

Manager insight – 31 October 2009

The Portfolio returned 1.53%¹ in October, while the NZX50 Index was up 1.76%². For the year to date the Portfolio is up 8.87%¹ against the NZX50 Index's performance of 18.44%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.

Sector insight: Retail

One sector that your manager has been focusing on over recent months is retail. It is a large part of the broader economy and is represented on the New Zealand share market by several companies including The Warehouse, Michael Hill International, Pumpkin Patch, Briscoes and Hallensteins Glassons. Retail companies in general are faced with the same issues so it is worthwhile to think about the sector as a whole. The shares tend to be quite volatile performers. This is not because retail sales are volatile, on the contrary sales figures tend to be reasonably stable and growth tends to be incremental. The reason the prices of retail companies' shares move around a lot is that retailers have a high level of fixed operating costs in the form of employee expenses and leases. These fixed costs are the method by which retailers convert small growth in overall sales into higher growth in profit. The risk is that small declines in revenue can cause a much larger fall in profit. When, as has occurred over the past year, overall retail sales fall, investors become concerned about the earnings power and even solvency of the sector. That is what happened over late 2008 and early 2009.

However, it is easy to overstate the impact of economic weakness on retail sales. People still need basic essentials, clothes and entertainment. Core consumables still get bought. More importantly, although earnings may be volatile, scale retailers are very attractive businesses. A national chain of stores that dominates a sector is very hard to replicate. It is often difficult to own a stake in a good retailer at a reasonable price. As such, when the market is running scared it can be the best time to be buying.

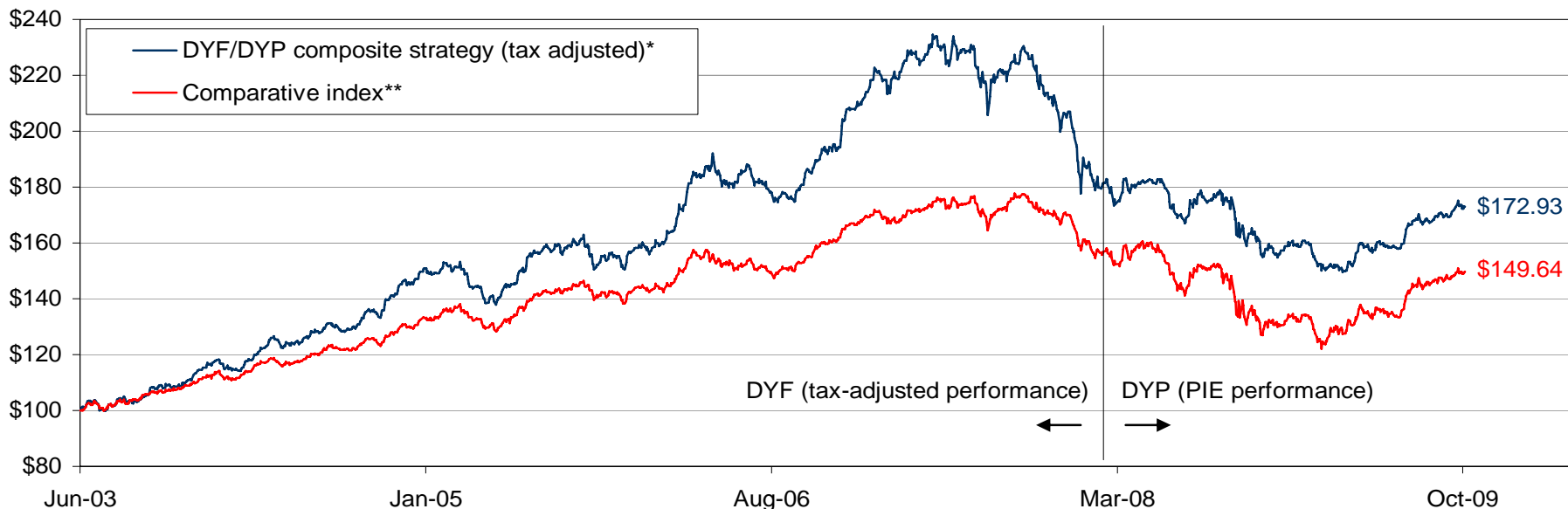
Before a retail share becomes a part of the Portfolio it needs to tick a few key boxes. Consistently good margins are important as they are evidence of a powerful brand and provide comfort in the event of a declining top line. Market share is often a driver of margins and is an important indicator of defensibility of earnings. From a risk point of view your manager looks for companies with no debt or, even better, positive cash balances – retailers have enough operational leverage without taking on financial leverage. Most importantly, of course, is good value. The Warehouse fulfills these criteria and was added to the Portfolio some time ago as a conviction position. A pair of smaller retailers that present some attraction are Briscoes and Hallensteins Glassons. Both have great brands, are powerful players in their own markets and have a lot of cash on their balance sheets. They also look cheap relative to their earnings. Of the two, the most attractive in pure valuation terms is Hallensteins Glassons which has recently been added to the Portfolio.

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

Dividend Yield Portfolio

Performance to 31 October 2009 for DYF/DYP composite strategy* (Part 1)

DYP performance attribution	1 month	3 month	6 month
Positive	The Warehouse	Mainfreight	Restaurant Brands
Neutral	Trustpower	AMP NZ Property Trust	Kiwi Income Property
Negative	Fisher & Paykel Healthcare	Telecom	Vector



Comparison	DYP 1 month	DYP 3 month	DYP 6 month	DYP 1 year
DYF/DYP (tax adjusted)*	1.53%	3.75%	10.59%	5.92%
Comparative index**	1.27%	4.73%	12.16%	10.71%

Composite 2 year pa	Composite 5 year pa	Composite 7 year pa	Composite since inception pa	Composite maximum drawdownx
-12.72%	4.93%	-	8.92%	-36.26%
-7.36%	3.75%	-	6.49%	-31.29%

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

Tax-adjusted performance to 31 October 2009 for DYF/DYP composite strategy* (Part 2)

Tax-adjusted composite strategy

* Tax-adjusted composite strategy is stated after portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns. The composite covers Dividend Yield Fund (DYF) data from 6 June 2003 to 27 February 2008, and Dividend Yield Portfolio (DYP) data from 28 February 2008 to 31 October 2009.

DYF was established as an Australian Unit Trust (AUT). In calculating the tax-adjusted composite strategy, for DYF the return has been 'grossed up' at 33% (being the tax rate applicable to New Zealand Unit Trusts) to reflect the fact that the return was generally not taxable to an investor. The tax-adjusted composite strategy is designed to remove, as much as possible, the impact of the different tax regimes that applied during the calculation period. By doing so it enables the returns from DYF and DYP to be represented in a substantially consistent manner.

The tax-adjusted composite strategy covers three different tax regimes, and accordingly three different calculation methods are applied over the course of the strategy. The three calculation periods are:

- i) the period pre 31 March 2007 (being the period prior to the introduction of the FDR regime);
- ii) the period from 1 April 2007 to 28 February 2008 (being the period that a New Zealand investor in DYF was subject to the FDR regime);
- iii) the period post 1 March 2008 (establishment date of DYP under the PIE regime).

This calculation is undertaken for comparative purposes only, and should not be confused with the portfolio return generated from DYF or DYP.

More details on these calculations, together with the formulae used, are available on request from NZ Funds.

Comparative index

** The comparative index is made up of 70% NZX50 Index and 30% 90-day bank bill rate. All index figures are sourced from Bloomberg. A fee of 0.60% pa has been deducted from the NZX50 Index to reflect the cost of obtaining a passive New Zealand share market exposure using an Exchange Traded Fund and the brokerage associated with purchasing it. A fee of 0.20% pa has been deducted from the 90-day bank bill rate as bank bills are usually accessed by retail investors through a managed fund. The 90-day bank bill rate has been included in the comparison because the mandate allows the manager to invest up to 30% of the Portfolio in cash and capital notes. The comparative index is stated on a pre-tax basis.

Maximum drawdown

× 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 strategy and the comparison. Maximum drawdown is a measure of volatility and represents the largest cumulative decline experienced during the reporting period.

Dividend Yield Portfolio

Portfolio summary as at 31 October 2009

Portfolio summary

Number of securities	28
Yield ¹	6.8%
Average market capitalisation (share holdings)	\$3,078
Cash, capital notes & other	19.6%
Shares	80.4%
Total economic exposure	100.0%

Sector / Security	Portfolio value	Proportion of portfolio	Market cap (\$m)	Yield ¹	Payout ratio
Cash		9.0%			
Cash	\$1,544,355	9.0%	-	2.8%	-
Cyclicals (Top five shown below)		24.8%			
The Warehouse	\$1,251,668	7.3%	\$1,307	7.5%	75.0%
Freightways	\$1,179,357	6.9%	\$464	7.6%	67.0%
Fletcher Building	\$807,472	4.7%	\$5,065	5.1%	70.0%
Restaurant Brands	\$468,299	2.7%	\$119	8.6%	59.0%
Mainfreight	\$426,979	2.5%	\$524	5.1%	43.0%
Non cyclicals (Top five shown below)		55.7%			
Goodman Fielder	\$1,239,616	7.2%	\$2,764	6.3%	77.0%
Trustpower	\$1,212,069	7.0%	\$2,367	7.0%	114.0%
Metcash	\$853,958	5.0%	\$4,113	5.7%	60.0%
Kiwi Income Property	\$833,297	4.8%	\$835	10.2%	100.0%
Coca Cola Amatil	\$831,576	4.8%	\$8,983	4.3%	71.9%
Capital notes & other (Top five shown below)		10.6%			
Kiwi Income Property MCN	\$716,223	4.2%	-	7.9%	-
Sky City 8% 15 May 2010	\$330,564	1.9%	-	8.5%	-
Fletcher Building 7.5% 15 Mar 2012	\$208,324	1.2%	-	8.0%	-
GPG Finance 9% 15 Dec 2013	\$234,150	1.4%	-	10.1%	-
TrustPower 8.5% 15 Mar 2014	\$161,839	0.9%	-	7.7%	-
Total economic exposure	\$17,216,888	100.0%		6.8%	

¹ 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. Where applicable, the security's yield reflects the benefit derived from imputation credits received. The yield is not the return on the Portfolio, nor is it a projection or forecast. 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 (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.

Note: Rounding may affect the subtotals and totals.

Dividend Yield Portfolio

Complete portfolio as at 31 October 2009

Portfolio summary

Number of securities	28
Yield ¹	6.8%
Average market capitalisation (share holdings)	\$3,078
Cash, capital notes & other	19.6%
Shares	80.4%
Total economic exposure	100.0%

Sector / Security	Portfolio value	Proportion of portfolio	Market cap (\$m)	Yield ¹	Payout ratio
Cash		9.0%			
Cash	\$1,544,355	9.0%	-	2.8%	-
Cyclicals		24.8%			
The Warehouse	\$1,251,668	7.3%	\$1,307	7.5%	75.0%
Freightways	\$1,179,357	6.9%	\$464	7.6%	67.0%
Fletcher Building	\$807,472	4.7%	\$5,065	5.1%	70.0%
Restaurant Brands	\$468,299	2.7%	\$119	8.6%	59.0%
Mainfreight	\$426,979	2.5%	\$524	5.1%	43.0%
Hallensteins Glassons	\$132,570	0.8%	\$187	10.0%	94.0%
Non cyclicals		55.7%			
Goodman Fielder	\$1,239,616	7.2%	\$2,764	6.3%	77.0%
Trustpower	\$1,212,069	7.0%	\$2,367	7.0%	114.0%
Metcash	\$853,958	5.0%	\$4,113	5.7%	60.0%
Kiwi Income Property	\$833,297	4.8%	\$835	10.2%	100.0%
Coca Cola Amatil	\$831,576	4.8%	\$8,983	4.3%	71.9%
Foster's Group	\$790,255	4.6%	\$13,038	5.2%	69.7%
Corporate Express	\$773,038	4.5%	\$830	5.8%	70.0%
Fisher & Paykel Healthcare	\$716,223	4.2%	\$1,637	5.5%	101.6%
Goodman Property Trust	\$700,727	4.1%	\$845	12.1%	99.9%
Port of Tauranga	\$420,092	2.4%	\$914	6.0%	79.0%
Sky City	\$413,205	2.4%	\$1,886	6.7%	71.0%
AMP NZ Office Trust	\$401,153	2.3%	\$838	10.2%	98.3%
Contact Energy	\$397,710	2.3%	\$3,498	6.9%	93.0%
Capital notes & other		10.6%			
Kiwi Income Property MCN	\$716,223	4.2%	-	7.9%	-
Sky City 8% 15 May 2010	\$330,564	1.9%	-	8.5%	-
Fletcher Building 7.5% 15 Mar 2012	\$208,324	1.2%	-	8.0%	-
GPG Finance 9% 15 Dec 2013	\$234,150	1.4%	-	10.1%	-
TrustPower 8.5% 15 Mar 2014	\$161,839	0.9%	-	7.7%	-
Infratil 8.5% 15 Sep 2013	\$172,169	1.0%	-	9.2%	-
Total economic exposure	\$17,216,888	100.0%		6.8%	

¹ 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. Where applicable, the security's yield reflects the benefit derived from imputation credits received. The yield is not the return on the Portfolio, nor is it a projection or forecast. 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 (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.

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.

DISCLAIMER: These Portfolio Insights have been provided for information purposes only. The content of this document is not intended as a substitute for specific professional advice on investments, financial planning or any other matter.

While the information provided in this document is stated accurately to the best of our knowledge and belief, New Zealand Funds Management Limited, its directors, employees and related parties accept no liability or responsibility for any loss, damage, claim or expense suffered or incurred by any party as a result of reliance on the information provided and opinions expressed in these Portfolio Insights except as required by law.