

## Manager insight – 31 October 2009

Over the past couple of months the composition of the Portfolio has changed. As a result, this month's 'Manager Insight' is dedicated to outlining these changes.

**“There is nothing wrong with change, if it is in the right direction.”**

Winston Churchill

These changes begin to transition the Portfolio towards new target allocations taking effect from 19 November 2009. The new target allocations more closely align the Portfolio's investments with its objectives (ie to provide clients with an allocation to protect their purchasing power from the effects of inflation).

While the income assets are included to aid in stabilising returns, these investment strategies are also designed to perform well during periods of inflation. One of the largest allocations in this part of the Portfolio is corporate bonds at 20%. This allocation is spread across two managers. The first is PIMCO. It is known for its long-term orientation and argues that future market trends are more reliably identified by secular rather than short-term indicators. The other corporate bond exposure is the iShares iBoxx Investment Grade Corporate Bond Fund. This is a relatively recent change to the Portfolio (in the past the Portfolio had a passive exposure that was managed in-house). The iShares fund provides a liquid, diversified exposure to US investment-grade corporate bonds. Using this fund will make it easier to alter the exposure when our momentum models indicate the need for caution.

The Portfolio also has a 20% allocation to inflation-linked bonds – the returns of these bonds are linked to inflation, making them an ideal investment for the Portfolio. This strategy has been the topic of past Manager insights. Normal government bonds make up 10% of the Portfolio – these bonds are managed by both Franklin Templeton, and in a passive manner by NZ Funds. Again this has been a topic of past Manager insights. An allocation to cash completes the income investments in the Portfolio.

The growth investments are included to boost performance, particularly during periods of high inflation. Currently, the largest allocation is to hedged global managers at approximately 15% but this will decline to 10% with the addition of commodities. The hedged global shares allocation is invested with three of our global equity managers. The vast majority of the share market risk is then removed using futures.

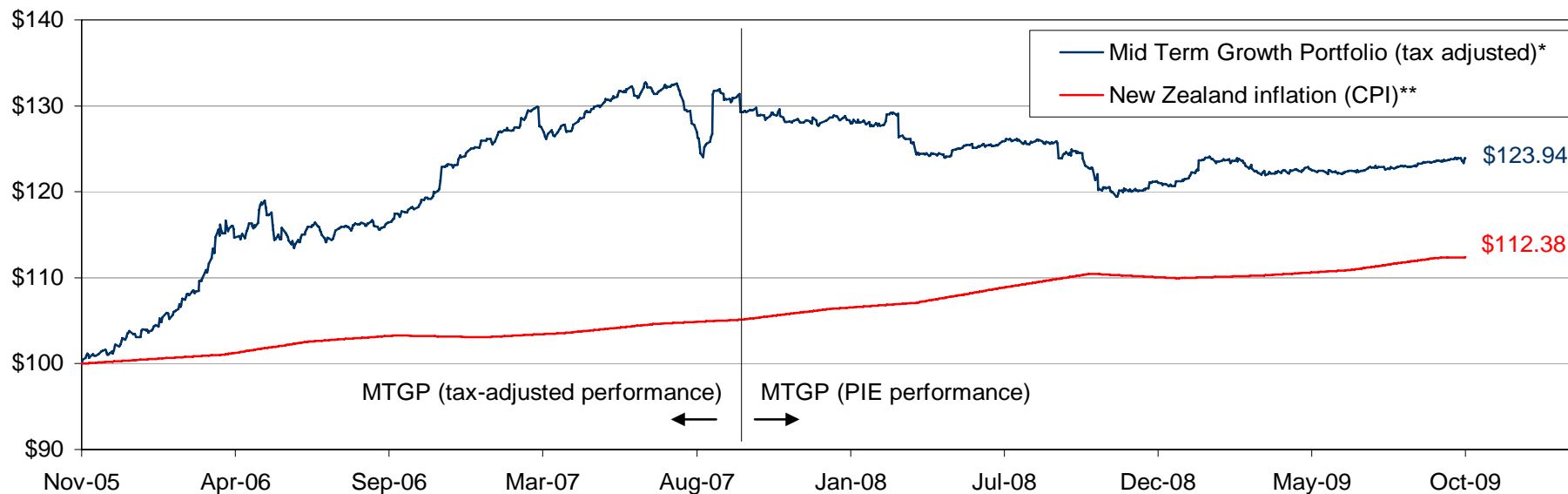
Exposure to global property shares is a relatively recent addition to the Portfolio and makes up 5% of the Portfolio. Property is an ideal addition as it produces fairly stable cash flows and performs well during periods of high inflation. This allocation comprises a passive exposure to domestic listed property trusts and an active exposure to international listed trusts. The capital protection models on both these investments have halved the exposure. Finally, the Portfolio's most recent investment is a 5% allocation to utilities. As the momentum model for European utilities is close to being triggered, this investment has been delayed.

# Mid Term Growth Portfolio



Performance since mandate change (3 November 2005) to 31 October 2009 (Part 1)

| MTGP performance attribution | 1 month                 | 3 month              | 6 month              |
|------------------------------|-------------------------|----------------------|----------------------|
| Positive                     | Equity manager alpha    | Bonds; global shares | Bonds                |
| Neutral                      | Bonds; cash             | Cash                 | Global shares; cash  |
| Negative                     | Global shares; property | Equity manager alpha | Equity manager alpha |



| Comparison                       | 1 month | 3 month | 6 month | 1 year | 2 year pa | 5 year pa | 7 year pa | Since inception pa | Maximum drawdownx |
|----------------------------------|---------|---------|---------|--------|-----------|-----------|-----------|--------------------|-------------------|
| <b>Portfolio (tax adjusted)*</b> | 0.31%   | 0.87%   | 1.26%   | 3.17%  | -2.06%    | -         | -         | 3.32%              | -10.03%           |
| <b>New Zealand inflation**</b>   | 0.07%   | 0.92%   | 1.74%   | 1.90%  | 3.19%     | -         | -         | 2.97%              | -0.46%            |

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

## Tax-adjusted performance to 31 October 2009\* (Part 2)

### Tax-adjusted performance

\* Tax-adjusted performance for the Mid Term Growth Portfolio (MTGP) 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 Portfolio was launched with its current mandate on 3 November 2005.

MTGP was established as a New Zealand Unit Trust (NZUT). In calculating the tax-adjusted performance for MTGP the return prior to 30 September 2007 has been 'grossed up' at 33% (being the tax rate applicable to a NZUT) to reflect that previously tax was paid within the trust. The tax-adjusted performance is designed to remove, as much as possible, the impact of the tax paid by the Portfolio during the calculation period. By doing so it enables the returns from MTGP to be represented in a substantially consistent manner throughout the measurement period.

The tax-adjusted performance covers two different tax regimes, and accordingly two different calculation methods are applied. The two calculation periods are:

- i) the period pre 30 September 2007 (being the period prior to the introduction of the PIE regime);
- ii) the period post 1 October 2007 (being the date from which MTGP was subject to the PIE regime).

This calculation is undertaken for comparative purposes only, and should not be confused with the return generated from the Mid Term Growth Portfolio.

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

### Comparative index

\*\* The comparative index is New Zealand's inflation rate as measured by the Consumers Price 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, we have included the 'maximum drawdown' for both the Portfolio and the comparison. Maximum drawdown is a measure of volatility and represents the largest cumulative decline experienced during the reporting period.

# Mid Term Growth Portfolio

## Portfolio summary as at 31 October 2009

### Portfolio summary

|  |      |
|--|------|
| Yield/Interest rate <sup>1</sup>       | 5.8% |
| Income strategies (before share hedge) | 72%  |
| Growth strategies (before share hedge) | 28%  |
| Currency strategies                    | 0%   |
| Total economic exposure                | 100% |

| Strategy                                  | Manager             | Asset class              | Portfolio value     | Proportion of portfolio | Yield <sup>1</sup> |
|---|---------------------|--------------------------|---------------------|-------------------------|--------------------|
| <b>Income strategies</b>                  |                     |                          |                     | <b>85.2%</b>            |                    |
| Bank deposits                             | NZ Funds            | Cash                     | \$6,242,115         | 10.9%                   | 2.5%               |
| Bank bills                                | NZ Funds            | Cash                     | \$4,093,230         | 7.1%                    | 2.8%               |
| Inflation-linked government bonds         | NZ Funds            | Government bonds         | \$10,634,320        | 18.5%                   | 5.4%               |
| Investment-grade corporate bonds          | PIMCO               | Corporate bonds          | \$6,550,516         | 11.4%                   | 7.8%               |
| Investment-grade corporate bonds          | iShares             | Corporate bonds          | \$5,277,094         | 9.2%                    | 7.4%               |
| High-quality government bonds             | NZ Funds            | Government bonds         | \$3,887,372         | 6.8%                    | 6.1%               |
| Global government bonds                   | Franklin Templeton  | Government bonds         | \$3,343,688         | 5.8%                    | 6.3%               |
| Loans (via Private Loan Trust)            | NZ Funds            | New Zealand direct loans | \$1,516,919         | 2.6%                    | 7.3%               |
| Share hedge <sup>2</sup>                  | NZ Funds            | Cash                     | \$7,373,057         | 12.8%                   | 2.5%               |
| <b>Growth strategies</b>                  |                     |                          |                     | <b>14.8%</b>            |                    |
| Global shares - Core                      | Lazard              | Global shares            | \$3,942,683         | 6.9%                    | 5.6%               |
| Global shares - Growth                    | T Rowe Price        | Global shares            | \$3,762,795         | 6.6%                    | 5.2%               |
| Global shares - Utilities                 | NZ Funds            | Global shares            | \$2,755,000         | 4.8%                    | 7.4%               |
| Global shares - High dividend yield       | Tweedy Browne       | Global shares            | \$2,392,651         | 4.2%                    | 7.1%               |
| Global property                           | Resolution/NZ Funds | Global property          | \$2,082,322         | 3.6%                    | 7.1%               |
| Australasian shares - High dividend yield | NZ Funds            | Australasian shares      | \$905,037           | 1.6%                    | 7.0%               |
| Share hedge <sup>2</sup>                  | NZ Funds            | Global shares            | -\$7,373,057        | -12.8%                  | 2.5%               |
| <b>Currency strategies</b>                |                     |                          |                     |                         |                    |
| Foreign currency exposure                 | NZ Funds            | Fully hedged             | \$0                 | 0.0%                    | n/a                |
| <b>Total economic exposure</b>            |                     |                          | <b>\$57,385,744</b> | <b>100.0%</b>           | <b>5.8%</b>        |

<sup>1</sup> 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, 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. <sup>2</sup> 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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