

Manager insight – 31 July 2009

In previous 'Manager insights' NZ Funds has discussed how we actively managed the Portfolio's sector allocations and interest rate exposure to protect it from the worst of the credit crunch. However, this is only half of the picture as active management is also about NZ Funds uncovering investment opportunities in unlikely places.

Bond insight: Mosaic

A good example of this is the Portfolio's holding in the US-based Fortune 500 company Mosaic. Mosaic is the world's second-largest fertiliser company (2008 sales of 15.7 million tonnes) behind the Canadian firm Potash Corp. It is the world's largest producer of phosphate and second-largest producer of potash – two crop nutrients which are primary ingredients in producing fertiliser.

At first glance an investment in the fertiliser industry may seem an unlikely exposure for the Credit Opportunities Portfolio to make. The fertiliser industry is highly cyclical as fertiliser demand is a by-product of agricultural production and prices. The years 2006, 2007 and early 2008 were boom times for the fertiliser industry as the world increasingly focused on the need for agricultural production to meet global population growth, rising affluence and bio-fuel demand (ethanol produced from grain). However, the optimism disappeared with the onset of the credit crunch, leading to a collapse in commodity prices which in turn resulted in a slump in fertiliser demand.

During the first half of 2009, US fertiliser application showed its biggest year-to-year decline since the early 1980s as farmers looked to manage their input costs by taking a 'fertiliser holiday' and delaying their purchasing of fertiliser.

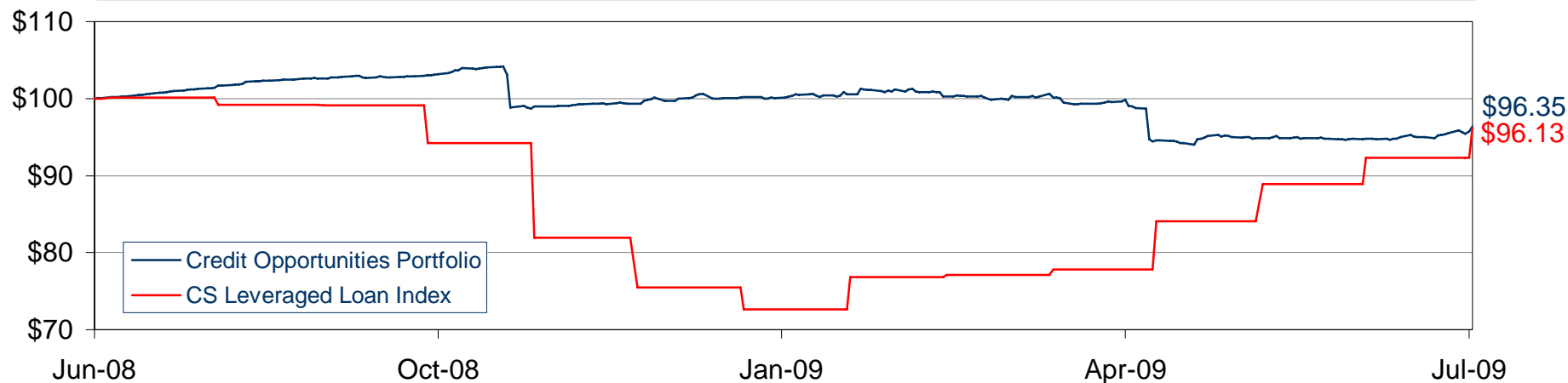
As is often the case, this bad news has a silver lining as it is a self-correcting cycle. Crop nutrient demand can only be deferred for so long. Nitrogen remains in the soil for one season. Phosphate and potash fertiliser remains in the ground for a couple of growing seasons in decreasing concentrations as the plants utilise the compounds. This means that the demand for fertiliser has not gone away – it is simply deferred. Thus, the stage may be set for a robust recovery in 2010.

We have chosen to gain access to the expected pickup in the fertiliser industry via Mosaic as we see this as the strongest name in the sector. Mosaic has made very good use of the boom years to reduce debt and rebuild their balance sheet. In 2004 the company had net debt of US\$2.3 billion. Now, thanks to careful management, the company has surplus cash (no net debt). Consequently, even in the face of a highly depressed fertiliser market, the company's earnings (EBITDA) cover its interest costs by 19x. This means that Mosaic has the strongest balance sheet in the industry at present, which positions the business to both weather the current fertiliser market downturn and then benefit from the inevitable pick up in demand.

Credit Opportunities Portfolio

Performance since 25 June 2008 to 31 July 2009

Performance attribution	One month	Three month	Six month
Positive	Corporate credit spreads	Cash; inv. grade credit	Cash
Neutral	Cash	n/a	n/a
Negative	Interest rates	Distressed credit	Distressed credit



One-month return	Three-month return	Six-month return	One-year return	Since inception return pa
1.64%	1.85%	-4.21%	-5.24%	-3.33%

Credit Opportunities Portfolio

Portfolio summary as at 31 July 2009

Portfolio summary

Number of securities	24*
Weighted average running yield (approximately)	6.5%**
Weighted average credit rating	BBB

Sector / Security	Portfolio value	Proportion of portfolio	Maturity date / Expected average life date	S&P rating	Yield to maturity***
Bank deposits / Bank bills		10%			
Westpac (Bank deposits)	\$630,979	6%	Current	A1+	2.5%
FX Asset	\$159,232	1%	N/a	A1+	N/a
ANZ (Bank bills)	\$77,751	1%	Oct-09	A1+	2.9%
Westpac (Bank bills)	\$77,688	1%	Oct-09	A1+	2.9%
ASB Bank (Bank bills)	\$75,281	1%	Oct-09	A1+	2.9%
BNZ (Bank bills)	\$55,705	1%	Sep-09	A1+	2.9%
Kiwibank (Bank bills)	\$53,247	0%	Sep-09	A1+	2.9%
Corporate bonds		64%			
Works Finance NZ	\$2,194,481	20%	Sep-12	BBB-	9.0%
Altria Group Inc	\$1,001,944	9%	Aug-19	BBB+	9.1%
Telecom Italia SA	\$843,132	8%	Jul-36	BBB	9.6%
Arcelor Mittal	\$648,792	6%	Jun-19	BBB-	10.1%
Citigroup	\$592,724	5%	May-19	A-	10.2%
Woolworths	\$580,590	5%	Nov-11	A-	6.5%
Mosaic	\$574,571	5%	Dec-16	BBB-	9.7%
Simon Property Group****	\$569,697	5%	Mar-12	A-	6.8%
Australian government-guaranteed bonds		21%			
Westpac	\$2,347,824	21%	Dec-11	AAA	4.1%
Residential mortgages		3%			
Sapphire New Zealand mortgage security	\$350,671	3%	Jul-37	BB	20.0%
Stressed assets		1%			
CLO equity (4 securities)	\$92,147	1%	Dec-10	NR	0%
Total	\$10,926,459	100%			

*With reference to bank bills, the Portfolio often holds more than one security under a given issuer. The 'number of securities' takes this into account. **This security has been purchased but not settled into the Portfolio. Note: Rounding may affect the subtotals and totals. ***The running yield is stated after the deduction of management, custodial and trustee fees. The running yield is not the actual return of the fund, nor is it a projection or forecast. ****This security has been purchased but not settled into the Portfolio.

Core Income Portfolio

Complete portfolio as at 31 July 2009

Portfolio summary						
Number of securities	54*					
Weighted average running yield (approximately)	5.7%**					
Weighted average credit rating	A					
Sector / Security	Portfolio value	Proportion of portfolio	Maturity date / Expected average life date	S&P rating	Yield to maturity***	
Bank deposits / Bank bills		9.4%				
Westpac (Bank deposits)****	\$1,305,770	2.2%	Current	A1+	2.5%	
ANZ (Bank bills)	\$945,278	1.6%	Oct-09	A1+	2.9%	
Westpac (Bank bills)	\$944,510	1.6%	Oct-09	A1+	2.9%	
ASB (Bank bills)	\$915,246	1.6%	Oct-09	A1+	2.9%	
BNZ (Bank bills)	\$677,248	1.2%	Sep-09	A1+	2.9%	
Kiwibank (Bank bills)	\$647,369	1.1%	Sep-09	A1+	2.9%	
New Zealand / Australian corporate bonds		21.2%				
Woolworths	\$2,771,757	4.9%	Nov-11	A-	6.5%	
Fonterra	\$2,705,116	4.7%	Mar-15	A+	7.4%	
Telstra Corporation	\$2,210,591	3.8%	Nov-12	A	7.2%	
Vector	\$2,176,786	3.7%	Oct-14	BBB	7.3%	
Watercare	\$1,399,328	2.4%	May-14	AA	7.1%	
Bank of New Zealand	\$1,057,942	1.8%	Mar-14	AA	6.8%	
Global corporate bonds		35.9%				
Vodafone	\$2,629,831	4.5%	Jan-13	BBB+	6.9%	
Oracle Corp	\$1,431,515	2.5%	Jul-19	A	7.0%	
Citigroup	\$1,363,423	2.3%	May-12	A-	9.4%	
McDonalds	\$1,217,621	2.1%	Feb-39	A-	7.9%	
Kraft Foods	\$1,133,828	2.0%	Nov-11	BBB	5.8%	
Pfizer	\$1,035,990	1.8%	Mar-39	AA	8.0%	
IBM Corp	\$995,056	1.7%	Oct-18	A+	6.9%	
Time Warner Cable	\$966,469	1.7%	Apr-19	BBB	8.0%	
EDF SA	\$921,745	1.6%	Jan-16	AA-	6.4%	
AT&T Inc	\$865,352	1.5%	Feb-19	A	7.3%	
GlaxoSmithKline PLC	\$862,577	1.5%	May-18	A+	7.1%	
Comcast	\$848,312	1.5%	May-18	BBB+	7.4%	
Shell International	\$845,521	1.5%	Mar-14	AA+	5.4%	
Goldman Sachs	\$843,039	1.5%	Apr-18	A+	7.9%	
Microsoft Corp	\$809,415	1.4%	Jun-19	AAA	6.6%	
Fiserv	\$742,856	1.3%	Nov-12	BBB	6.7%	
Merrill Lynch	\$704,921	1.2%	Apr-18	A	9.2%	
CME Group	\$589,889	1.0%	Feb-14	AA-	5.9%	
Mozaic	\$566,844	1.0%	Dec-16	BBB-	9.1%	
Simon Property Group^	\$543,951	0.9%	Mar-12	A-	6.8%	
Computer Associates Inc	\$533,667	0.9%	Dec-14	BBB-	8.8%	
Bank of America	\$439,019	0.8%	Oct-16	A	8.4%	
New Zealand / Australian government guaranteed bonds		22.3%				
Westpac	\$5,571,968	9.6%	May-12	AAA	4.7%	
Commonwealth Bank of Australia	\$3,547,421	6.1%	Dec-13	AAA	5.5%	
BNZ	\$1,686,693	2.9%	Feb-14	AAA	6.0%	
ANZ	\$1,092,609	1.9%	Dec-10	AAA	3.6%	
National Australia Bank	\$1,083,932	1.9%	Jan-12	AAA	4.9%	
Residential mortgages		8.8%				
AMSNZ mortgage security (various issues)****	\$3,898,083	6.7%	May-10 to Mar-11	AA- to AAA	12.0%	
Sapphire New Zealand mortgage security (various issues)	\$1,221,486	2.1%	Jan-12 to Apr-14	AA	13.0%	
Loans		2.4%				
Private Loan Trust (Fidelity - 32 current loans)	\$1,374,925	2.4%	-	NR	7.5%	
Total	\$58,124,903	100.0%				

Interest rate swaps, notional value – \$19m.

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

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