

Portfolio overview – 31 August 2009

Needs category objective

- Meet the need of an investor to protect their future spending from the effects of inflation.

Investment objective

- A unique investment objective, namely to protect investors from the wealth destruction of inflation through investing in a conservative blend of inflation-sensitive investments.

Key features

- Generate capital growth in an inflationary environment in a manner that provides capital stability over the minimum investment time frame, with the potential for higher returns than bank deposits.
- Owns a defensive blend of assets whose returns are positively correlated with inflation including: cash, government-issued inflation-protected bonds, government bonds, corporate bonds, global and Australasian shares.

Risk management

- Maintaining a low exposure to global share markets. Risk is further reduced using NZ Funds' risk management strategy to manage risks associated with changes in interest rates and share market volatility.
- Diversification benefits are maximised by including investments managed by different managers, with varying investment approaches across a number of asset classes. This should lead to differences in returns across the Portfolio and thus diversification benefits.

Return enhancement

- Portfolio construction is designed to achieve the investment objective. Investments are included that should provide strong returns in periods of high inflation.
- Returns are further enhanced through a combination of superior investment manager selection and active asset allocation between a wide and varying selection of growth and income investment opportunities.

Manager insight – 31 August 2009

The Portfolio produced a return of -0.01%¹ in August and 1.33%¹ year to date. The Portfolio's objective is to protect against inflation, which is currently running at a subdued 0.84%² for first six months of 2009. This is equivalent to 0.14% a month or 1.13% year to date.

In this month's 'Manager insight' the work carried out on utilities is reviewed. While the Portfolio has yet to make an allocation to utilities, it is an excellent illustration of a sector that will help the Portfolio meet its objective of protecting investors against the ravages of inflation.

While the business model for companies in the utilities sector varies, a typical utility company owns and operates the infrastructure that transports water, gas or electricity to households and businesses. These companies tend to have monopoly positions. As the networks they own are extremely expensive to build and not cheap to maintain, duplication of the network is very inefficient. The provision of essential services through unique infrastructure creates a monopoly which would allow utility companies to jack up prices and exploit their market position. For this reason governments tend to regulate their pricing. While the price caps remove upside, they also provide certainty. Additionally, because they increase with inflation, they also provide inbuilt inflation protection.

When investigating whether a new asset should be added to the Portfolio the first test is how well it achieves the Portfolio's objectives. In this

case, this involves verifying that utility companies have strong performance in periods of inflation and are not overly risky. As periods of high inflation have occurred sporadically in the past, a long test period is required. As a result, the returns of the Dow Jones Utility Average were collected and used to measure the performance of the utilities sector. This index has been calculated since 1929 and during that time there have been six periods where inflation exceeded 6% per annum. In five of those periods the returns from utilities exceeded the rate of inflation. This is a significantly better batting average than shares (when measured by the S&P500 Index) and short-term bonds (US treasuries with one year to maturity) which outperformed inflation during two and three of the six periods respectively.

The next step in the process of adding a new type of asset to the Portfolio is identifying the optimal approach to gain exposure to that asset. A smart-index approach was selected as the optimal method of gaining exposure as it can be tailored to ensure the strategy is consistent with the Portfolio's objectives. In simple terms, the approach attempts to focus on the lower-risk regulated utilities with inbuilt inflation protection. It achieves this by excluding some utilities based on their industry classification and others due to high debt levels or high historical earnings variability. The final step is designing a risk management strategy, in this case a momentum-based approach much like that used on shares in the Growth Portfolios. In this way a low-risk exposure is created to a sector that performs well during inflationary episodes. 2

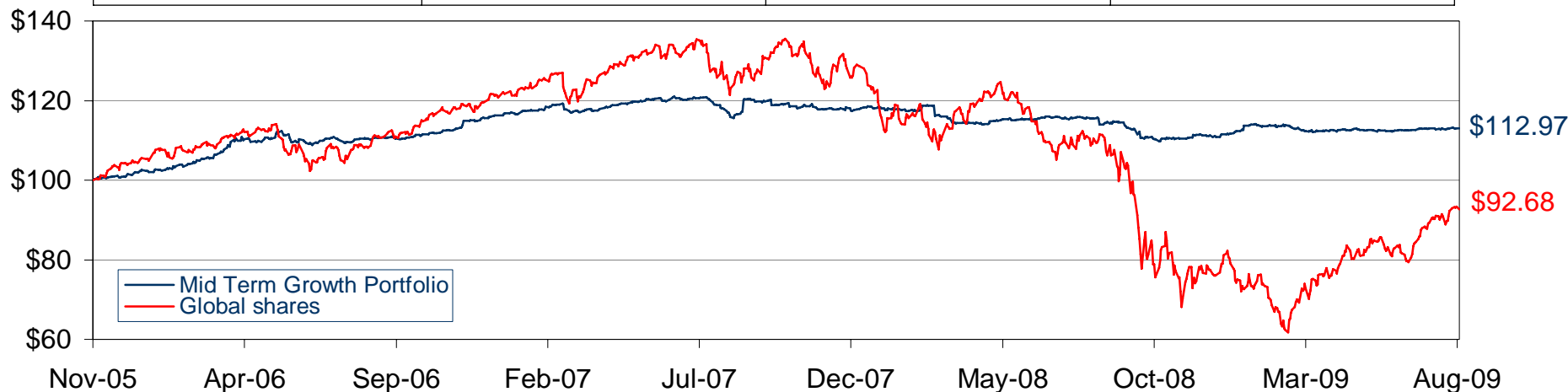
¹ Returns are stated after Portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns.

² Source: Bloomberg.

Mid Term Growth Portfolio

Performance since last mandate change (3 November 2005) to 31 August 2009

Performance attribution	One month	Three month	Six month
Positive	Global shares	Cash; bonds; global shares	Cash; bonds
Neutral	Bonds	n/a	n/a
Negative	n/a	n/a	Global shares



One-month return	Three-month return	Six-month return	One-year return	Since mandate change return pa
-0.01%	0.37%	-0.57%	-0.86%	3.24%

Source: Bloomberg. 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. Last mandate change was in November 2005. Global shares represented by MSCI World Index in local currency. The asset class index in the chart (MSCI World Index) is not for benchmarking purposes but rather to demonstrate the performance of the largest asset class allocation in the Portfolio.

Mid Term Growth Portfolio



Portfolio summary as at 31 August 2009

Portfolio summary

Yield*	3.2%
Income strategies (before share hedge)	79%
Growth strategies (before share hedge)	21%

Sector / Security	Manager	Portfolio value	Proportion of portfolio	Yield*
Income strategies			94%	
Cash - Bank deposits	NZ Funds	\$10,414,068	20%	2.5%
Cash - Bank bills	NZ Funds	\$14,391,748	27%	2.8%
Loans (via Private Loan Trust)	NZ Funds	\$1,499,973	3%	7.8%
Inflation-linked government bonds	NZ Funds	\$5,714,668	11%	5.7%
NZ government bonds	NZ Funds	\$1,049,978	2%	5.3%
Global government bonds	Franklin Templeton	\$2,643,891	5%	8.8%
Corporate bonds	PIMCO	\$5,556,054	11%	8.7%
Share hedge*	NZ Funds	\$7,764,147	15%	2.5%
Growth strategies			6%	
Australasian shares - High dividend yield	NZ Funds	\$868,947	2%	8.1%
Global shares - Core	Lazard	\$4,067,545	8%	3.5%
Global shares - Growth	T Rowe Price	\$3,855,833	7%	1.8%
Global shares - High dividend yield	Tweedy Browne	\$2,366,814	5%	4.8%
Share hedge**	NZ Funds	-\$7,764,147	-15%	2.5%
Total		\$52,429,518	100%	4%
Currency				
Foreign currency exposure	NZ Funds	Fully hedged	0%	

*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.

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