

## MANAGER INSIGHT – 31 JANUARY 2010

The Portfolio's objective is to protect against inflation, which over calendar year 2009 was up 2%<sup>2</sup>. Over the same period, the Portfolio appreciated by 3%<sup>1</sup>, solidly achieving its objective of beating inflation. New Zealand recently experienced a quarter of deflation – the Consumer Price Index declined slightly, wrong-footing a number of economic forecasters. This trend is unlikely to continue as it was driven by a slump in food prices over the quarter and unfortunately, leading indicators suggest that the escalation in food prices will once again resume.

The accompanying chart illustrates the impact that food inflation has had on the Consumer Price Index. It shows that the growth in food prices has outpaced the general price level by a significant margin over the last three years – food prices have grown at 5% per annum while general inflation ran at 2.8% per annum. This escalation has been a major contributor to consumer price inflation in New Zealand. The chart also shows that food prices dropped in the most recent quarter by 2.4%. This decline can almost entirely explain the drop in the Consumer Price Index over the quarter. The decline in food prices over the last quarter can be partly explained by seasonal factors – food prices tend to decline during the fourth quarter as the price of summer fruits and vegetables plummet. For instance, the cost of lettuce was down 64% and tomatoes were down 32% over the quarter. However, these declines do not tend to make food inflation negative for the quarter – in the past 50 years, food prices have only declined six times during the December quarter and last year's decline was almost twice the size of the next largest.

Economists tend to use futures prices on soft commodities as a leading indicator for food prices as soft commodities (commodities that are grown

rather than mined) are either used directly or as an input in processed foods. There is a lag in the impact of futures prices on soft commodities for a number of reasons – these include hedging by food producers (as this locks in old pricing for a period of time) and a reluctance to change prices (producers risk losing market share). Interestingly, soft commodities' futures prices (when measured in New Zealand dollars) declined dramatically a few years ago, but have now bottomed and are starting to show some signs of life again. If the relationship holds and this recovery continues, food prices will begin to rise, putting upward pressure on inflation.

**New Zealand food price annual inflation versus soft commodity prices**

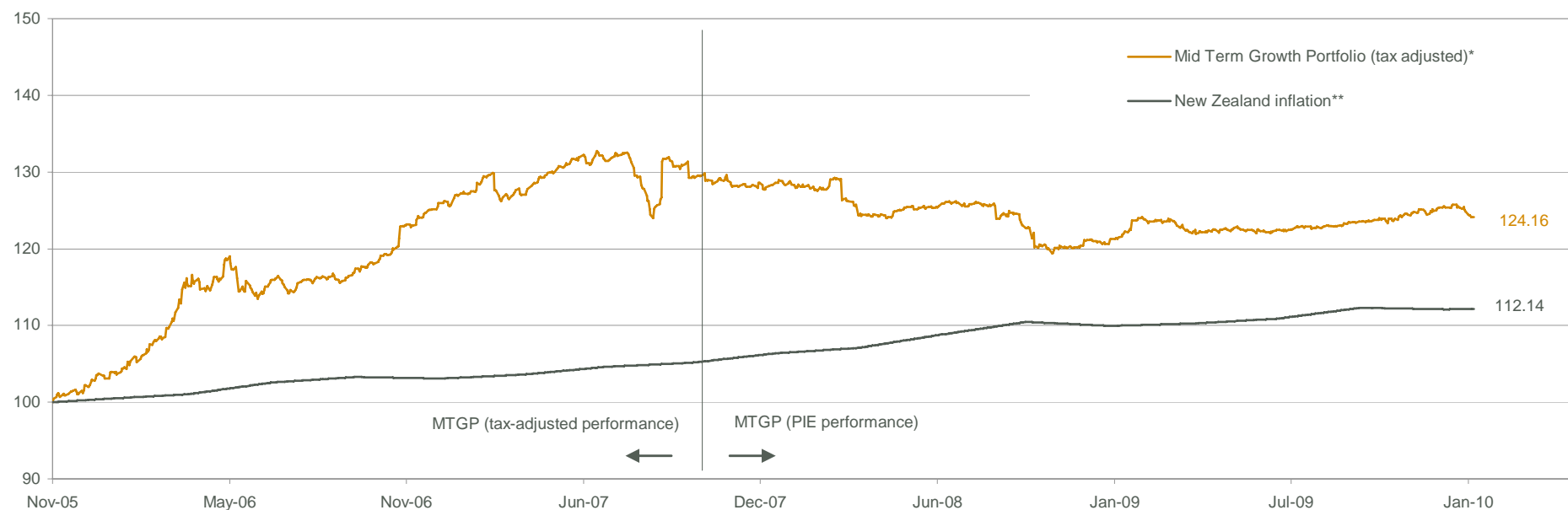


Source: Bloomberg

<sup>1</sup> 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. <sup>2</sup> Source: Bloomberg.

## TAX-ADJUSTED PERFORMANCE SINCE MANDATE CHANGE (3 NOVEMBER 2005) TO 31 JANUARY 2010\* (PART 1)

MTGP PERFORMANCE ATTRIBUTION	1 MONTH	3 MONTH	6 MONTH
Positive	Cash; bonds	Bonds; global shares	Bonds; global shares
Neutral	Equity manager alpha	Cash	Cash; equity manager alpha
Negative	Global shares; property	Property; equity manager alpha	Property



COMPARISON	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	5 YEAR PA	7 YEAR PA	SINCE MANDATE CHANGE <sup>1</sup>	MAXIMUM DRAWDOWN*
Portfolio*	-0.96%	0.18%	1.05%	0.17%	-1.54%	-	-	24.16%	-10.03%
New Zealand inflation**	0.03%	-0.09%	0.71%	1.90%	2.56%	-	-	12.14%	-0.46%

<sup>1</sup> 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 31 JANUARY 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**

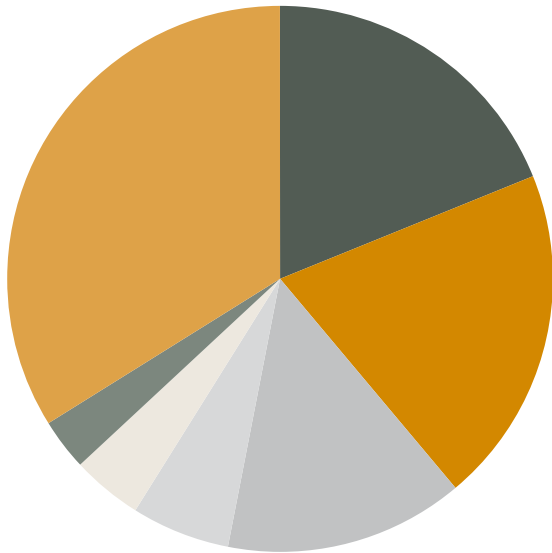
- \*\* The comparative index is New Zealand's inflation rate as measured by the Consumers Price Index. Source: Bloomberg.

**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.

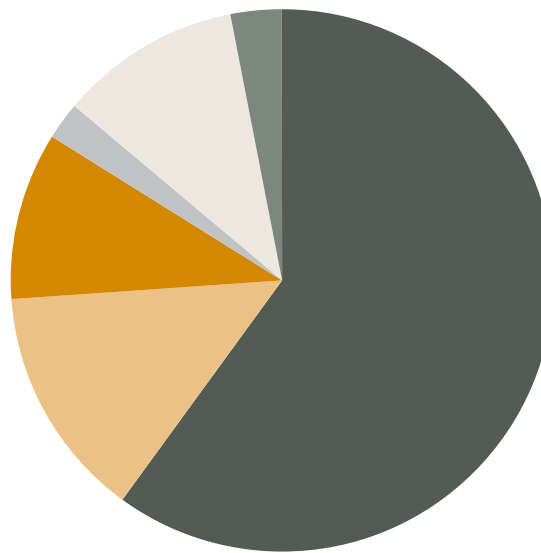
ASSET ALLOCATION (%)

January 2008



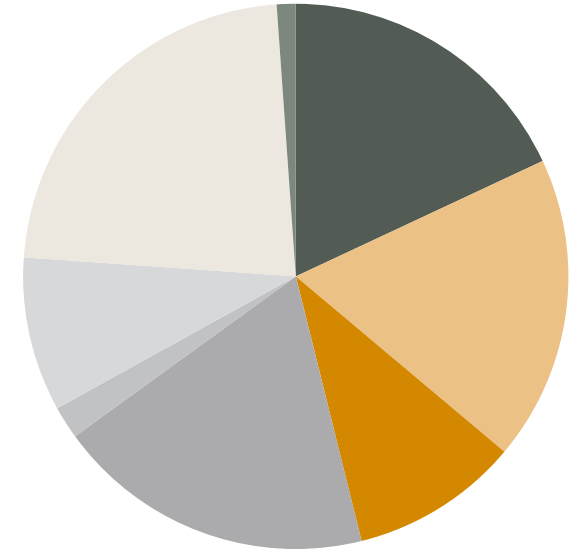
● CASH	19
● BONDS	20
● STRUCTURED CREDIT	14
● PRIVATE EQUITY	6
● GLOBAL SHARES (HEDGED)	4
● AUSTRALASIAN SHARES (HEDGED)	3
● ABSOLUTE RETURN STRATEGIES	34
TOTAL	100

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	9
● GLOBAL SHARES (HEDGED)	23
● AUSTRALASIAN SHARES (HEDGED)	1
TOTAL	100

## COMPLETE PORTFOLIO AS AT 31 JANUARY 2010

## PORTFOLIO SUMMARY

Yield <sup>1</sup>	5.6%
Income strategies (before share hedge)	66%
Growth strategies (before share hedge)	34%
Currency strategies	0%
Total economic exposure	100%

STRATEGY / SECURITY	MANAGER	ASSET CLASS	PORTFOLIO VALUE	PORTFOLIO ALLOCATION	YIELD
<b>INCOME STRATEGIES</b>				<b>80.2%</b>	
Bank deposits / Bank bills	NZ Funds	Cash	\$11,770,991	18.1%	2.8%
United States inflation-linked government bonds	NZ Funds	Government bonds	\$5,483,504	8.4%	5.6%
New Zealand inflation-linked government bonds	NZ Funds	Government bonds	\$3,302,710	5.1%	5.3%
German inflation-linked government bonds	NZ Funds	Government bonds	\$3,027,474	4.7%	5.3%
Investment-grade corporate bonds	PIMCO	Corporate bonds	\$6,199,204	9.5%	7.8%
Investment-grade corporate bonds	iShares	Corporate bonds	\$5,862,335	9.0%	7.3%
German government bonds	NZ Funds	Government bonds	\$1,133,572	1.7%	5.5%
United States government bonds	NZ Funds	Government bonds	\$1,106,839	1.7%	6.2%
United Kingdom government bonds	NZ Funds	Government bonds	\$1,048,680	1.6%	6.1%
Global government bonds	Franklin Templeton	Government bonds	\$3,165,218	4.9%	6.3%
Loans (via Private Loan Trust)	Fidelity	New Zealand direct loans	\$1,129,546	1.7%	7.8%
Share hedge <sup>2</sup>	NZ Funds	Cash	\$8,934,228	13.7%	2.8%
<b>GROWTH STRATEGIES</b>				<b>19.8%</b>	
Global property	Challenger/Resolution/NZ Funds	Global property	\$6,081,413	9.4%	4.7%
Global shares - Core	Lazard	Global shares	\$4,189,055	6.4%	5.6%
Global shares - Growth	T Rowe Price	Global shares	\$3,886,705	6.0%	5.2%
Global shares - High dividend yield	Tweedy Browne	Global shares	\$3,738,287	5.8%	7.0%
Global shares - Utilities	NZ Funds	Global shares	\$2,984,383	4.6%	7.2%
Australasian shares - High dividend yield	NZ Funds	Australasian shares	\$900,267	1.4%	6.9%
Share hedge <sup>2</sup>	NZ Funds	Global shares	-\$8,934,228	-13.7%	2.8%
<b>CURRENCY STRATEGIES</b>					
Foreign currency exposure	NZ Funds	Fully hedged	\$0	0.0%	n/a
<b>TOTAL ECONOMIC EXPOSURE</b>			<b>\$65,010,183</b>	<b>100.0%</b>	<b>5.6%</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. 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. <sup>2</sup> The effect of the share hedge is to reduce the allocation to shares and increase the allocation to cash. <sup>3</sup> 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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