MANAGER INSIGHT – 30 JUNE 2010

The Portfolio returned 1.94%[1] in June, taking the year-to-date performance to 4.97%[1]. The performance for the month was driven by a continued decline in medium to long-term interest rates in New Zealand and offshore.

Bond insight: Rio Tinto

"The lowest ebb is the turn of the tide."

- Henry Wadsworth Longfellow, Poet

At the height of the Global Financial Crisis, the Anglo/Australian mining giant, Rio Tinto (Rio), looked poised to become a high-profile casualty as it suffered under the weight of a US$40 billion mountain of short-term debt. The debt in question was thanks to an ill-timed, with the joys of hindsight, purchase of Alcan Aluminum at the peak of the market for US$36 billion. Rio's initial intention was to sell down parts of the business to repay its short-term debt, however, the onset of the Global Financial Crisis rapidly put a halt to these plans.

What a difference two years can make. Today, Rio's balance sheet is a picture of corporate health. But before delving into the reasons for this dramatic turnaround, firstly some background on the company. Rio is one of the world's largest mining companies with a market capitalisation of approximately US$90 billion. From its headquarters in London, the company is involved in the exploration, mining and processing of mineral resources around the globe and, in particular, Australia and Canada. Operations are focused on five product groups: Aluminum; Copper; Diamonds and Minerals; Energy (coal and uranium oxide); and Iron Ore.

Since the dark days of 2008, Rio has raised a massive US$15 biilion of new equity and sold around US$10 billion of assets. On top of this, the demand from China for iron ore has skyrocketed. This has led to a sharp increase in iron ore prices and, in turn, Rio's annual earnings.

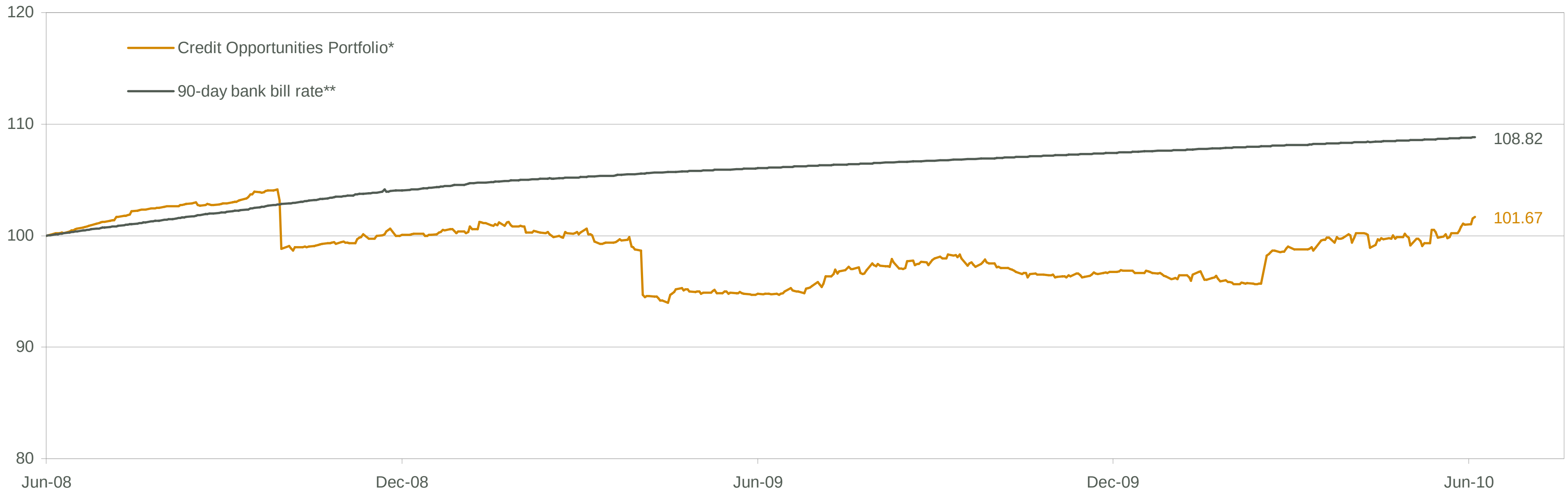
Through raising capital, asset sales and increased earnings, Rio has been able to dramatically reduce its debt from a peak of $47 billion in 2007 to $20 billion in 2009. The forecast for 2010 is for the company to have no net debt and for 2011, a cash surplus of US$17 billion. The large reduction in debt and the increasing cashflow from the iron ore business were the principal reasons that Rio's bonds, maturing in 2019, were added to the Portfolio in 2009.

Incredibly, Rio achieved this turnaround without any earnings contribution from their Aluminum assets, which comprise 50% of their asset base. In two respects, this is positive for the Portfolio's holding in Rio bonds. First, it is an earnings cushion which increases confidence that Rio it will be able to have sufficient cash in the future to meet the interest and principal repayments on its bonds. Second, it means there is significant scope for the Aluminum assets to boost earnings for the company going forward, creating the potential for capital appreciation as investors seek exposure to the strong balance sheet and forecast earnings. Either way, it means that the bonds should generate an attractive yield for the Portfolio until their maturity in 2019. Given the running yield is currently 7.6%, this would imply a cumulative return of approximately 70% over the nine-year time frame.

[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 30 JUNE 2010 (PART 1)

COP PERFORMANCE ATTRIBUTION	1 MONTH	3 MONTH	6 MONTH
Positive	Interest rates	Inv. grade credit; interest rates; currency	Distressed credit; interest rates
Neutral	Distressed credit; cash; inv. grade credit	Government bonds	Inv. grade credit
Negative	Currency	Cash	Cash



COMPARISON	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	5 YEAR PA	7 YEAR PA	SINCE INCEPTION	MAXIMUM DRAWDOWN[x]
Portfolio*	1.94%	2.93%	4.97%	7.25%	0.72%	-	-	1.67%	-9.76%
90 day bank bill rate**	0.21%	0.62%	1.26%	2.59%	4.25%	-	-	8.82%	-0.18%

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

PERFORMANCE SINCE 25 JUNE 2008 TO 30 JUNE 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 30 JUNE 2010

PORTFOLIO SUMMARY

Number of securities	20[1]
Yield	5.8%[2]
Weighted average credit rating	BBB+[3]
Weighted average credit spread duration	5.9 years
Weighted average interest rate duration	5.6 years

SECTOR / SECURITY	PORTFOLIO VALUE	PROPORTION OF PORTFOLIO	EXPECTED MATURITY	S&P RATING	YIELD TO MATURITY[4]
BANK DEPOSITS / BANK BILLS		**15.2%**			
Westpac (Bank deposits)	$1,720,479	15.8%	Current	A1+	2.5%
FX Asset	-$68,600	-0.6%	n/a	A1+	n/a
NEW ZEALAND / AUSTRALIAN CORPORATE BONDS		**19.2%**			
Fonterra 7.75% 10/03/2015	$521,742	4.8%	Mar-15	A+	6.2%
University of Canterbury 7.25% 15/12/2019	$504,146	4.6%	Dec-19	NR	6.9%
Vector 7.5% 15/10/2014	$426,239	3.9%	Oct-14	BBB+	6.7%
Meridian Energy 7.55% 16/03/2017	$425,388	3.9%	Mar-17	BBB+	6.8%
The Warehouse 7.3% 15/06/2015	$208,967	1.9%	Jun-15	NR	6.8%
GLOBAL CORPORATE BONDS		**32.9%**			
Simon Property Group 5.65% 01/02/2020	$559,246	5.1%	Feb-20	A-	7.6%
Rio Tinto 9% 01/05/2019	$525,266	4.8%	May-19	BBB+	7.4%
Oracle 6.125% 08/07/2039	$524,764	4.8%	Jul-39	A	7.7%
Citigroup 7.825% 18/05/2012	$524,012	4.8%	May-12	A-	6.9%
Comcast 5.7% 01/07/2019	$505,774	4.6%	Jul-19	BBB+	7.0%
Barrick Australia 4.95% 15/01/2020	$485,071	4.5%	Jan-20	BBB+	6.9%
Goldman Sachs 5% 15/03/2020	$454,548	4.2%	Mar-20	A+	8.2%
RESIDENTIAL MORTGAGES		**2.7%**			
Sapphire New Zealand mortgage security	$292,530	2.7%	Jul-12	BB	20.0%
EXTERNALLY MANAGED FUNDS		**29.8%**			
iShares iBoxx Investment Grade US Corporate Bond Fund	$3,247,008	29.8%	May-22	BBB+	7.3%
STRESSED ASSETS		**0.2%**			
CLO equity (2 securities)	$21,458	0.2%	Dec-10	NR	0.0%
DEBT STRATEGIES		**0.0%**			
International interest rate hedges - cash	$1,287,763	11.8%	n/a	n/a	n/a
New Zealand/Australia interest rate hedges	$1,076,025	9.9%	n/a	n/a	n/a
New Zealand/Australia interest rate hedges - cash	-$1,076,025	-9.9%	n/a	n/a	n/a
International interest rate hedges	-$1,287,763	-11.8%	n/a	n/a	n/a
CURRENCY STRATEGIES		**28.7%**			
United States Dollar/Euro	$787,522	7.2%	n/a	n/a	n/a
Yen/Swiss Franc	$782,733	7.2%	n/a	n/a	n/a
New Zealand Dollar/United States Dollar	$782,612	7.2%	n/a	n/a	n/a
United States Dollar/Norwegian Krone	$769,295	7.1%	n/a	n/a	n/a
Yen/New Zealand Dollar	$0	0.0%	n/a	n/a	n/a
TOTAL ECONOMIC EXPOSURE[5]	**$14,000,199**	**128.7%**			

[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 New Zealand Funds Management. [3] The weighted average credit rating is calculated excluding the University of Canterbury and The Warehouse bonds. The University of Canterbury and The Warehouse bonds have not been rated by a ratings agency. Our internal analysis suggests that if the bonds were to be rated, they would each receive an investment-grade rating. [4] The yield to maturity is stated before the deduction of management, custodial and trustee fees. [5] 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.

NZFUNDS

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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