

## MANAGER INSIGHT – 31 JANUARY 2010

The Portfolio aims to provide clients with a stable source of funds, which are available at short notice, so that they can meet short-term living expenses and have a contingency for emergencies. In order to meet this objective, the manager has chosen to invest in liquid bank deposits across four banks and also to have coverage under the Crown Deposit Guarantee Scheme. This combination of diversified, liquid bank exposures and coverage under the Crown Deposit Guarantee Scheme offers a safe haven for clients' short-term income needs.

This investment strategy means the driver of the Portfolio's performance is the level of interest rates offered on the call deposits it holds with a range of New Zealand banks. In turn, the returns from these call deposits are driven by New Zealand's Official Cash Rate which is set by the Reserve Bank of New Zealand (RBNZ). With the Official Cash Rate at an all-time low of 2.50%, the returns generated by the Portfolio are low. That said, it is worth noting that security of capital and availability of capital are the primary considerations of the Portfolio.

In this low interest rate environment, portfolio managers could be tempted to try and boost the returns of cash portfolios by investing in other short-term assets such as commercial paper (CP) or longer-term assets such as mortgage securities. This strategy would boost returns but introduces both liquidity and credit risks into the Portfolio. In other words, adding these investments creates the potential, albeit minor, for investors to face a capital loss or for them not to have access to their investment when required. This is at odds with the primary goals of the short-term income needs category – stability and access.

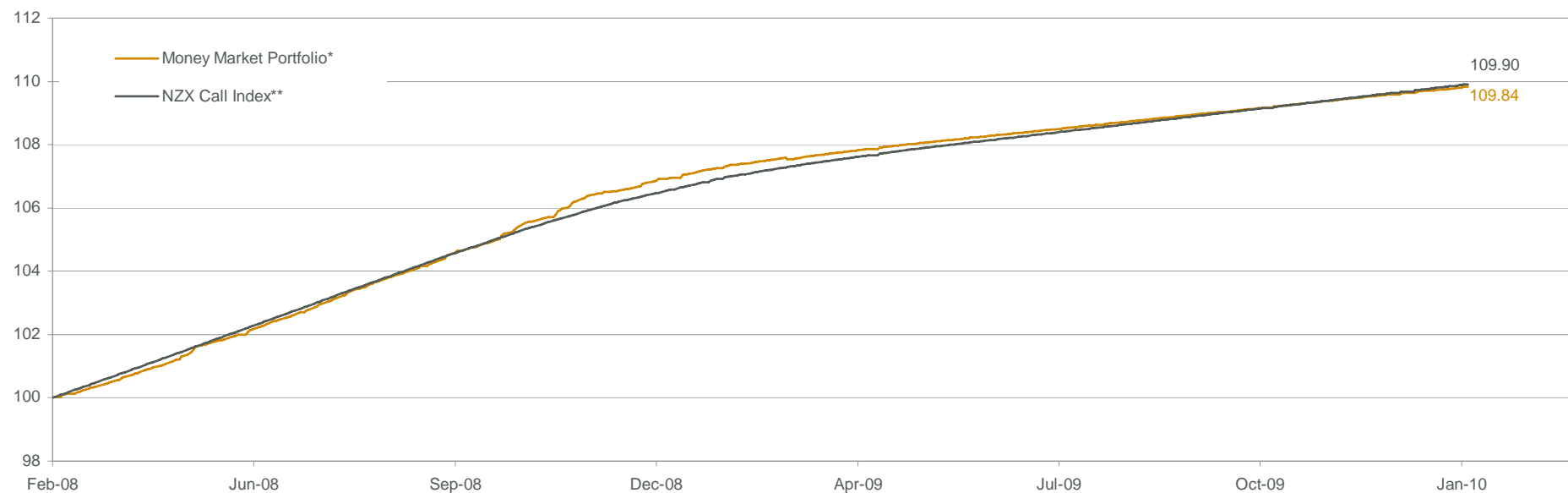
The question to ask is, is the additional return sufficient to compensate for the risks? The following numeric example suggests that it is probably not sufficient. If the portfolio was to boost returns by 1% by investing in these securities, it would result in an additional \$1,000 per year for an investor with a \$100,000 investment. Is an extra \$1,000 enough to put \$100,000 at risk of being readily accessible?

Highly rated A1+ CP issued in New Zealand currently has an average spread over cash of approximately 0.20%. Certainly, A1+ CP is low risk but not riskless, and however minor the likelihood of a problem, the consequences are extreme. In the middle of the credit crisis both in New Zealand and offshore the CP market seized up due to Lehman Brothers defaulting on their CP. This default led to a run on cash in United States money market funds as clients tried to withdraw their investments. The Reserve Primary Fund, one of the original and largest money market funds in the United States, had a US\$785 million holding in Lehman's CP which it had to value to zero, resulting in the unit price falling below US\$1, a rare occurrence called 'breaking the buck'. The subsequent client redemptions totalled more than US\$40 billion in one day from the US\$60 billion fund. These redemptions resulted in the fund being frozen as it could not liquidate its other holdings to meet these redemptions.

So while the Portfolio's returns are low at present due to the historically low Official Cash Rate, the combination of diversified, liquid bank exposures and coverage under the Crown Deposit Guarantee Scheme offers some comfort that clients' short-term income needs can be met. Furthermore, with the RBNZ signalling an increase in the Official Cash Rate "around the middle of 2010", the performance of the Portfolio from here is likely to improve.

## PERFORMANCE SINCE INCEPTION (28 FEBRUARY 2008) TO 31 JANUARY 2010 2010 (PART 1)

MMP PERFORMANCE ATTRIBUTION	1 MONTH	3 MONTH	6 MONTH
Positive	Running yield	Running yield	Running yield
Neutral	Interest rate unchanged	Interest rate unchanged	Interest rate unchanged
Negative	n/a	n/a	n/a



COMPARISON	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	5 YEAR PA	7 YEAR PA	SINCE INCEPTION <sup>1</sup>	MAXIMUM DRAWDOWN <sup>x</sup>
Portfolio*	0.19%	0.56%	1.12%	2.31%	-	-	-	9.84%	-0.04%
NZX Call Index**	0.20%	0.62%	1.25%	2.70%	-	-	-	9.90%	0.00%

<sup>1</sup> Pre-tax equivalent gross return. IMPORTANT: Please refer to the slide that follows for the footnotes relating to this slide.

### PERFORMANCE SINCE INCEPTION (28 FEBRUARY 2008) TO 31 JANUARY 2010 (PART 2)

#### Money Market 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 the NZX Call Index. Source: Bloomberg.

#### 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 31 JANUARY 2010

## PORTFOLIO SUMMARY

Number of bank exposures	4
Yield	2.3% <sup>1</sup>
Weighted average credit rating	A1+
Weighted average credit spread duration	0 days
Weighted average interest rate duration	0 days

SECTOR / SECURITY	PORTFOLIO VALUE	PORTFOLIO ALLOCATION	WEIGHTED AVERAGE LIFE	S&P RATING	GROSS YIELD
<b>BANK DEPOSITS</b>					
ASB call account	\$13,896,721	25.3%	0 days	A1+	2.5%
Westpac call account	\$13,784,792	25.1%	0 days	A1+	2.5%
BNZ call account	\$13,684,947	24.9%	0 days	A1+	2.5%
ANZ call account	\$13,401,500	24.4%	0 days	A1+	2.6%
Westpac current account	\$126,268	0.2%	0 days	A1+	2.5%
<b>TOTAL ECONOMIC EXPOSURE</b>	<b>\$54,894,228</b>	<b>100.0%</b>			

<sup>1</sup> 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. Note: Rounding may affect the subtotals and totals.

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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