

MANAGER INSIGHT – 30 JUNE 2010

This 'Manager insight' takes a closer look at the Global Sector Strategy which was recently added to the Portfolio.

Strategy insight: Global Sector Strategy

"The first step in the risk management process is to acknowledge the reality of risk. Denial is a common tactic that substitutes deliberate ignorance for thoughtful planning."

- Charles Tremper, Researcher

The Global Sector Strategy is designed to provide the Portfolio with exposure to shares that perform well during periods of high inflation and have a risk level that is consistent with that of the Portfolio's objectives.

The Strategy provides exposure to four sectors that benefit from inflation: Consumer Goods; Healthcare; Energy; and Materials. These sectors include companies whose revenues are bolstered by inflation, but costs are relatively fixed. This means that, in times of high inflation, these companies experience strong growth in profitability which, in turn, leads to strong share price appreciation.

To manage the risk of share market exposures, each of the four sectors has its own bespoke systematic risk management strategy. These risk management strategies are designed to identify when a sector is trending down – at which point, the exposure is sold and cash is held until the strategy indicates that the downward trend has reversed. Systematic risk management strategies were selected over qualitative subjective decision-making processes for a number of reasons.

The first reason is that systematic risk management approaches do not rely on key people making good decisions in stressful environments. As risk management decisions occur around market turning points, picking these points is both difficult and extremely stressful. A number of physiological researchers have reviewed decision making in stressful environments and concluded that thorough structured decision-making processes are compromised.

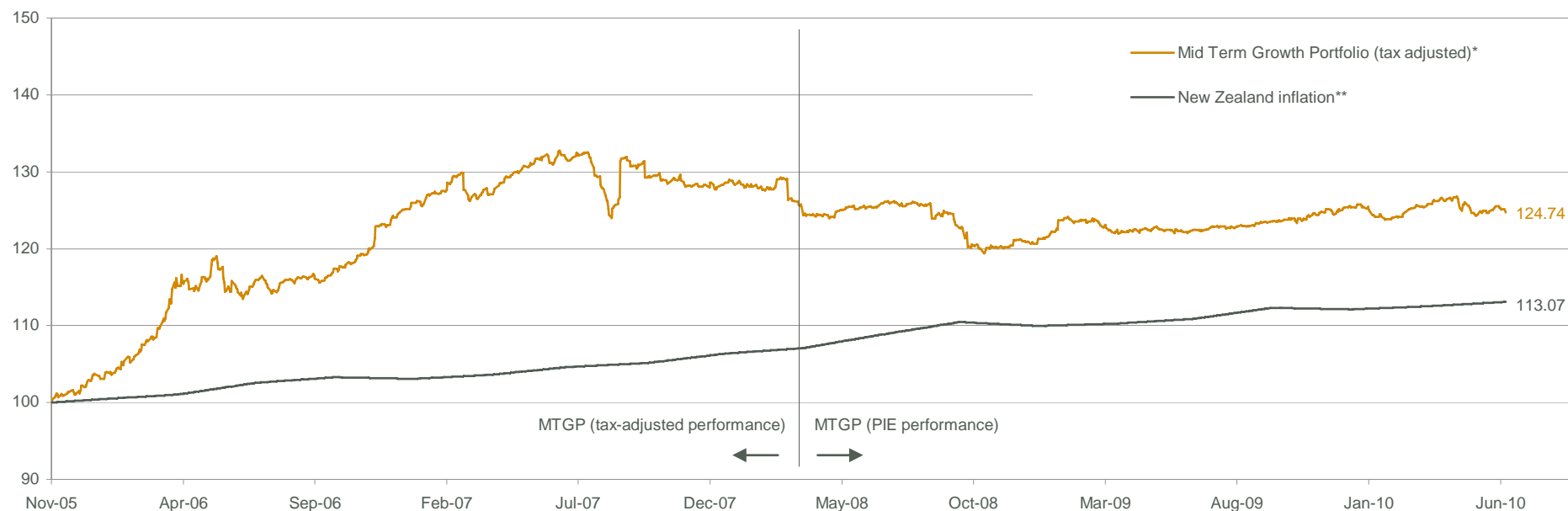
The second reason is that systematic risk management strategies can be back-tested. This provides insights into how they would have impacted performance. A quote often attributed to Mark Twain sums up the usefulness of this testing: "History does not repeat itself, but it does rhyme." The performance of the Strategy will not be the same in the future as it was in the past, but history provides clues as to what can be expected and where its weaknesses lie, thereby increasing its reliability.

During the month of May, when these strategies were implemented, global share markets suffered a sharp reversal of fortunes. Global shares were down 7.48%¹ over the month. This decline triggered the systematic risk management strategies and, as a result, cash is held in place of investments in the four sectors. In time, when share markets bounce back and the sectors start to trend up, the systematic risk management strategies will be triggered. At that time, the Portfolio will gain a valuable exposure to the four sectors through the Global Sector Strategy. One way to get a feel for the potential of a strategy is to look at past returns. Had the Global Sector Strategy been implemented for the period January 1974 to July 2009, it would have resulted in an investor's initial investment of \$100 increasing to almost \$1,305. To put this into perspective, during the same period, a passive investment in the S&P500 Index would have only appreciated to \$951.

¹ Source: Bloomberg.

TAX-ADJUSTED PERFORMANCE SINCE MANDATE CHANGE (3 NOVEMBER 2005) TO 30 JUNE 2010* (PART 1)

MTGP PERFORMANCE ATTRIBUTION	1 MONTH	3 MONTH	6 MONTH
Positive	Bonds; cash; equity manager alpha	Equity manager alpha; bonds	Equity manager alpha; bonds
Neutral	n/a	Cash	Cash; bonds
Negative	Global shares; property	Global shares; property	Global shares; property



COMPARISON	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	5 YEAR PA	7 YEAR PA	SINCE MANDATE CHANGE ¹	MAXIMUM DRAWDOWN*
Portfolio*	-0.07%	-0.86%	-0.50%	1.89%	-0.44%	-	-	24.74%	-10.03%
New Zealand inflation**	0.16%	0.50%	0.87%	1.99%	1.94%	-	-	13.07%	-0.46%

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

TAX-ADJUSTED PERFORMANCE SINCE MANDATE CHANGE (3 NOVEMBER 2005) TO 30 JUNE 2010* (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's mandate was changed on 3 November 2005, providing clients with a portfolio that allows them to protect their purchasing power from the effects of inflation.

MTGP was established as a New Zealand Unit Trust. 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 New Zealand Unit Trust) 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 New Zealand Funds Management.

Comparative Index

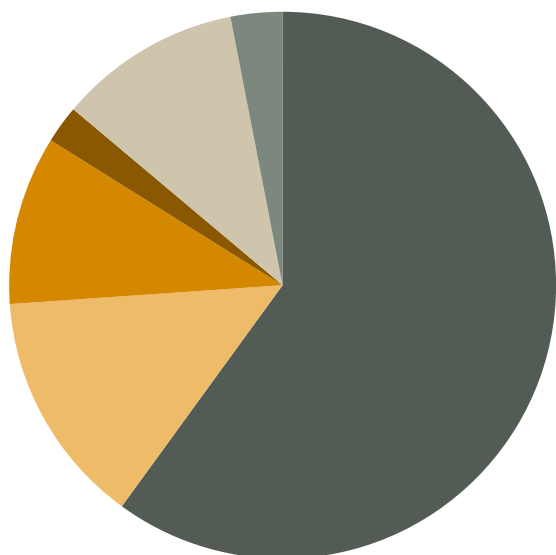
- ** The comparative index is New Zealand's inflation rate as measured by the Consumers Price Index. Source: Bloomberg.

Maximum Drawdown

- x Returns should be looked at in conjunction with the level of risk associated with an investment. For this reason, 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.

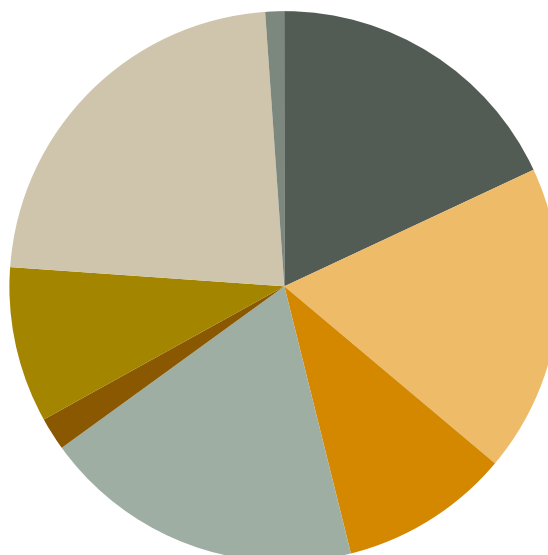
ASSET ALLOCATION (%)

January 2009



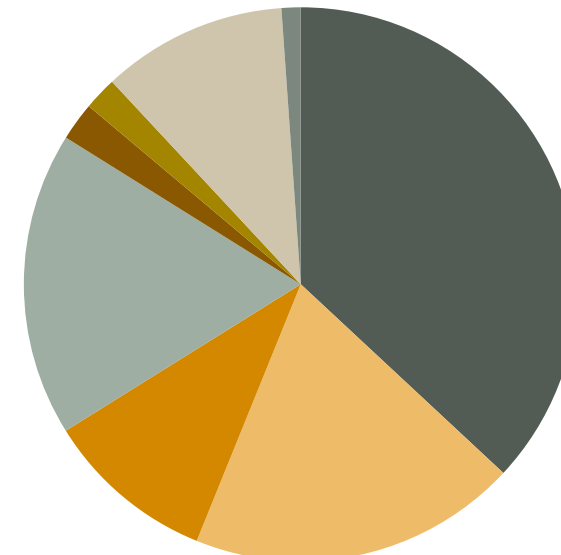
● CASH	60
● INFLATION-LINKED GOVERNMENT BONDS	14
● GOVERNMENT BONDS	10
● LOANS	2
● GLOBAL SHARES (HEDGED)	11
● AUSTRALASIAN SHARES (HEDGED)	3
TOTAL	100

January 2010



● CASH	18
● INFLATION-LINKED GOVERNMENT BONDS	18
● GOVERNMENT BONDS	10
● CORPORATE BONDS	19
● LOANS	2
● GLOBAL PROPERTY (UNHEDGED)	9
● GLOBAL SHARES (PARTIALLY HEDGED)	23
● AUSTRALASIAN SHARES (UNHEDGED)	1
TOTAL	100

June 2010



● CASH	37
● INFLATION-LINKED GOVERNMENT BONDS	19
● GOVERNMENT BONDS	10
● CORPORATE BONDS	18
● LOANS	2
● GLOBAL PROPERTY (PARTIALLY HEDGED)	2
● GLOBAL SHARES (PARTIALLY HEDGED)	11
● AUSTRALASIAN SHARES (UNHEDGED)	1
TOTAL	100

COMPLETE PORTFOLIO AS AT 30 JUNE 2010

PORTFOLIO SUMMARY

Yield ¹	4.8%
Income strategies (before share hedge)	86%
Growth strategies (before share hedge)	14%
Currency strategies	0%
Total economic exposure	100%

STRATEGY / SECURITY	MANAGER	ASSET CLASS	PORTFOLIO VALUE	PORTFOLIO ALLOCATION	YIELD
INCOME STRATEGIES				91.8%	
Bank deposits / Bank bills	NZ Funds	Cash	\$27,109,004	38.0%	2.6%
United States inflation-linked government bonds	NZ Funds	Inflation-linked bonds	\$5,466,928	7.7%	5.3%
New Zealand inflation-linked government bonds	NZ Funds	Inflation-linked bonds	\$3,254,308	4.6%	5.1%
German inflation-linked government bonds	NZ Funds	Inflation-linked bonds	\$2,819,899	4.0%	4.8%
Transpower inflation-linked bonds	NZ Funds	Inflation-linked bonds	\$2,163,315	3.0%	7.1%
Investment-grade corporate bonds	PIMCO	Corporate bonds	\$6,534,375	9.2%	7.2%
Investment-grade corporate bonds	iShares	Corporate bonds	\$5,937,907	8.3%	7.1%
Global government bonds	Franklin Templeton	Government bonds	\$3,306,674	4.6%	6.5%
German government bonds	NZ Funds	Government bonds	\$1,230,458	1.7%	5.2%
United States government bonds	NZ Funds	Government bonds	\$1,214,672	1.7%	5.7%
United Kingdom government bonds	NZ Funds	Government bonds	\$1,113,260	1.6%	5.9%
Loans (via Private Loan Trust)	Fidelity	New Zealand direct loans	\$1,148,951	1.6%	7.6%
Share hedge cash ²	NZ Funds	Cash	\$4,227,976	5.9%	2.6%
GROWTH STRATEGIES				8.2%	
Global shares - Core	Lazard	Global shares	\$4,014,487	5.6%	5.4%
Global shares - Utilities	NZ Funds	Global shares	\$3,626,714	5.1%	7.1%
Global property	Challenger/Resolution/NZ Funds	Global property	\$1,583,749	2.2%	4.9%
Australasian shares - High dividend yield	NZ Funds	Australasian shares	\$859,947	1.2%	7.2%
Global sector strategy	NZ Funds	Global shares	\$0	0.0%	2.8%
Commodities	Standard & Poor's	Commodities	\$0	0.0%	n/a
Share hedge ²	NZ Funds	Global shares	-\$4,227,976	-5.9%	2.6%
CURRENCY STRATEGIES				0.0%	
Foreign currency exposure	NZ Funds	Fully hedged	\$0	0.0%	n/a
TOTAL ECONOMIC EXPOSURE³			\$71,384,649	100.0%	4.8%

¹ 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. The Portfolio's return could be less than the Portfolio's yield. Details of the yield calculation are available on request from New Zealand Funds Management. ² The effect of the share hedge is to reduce the allocation to shares and increase the allocation to cash. ³ Total economic exposure represents the total economic value of a Portfolio, which is the gross asset value of the Portfolio adjusted for the effect of direct or indirect derivative positions taken by the Portfolio. 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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