

Manager insight – 30 September 2009

The Portfolio produced a return of 0.57%¹ in September and 1.90%¹ year to date. The Portfolio's objective is to protect against inflation, which is currently running at a subdued 0.84%² for the first six months of 2009. This is equivalent to 0.14% a month or 1.26% year to date.

This month's 'Manager Insight' is dedicated to government bonds. The key risk for government bond investments is interest rates. When interest rates rise, government bond investments suffer capital losses. A common reason for interest rates to increase is an increase in inflation expectations. This of course creates problems for the Portfolio as it cannot tolerate losses in high inflation environments – this is exactly the wrong time! The Portfolio's government bond investments therefore need to be carefully structured to minimise the risk of capital losses during periods of high inflation.

Half of the Portfolio's government bond exposure is managed by Michael Hasenstab at Franklin Templeton. Hasenstab's fund recently topped the performance tables for US and global bonds in a study by Bloomberg Markets¹. Earlier this year Michael Hasenstab addressed the thorny inflation issue head on²:

"... we would embrace a scenario of rapid rising inflation because it could present us with some very compelling investment opportunities.

- In the foreign currency markets, if we have high inflation in the US relative to other countries, they could weaken the US dollar and benefit other currencies.

- Additionally, we would shorten duration to protect capital. We could also benefit from probably some spread product compressing.
- Finally, similar to what we did in the currency markets, we could position for a rise in interest rates through swaps and options in futures markets to actually make money potentially off of rising rates.

So, there is a lot of flexibility in the strategy to position for that environment if it does come about. It is certainly something we were thinking a lot about."

This quote sums up the value of a good investment manager that has similar objectives to the Portfolio – it can turn a threat into an opportunity!

The other government bond exposure is included to add a flight to quality element to the Portfolio. In tremulous times, bonds issued by high-quality government issuers perform well, offsetting the losses in other parts of the Portfolio. Franklin Templeton has limited exposure to these bonds and so this component complements the government bonds it manages.

To protect against capital losses, this component uses a momentum-based capital protection strategy. When interest rates are trending upwards, the capital protection kicks in and the fixed interest rate exposure is transformed to floating interest rates or cash.

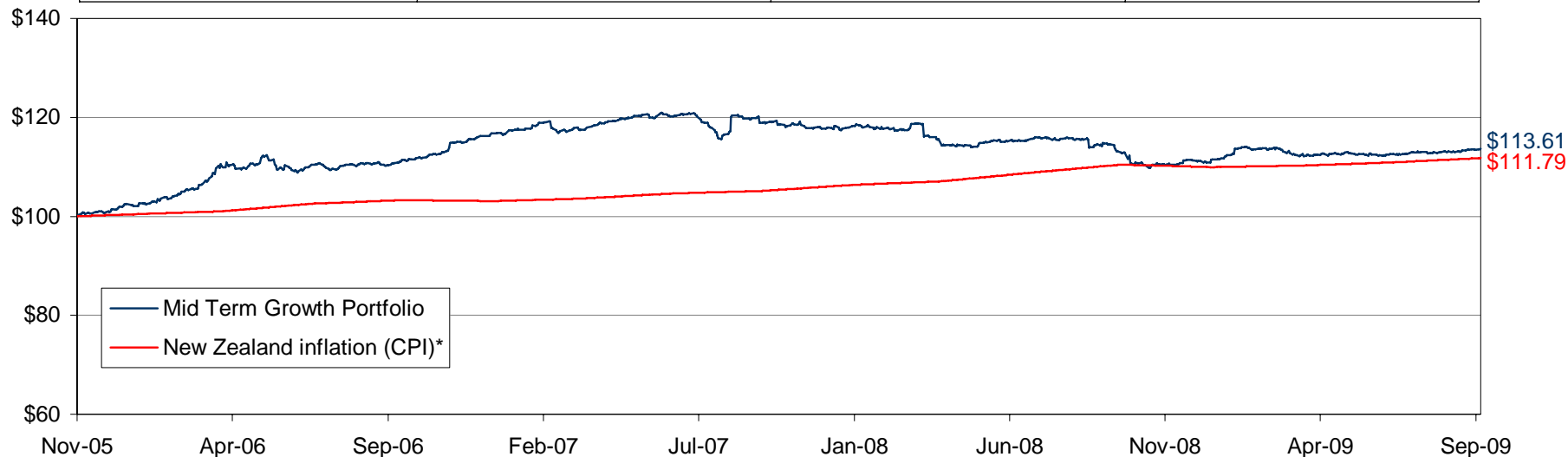
¹ Returns are stated after Portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns.

² Source: Bloomberg. ¹Bloomberg Markets, October 2009 issue. ² Global Bond Update, Dr Michael Hasenstab, April 2009.

Mid Term Growth Portfolio

Performance since mandate change (3 November 2005) to 30 September 2009

Performance attribution	1 month	3 month	6 month
Positive	Bonds; global shares	Bonds; global shares	Bonds
Neutral	Cash	Cash	Cash
Negative	Equity manager alpha	Equity manager alpha	Equity manager alpha



Period	1 month	3 month	6 month	1 year	2 year pa	Since inception pa
Portfolio	0.57%	0.91%	1.07%	0.73%	-2.24%	3.32%

Mid Term Growth Portfolio

Portfolio summary as at 30 September 2009

Portfolio summary

Yield/Interest rate*	5.4%
Income strategies (before share hedge)	70%
Growth strategies (before share hedge)	30%
Currency strategies	0%
Total economic exposure	100%

Strategy	Manager	Asset class	Portfolio value	Proportion of portfolio	Yield*
Income strategies				83.8%	
Bank deposits	NZ Funds	Cash	\$6,519,065	11.7%	2.5%
Bank bills	NZ Funds	Cash	\$2,510,710	4.5%	2.7%
Inflation-linked government bonds	NZ Funds	Government bonds	\$11,683,191	20.9%	4.7%
Investment-grade corporate bonds	NZ Funds	Corporate bonds	\$5,801,580	10.4%	8.8%
Investment-grade corporate bonds	PIMCO	Corporate bonds	\$5,134,262	9.2%	7.8%
High-quality government bonds	NZ Funds	Government bonds	\$3,287,695	5.9%	5.5%
Global government bonds	Franklin Templeton	Government bonds	\$2,610,352	4.7%	6.5%
Loans (via Private Loan Trust)	NZ Funds	New Zealand direct loans	\$1,507,762	2.7%	7.8%
Share hedge**	NZ Funds	Cash	\$7,704,486	13.8%	2.5%
Growth strategies				16.2%	
Global property	Resolution/NZ Funds	Global property	\$5,664,219	10.2%	3.6%
Global shares - Core	Lazard	Global shares	\$3,967,103	7.1%	5.7%
Global shares - Growth	T Rowe Price	Global shares	\$3,845,805	6.9%	4.3%
Global shares - High dividend yield	Tweedy Browne	Global shares	\$2,364,533	4.2%	7.1%
Australasian shares - High dividend yield	NZ Funds	Australasian shares	\$889,917	1.6%	7.0%
Share hedge**	NZ Funds	Global shares	-\$7,704,486	-13.8%	2.5%
Currency strategies					
Foreign currency exposure	NZ Funds	Fully hedged	\$0	0.0%	n/a
Total economic exposure			\$55,796,371	100.0%	5.4%

*The yield calculation represents an estimate of the yield on the Portfolio, calculated using the most recent information provided by the investment managers involved in managing the Portfolio, hedged back to New Zealand dollars where appropriate. It is not calculated 'as at' any particular date as different investment managers provide data at varying dates. As a result, in some instances the yields may lag the date of this portfolio summary. 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. **The effect of the share hedge is to reduce the allocation to shares and increase the allocation to cash. 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: This document has 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 this document except as required by law.