolio often holds more than one security under a given issuer. The 'number of securities' represents the total securities held by the Portfolio. However, in the table all securities from a given issuer are treated as one security. 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. 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 Total economic exposure represents the total economic value of a Portfolio, which is the gross asset value of the Portfolio adjusted for the effect of direct or indirect derivative positions taken by the Portfolio. Note: Rounding may affect the subtotals and totals.

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

Past performance is not necessarily an indication of future returns.

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