Dividend Yield Portfolio

NZFUNDS

Manager insight – 30 September 2009

The Portfolio returned 1.48%[1] in September, while the NZX50 Index was up 2.04%[2]. For the year to date the Portfolio is up 7.22%[1] against the NZX50 Index's performance of 16.40%[2]. The recent performance is consistent with the long-term goal of growing investors' capital for future needs by investing in well-analysed, high-dividend-yielding shares.

Share insight: Mainfreight

A share that was added back into the Portfolio a few months ago and has performed very well is Mainfreight. The freight and logistics company was held by the Portfolio several years ago but its share price rose so high relative to its dividend that it began to look like the market was overestimating its future earnings growth path. Consequently it was sold and the proceeds reinvested elsewhere.

Freight distribution businesses that, like Mainfreight, are broadly employed across the whole country, are almost uniquely exposed to the business cycle because they are plugged into every industry and sector. When the domestic economy fell into recession last year, Mainfreight's share price also began to weaken. However, it was when the global recession began to be felt that Mainfreight really started to slide. This may seem counterintuitive as, although the company has operations offshore, it still generates the bulk of its earnings from New Zealand. Partly, investors probably felt that global weakness would have an impact on the New Zealand economy but the largest driver was more likely the fact that financial markets engage in the fraught business of trying to predict the future. Mainfreight has made it clear that its strategy is to become a global freight business. The reason the price was so high in 2007 was that investors were projecting those plans into future earnings and incorporating them into the current share price. When it seemed that the more optimistic of those goals was to be stymied by the global credit crunch, the price fell. Having touched $8 in 2007, in August of 2008 it was still around $7 and at the time of the market bottom in March this year it had fallen to around $3.50.

Despite the price fall, not much had changed in the underlying business. Mainfreight is an excellent company. It is by far the largest operator in the domestic 'LCL' (less-than-container-load) freight market and as a consequence is able to generate operating margins of around 11%, exceptional for this sort of business. In addition, it has developed a large and successful business in Australia, has a very promising division in the United States and has begun to establish operations in Asia. While some of these offshore businesses earn negligible profits, at present they offer growth potential and, importantly, help protect the domestic franchise by collecting New Zealand destined freight and shipping it to its local business. As your manager felt the basic strength of the company remained intact, a position in Mainfreight was taken in early July for an average price of less than $4.20. It was trading on an EV/EBITDA of only 6.4x and the market appeared to be assuming its growth was at an end. Since then the price has rallied to $5.32 and it has paid a 10c dividend, a total return of 29% versus the market's return of 14%.

[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. [2] Source: Bloomberg.

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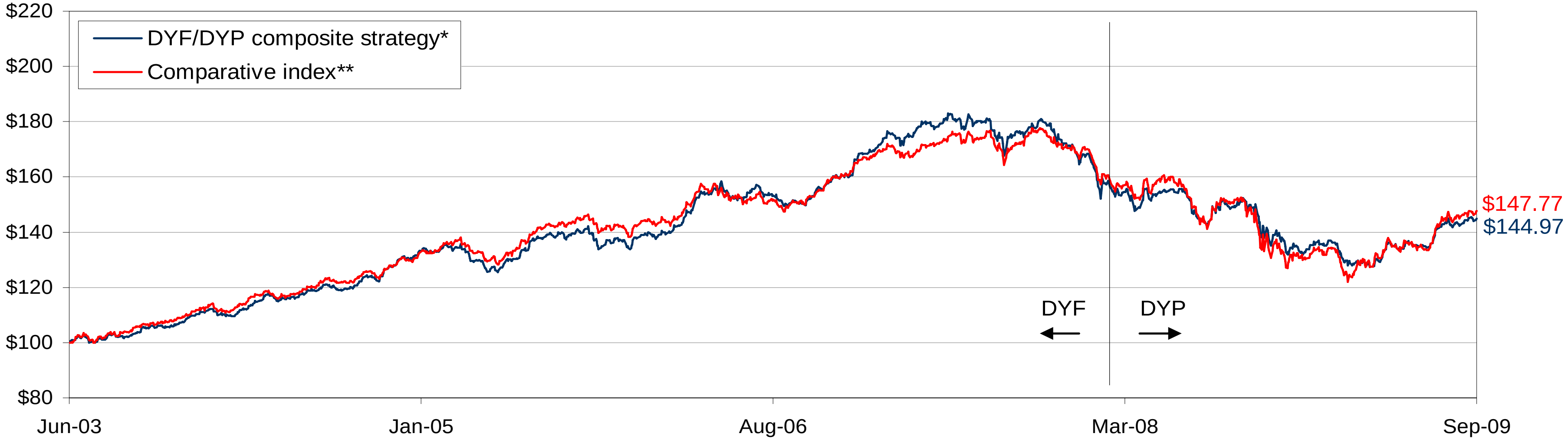
Performance to 30 September 2009 for DYF/DYP composite strategy*

DYP Performance attribution	1 month	3 month	6 month
Positive	Restaurant Brands	Mainfreight	Goodman Fielder
Neutral	Port of Tauranga	Kiwi Income Property	Goodman Property
Negative	Fisher & Paykel Healthcare	Infratil	Vector



Period	DYP 1 month	DYP 3 month	DYP 6 month	Composite 1 year	Composite 2 year pa	Composite since inception pa
Portfolio	1.48%	7.35%	12.50%	-1.12%	-9.74%	6.05%

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. *Dividend Yield Fund (DYF) data from 6 Jun 03 to 28 Feb 08. Dividend Yield Portfolio (DYP) data from 28 Feb 08 to 30 Sep 09. **Source: Bloomberg. 70% NZX50 Index and 30% 90-day bank bill rate. Comparative index adjusted for assumed portfolio management fees of 0.60% pa (NZX50 Index) and 0.20% pa (90-day bank bill rate). Details of the comparative index calculation are available on request from NZ Funds.

Dividend Yield Portfolio

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Portfolio summary as at 30 September 2009

Portfolio summary	
Number of securities	28
Yield*	6.8%
Average market capitalisation (share holdings)	$3,078
Cash, capital notes & other	20%
Shares	80%
Total economic exposure	100%

Sector / Security	Portfolio value	Proportion of portfolio	Market cap ($m)	Yield*	Payout ratio
Cash		**10.0%**			
Cash	$1,726,407	10.0%	-	2.8%	-
Cyclicals (Top five shown below)		**19.1%**			
Freightways	$1,215,391	7.0%	$464	7.6%	67.0%
The Warehouse	$839,034	4.9%	$1,307	7.5%	75.0%
Fletcher Building	$421,243	2.4%	$5,065	5.1%	70.0%
Mainfreight	$431,602	2.5%	$524	5.1%	43.0%
Restaurant Brands	$393,621	2.3%	$119	8.6%	59.0%
Non cyclicals (Top five shown below)		**60.5%**			
Fisher & Paykel Healthcare	$864,930	5.0%	$2,367	7.0%	114.0%
Infratil	$859,751	5.0%	$845	12.1%	99.9%
Kiwi Income Property	$820,043	4.8%	$835	10.2%	100.0%
Trustpower	$787,242	4.6%	$13,038	5.2%	69.7%
Metcash	$694,016	4.0%	$4,939	9.1%	96.0%
Capital notes & other (Top five shown below)		**10.4%**			
Kiwi Income Property MCN	$713,006	4.1%	-	8.6%	-
Sky City 8% 15 May 2010	$331,470	1.9%	-	8.5%	-
Fletcher Building 7.5% 15 Mar 2012	$234,791	1.4%	-	10.1%	-
GPG Finance 9% 15 Dec 2013	$174,367	1.0%	-	8.0%	-
TrustPower 8.5% 15 Mar 2014	$174,367	1.0%	-	9.2%	-
Total economic exposure	**$17,264,073**	**100.0%**		**6.8%**	

*The yield calculation represents an estimate of the yield on the Portfolio, calculated using yields forecast by NZ Funds for each company's current financial year. The yield is not the return on the Portfolio. Rather, it is an estimate of the pre-tax and fees income stream generated from investing in the Portfolio. The Portfolio return consists of yield and capital gains and losses. Therefore, the Portfolio's return could be less than the Portfolio's yield. The yield is not a projection or forecast of future performance or of future income streams. Past yields are not necessarily an indication of future yields. Details of the yield calculation are available on request from NZ Funds. Where applicable, the security's yield reflects the benefit derived from imputation credits received. Note: Rounding may affect the subtotals and totals.

Dividend Yield Portfolio

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Complete portfolio as at 30 September 2009

Portfolio summary

Number of securities	28
Yield*	6.8%
Average market capitalisation (share holdings)	$3,078
Cash, capital notes & other	20%
Shares	80%
Total economic exposure	100%

Sector / Security	Portfolio value	Proportion of portfolio	Market cap ($m)	Yield*	Payout ratio
Cash		**10.0%**			
Cash	$1,726,407	10.0%	-	2.8%	-
Cyclicals		**19.1%**			
Freightways	$1,215,391	7.0%	$464	7.6%	67.0%
The Warehouse	$839,034	4.9%	$1,307	7.5%	75.0%
Fletcher Building	$421,243	2.4%	$5,065	5.1%	70.0%
Mainfreight	$431,602	2.5%	$524	5.1%	43.0%
Restaurant Brands	$393,621	2.3%	$119	8.6%	59.0%
Non cyclicals		**60.5%**			
Trustpower	$864,930	5.0%	$2,367	7.0%	114.0%
Goodman Property Trust	$859,751	5.0%	$845	12.1%	99.9%
Kiwi Income Property	$820,043	4.8%	$835	10.2%	100.0%
Metcash	$807,959	4.7%	$4,113	5.7%	60.0%
Foster's Group	$787,242	4.6%	$13,038	5.2%	69.7%
Infratil	$785,515	4.6%	$943	5.3%	160.0%
Fisher & Paykel Healthcare	$766,525	4.4%	$1,637	5.5%	101.6%
Coca Cola Amatil	$756,166	4.4%	$8,983	4.3%	71.9%
Telecom	$694,016	4.0%	$4,939	9.1%	96.0%
Vector	$690,563	4.0%	$1,872	10.4%	82.0%
Goodman Fielder	$422,970	2.5%	$2,764	6.3%	77.0%
AMP NZ Office Trust	$409,159	2.4%	$838	10.2%	98.3%
Port of Tauranga	$409,159	2.4%	$914	6.0%	79.0%
Corporate Express	$405,706	2.4%	$830	5.8%	70.0%
Contact Energy	$369,451	2.1%	$3,498	6.9%	93.0%
Sky City	$350,461	2.0%	$1,886	6.7%	71.0%
Lion Nathan	$252,055	1.5%	$8,991	4.0%	79.0%
Capital notes & other		**10.4%**			
Kiwi Income Property MCN	$713,006	4.1%	-	8.6%	-
Sky City 8% 15 May 2010	$331,470	1.9%	-	8.5%	-
GPG Finance 9% 15 Dec 2013	$234,791	1.4%	-	10.1%	-
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Infratil 8.5% 15 Sep 2013	$174,367	1.0%	-	9.2%	-
TrustPower 8.5% 15 Mar 2014	$164,009	1.0%	-	7.7%	-
Total economic exposure	**$17,264,073**	**100.0%**		**6.8%**	

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Notes

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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