

Manager insight – 30 November 2009

The Portfolio returned -0.78%¹ for the month of November and -3.82%¹ for the year to date. The weaker performance during the month reflects the combination of the Portfolio being hedged to US interest rates (which moved lower over the month) and a long position to the New Zealand dollar (in line with the currency risk models) for a short period during the middle of November.

European Banks – more of the same

A recent Bloomberg article highlighted the stark differences between the banking systems in the US and those in Europe. Put simply, European banks are much bigger than their US counterparts, particularly when compared to the economies in which they operate. In the US, the five largest lenders – Bank of America, JP Morgan, Citigroup, Wells Fargo and Goldman Sachs held NZ\$11.7 trillion in assets as at the end of September. This equates to approximately 60% of US GDP. The case in Europe and the UK is dramatically different. In the UK, the five largest banks - HSBC, Barclays, RBS, Lloyds and Standard Chartered have NZ\$14 trillion of assets – a figure which is approximately 400% of UK GDP. In France, the assets of BNP Paribas are approximately 117% of French GDP while in Spain, Banco Santander's assets are approximately 100% of Spanish GDP.

In some instances, these numbers may not be as disturbing as they first appear. In the case of HSBC, their outstanding loans of NZ\$1.3 trillion are more than covered by customer deposits of NZ\$1.6 trillion. However,

only 18 of the top 100 lenders in Europe have deposits in excess of loans. As a result, most banks remain highly dependent on both wholesale funding and on governmental/central bank liquidity facilities, such as the government-guarantee programs.

Thanks to the high-profile defaults in the US such as Lehman Brothers, US banks have taken decisive action and are now in much better shape. They have written down troubled assets, raised significant new capital and, more importantly, reduced the size of their loan books. The European banks, however, are acting as if the credit crunch never happened and have increased the size of their assets by 20% since the beginning of 2007.

This combination of large balance sheets and a reliance on wholesale funding/government support means that the European banking sector faces a critical challenge in 2010, namely coping with the removal of central bank liquidity facilities. Indeed, the competition for wholesale funding will continue to increase at a time when government bond issuance is at a record. In time, the only option is for the European banks to shrink the amount of their loans. The question is whether this happens in an orderly fashion or whether they are forced into it by investors demanding higher interest rates (for the higher risk). Either way, it is clear that there will be opportunities for the Portfolio to buy, focusing on the winners (US and Australasian banks) and avoiding the losers (European banks).

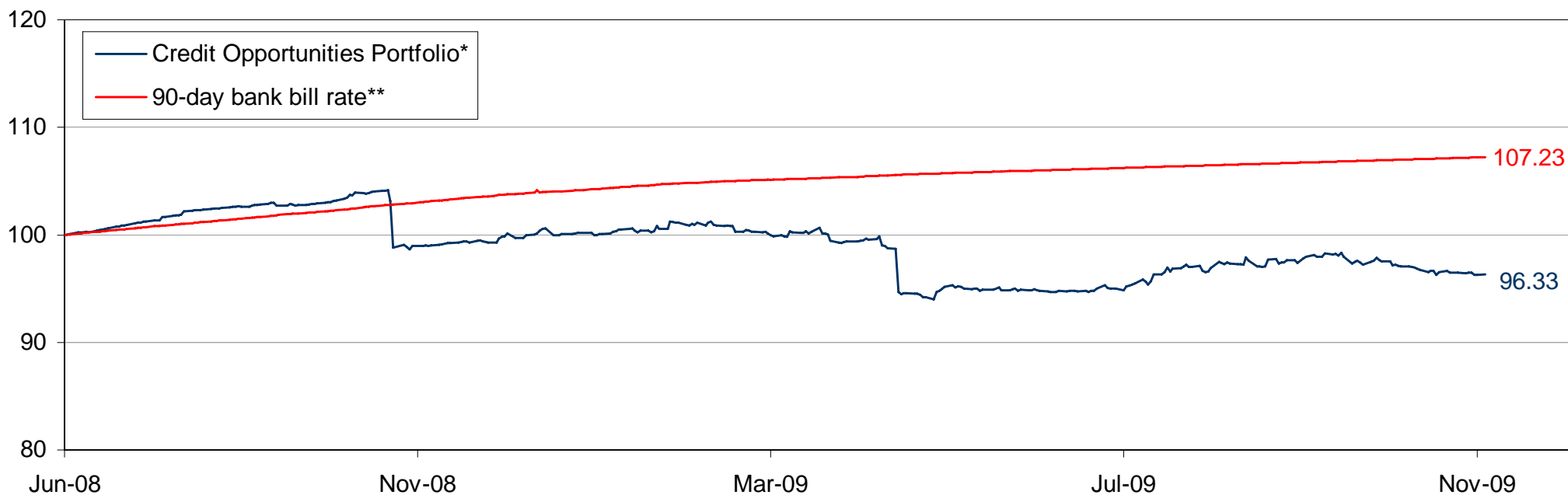
¹ Returns are stated after Portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns.

Credit Opportunities Portfolio



Performance since 25 June 2008 to 30 November 2009 (Part 1)

COP performance attribution	1 month	3 month	6 month
Positive	NZ Interest rates; credit	Cash; inv. grade credit	Investment grade credit
Neutral	Cash	Cash	Cash
Negative	Currency; US rate hedging	Distressed credit	Distressed credit



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*	-0.78%	-0.97%	1.53%	-3.00%	-	-	-	-2.58%	-9.76%
90-day bank bill rate**	0.21%	0.64%	1.30%	3.48%	-	-	-	4.99%	-0.18%

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

Performance since 25 June 2008 to 30 November 2009 (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, 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.

Credit Opportunities Portfolio

Complete portfolio as at 30 November 2009

Portfolio summary

Number of securities	15 ¹
Yield	5.2% ²
Weighted average credit rating	A-
Weighted average credit spread duration	0.6 years
Weighted average interest rate duration	5.9 years

Sector / Security	Portfolio value	Proportion of portfolio	Expected maturity	S&P rating	Yield to maturity ³
Bank deposits / Bank bills		13.2%			
Westpac (Bank deposits)	\$1,506,433	14.1%	Current	A1+	2.5%
BNZ (Bank bills)	\$4,286	0.0%	Dec-09	A1+	2.7%
Kiwibank (Bank bills)	\$4,286	0.0%	Dec-09	A1+	2.7%
ANZ (Bank bills)	\$4,279	0.0%	Dec-09	A1+	2.8%
ASB Bank (Bank bills)	\$3,929	0.0%	Dec-09	A1+	2.7%
FX Asset	-\$110,700	-1.0%	n/a	A1+	n/a
Corporate bonds		20.0%			
Works Finance NZ	\$1,561,906	14.6%	Sep-12	BBB	7.9%
Woolworths	\$578,007	5.4%	Nov-11	A-	5.5%
Government/Government-guaranteed bonds		63.0%			
US Treasury	\$6,739,449	63.0%	Jul-21	AAA	5.9%
Residential mortgages		3.1%			
Sapphire New Zealand mortgage security	\$332,970	3.1%	Jul-37	BB	20.0%
Stressed assets		0.9%			
CLO equity (4 securities)	\$91,481	0.9%	Dec-10	NR	0.0%
Debt Strategies		-0.3%			
Interest rate swaps	-\$26,828	-0.3%			
Total economic exposure	\$10,689,497	100.0%			

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.

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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