

Portfolio overview – 31 December 2009

Needs category objective

- To provide clients with an allocation of funds to protect their purchasing power from the effects of inflation.

Investment objective

- To primarily invest in a diversified range of income-producing assets and growth assets, utilising active investment management.

New Investment Statement

- On 30 October 2009 a new Investment Statement covering the Portfolio came into effect. This new Investment Statement altered the needs category objective and investment objective of the Portfolio. These changes were implemented from 19 November 2009, after the expiration of the notice period prescribed in the Trust Deed.

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

The Portfolio produced a return of 0.52%¹ in December and 3.40%¹ for the year. The Portfolio's objective is to protect against inflation, which was running at 2.15%² for the first nine months of 2009. This is equivalent to 0.24% a month or 2.87% for the year.

Commodities

The argument for including commodities in the Portfolio is relatively simple – commodities perform strongly during periods of high inflation. Using the 1970s as an example, inflation averaged 7.3% pa and the S&P Goldman Sachs Commodity Index appreciated 21.2% pa. The best explanation for this strong performance is that commodities are real assets. When inflation is running hot the value of paper money is declining. Real assets, however, hold their value in real terms and thus their prices appreciate in nominal terms. Another take on this line of thought is a quote from David Ricardo, a political economist:

“Gold and silver, like other commodities, have an intrinsic value, which is not arbitrary, but is dependent on their scarcity, the quantity of labour bestowed in procuring them, and the value of the capital employed in the mines which produce them.”

David Ricardo (1772–1823)

To gain an exposure to commodities, the Portfolio holds long positions in futures contracts on the S&P Goldman Sachs Commodity Index. These futures contracts allow the Portfolio to participate in the returns of this

index in an extremely cost efficient manner. To avoid leveraging the Portfolio, cash is held that is equivalent to the face value of these contracts. The end result is very similar to the Portfolio investing in a passive fund that follows the index. A number of parallels can be made between the S&P Goldman Sachs Commodity Index and share market indices such as the S&P 500 Index. For a commodity to be eligible for inclusion it has to pass a liquidity test – in this case the physical commodities have to have active, liquid futures markets denominated in US dollars. The allocations are then determined by relative size – in this case allocations are determined by the value of global production of the physical commodity.

The biggest obstacle to adding commodities to the Portfolio is the large swings in their returns. To control this risk, a relatively modest allocation to commodities is made and a systematic hedging approach is also utilised. The hedging approach uses two signals. The first is the momentum-based approach used in other assets classes. Specifically, when commodity markets are trending downwards and thus generating losses, measures are taken to protect capital. While these systematic strategies are not perfect, they tend to reduce the losses in the worst years. The second approach protects capital when central banks are aggressively intervening in the economy. When this occurs inflation is either about to decline (if real interest rates are very high) or the economy risks entering a deflationary period (if real interest rates are negative).

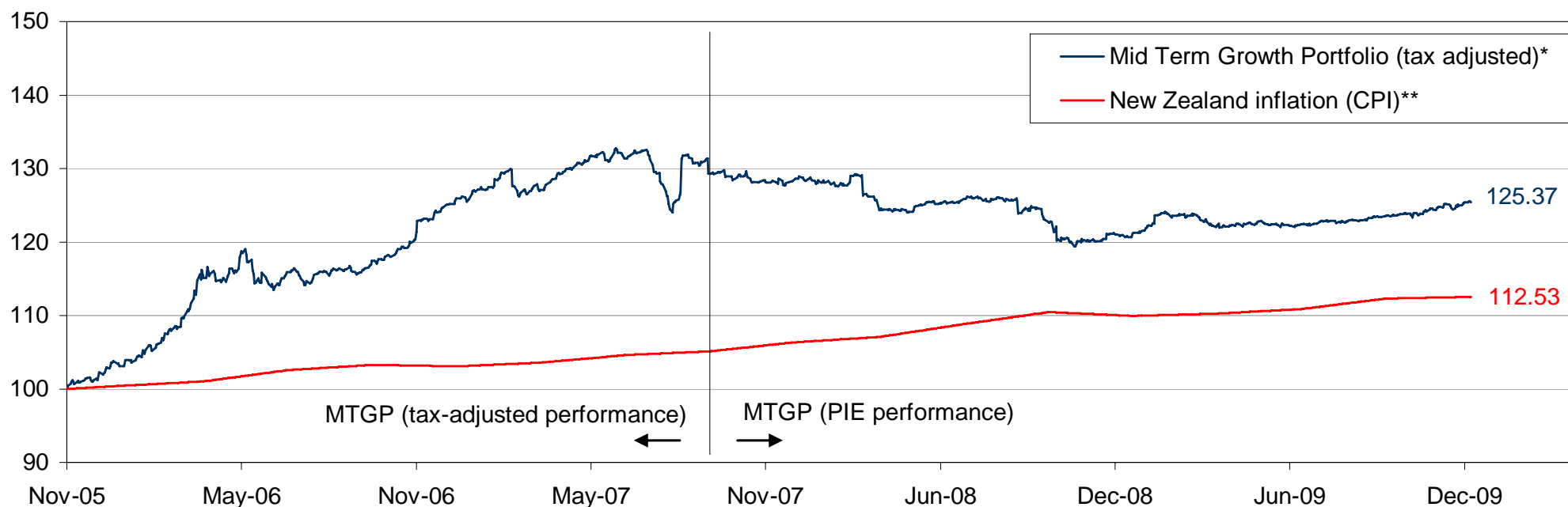
¹ Returns are stated after Portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns. ² Source: Bloomberg.

Mid Term Growth Portfolio



Tax-adjusted performance since mandate change (3 November 2005) to 31 December 2009* (Part 1)

MTGP performance attribution	1 month	3 month	6 month
Positive	Global shares; property	Bonds; global shares	Bonds; global shares
Neutral	Cash	Cash	Cash
Negative	Equity manager alpha; bonds	Property	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
Portfolio (tax adjusted)*	0.52%	1.48%	2.40%	3.40%	-1.27%	-	-	5.58%	-10.03%
New Zealand inflation**	0.07%	0.20%	1.50%	2.35%	2.86%	-	-	2.88%	-0.46%

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 December 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.

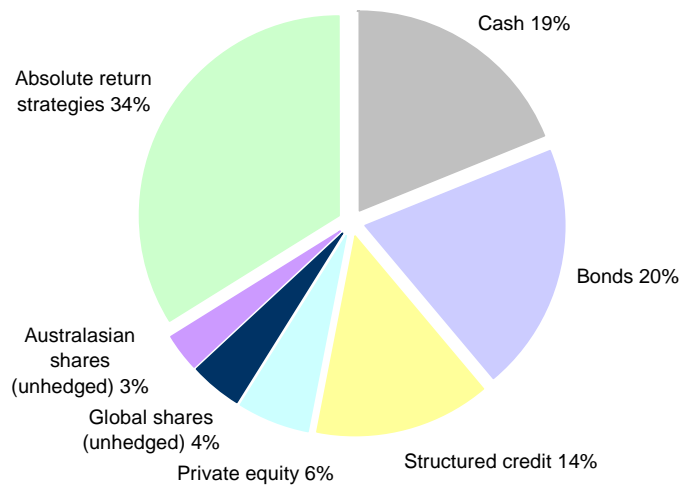
Maximum drawdown

- × 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.

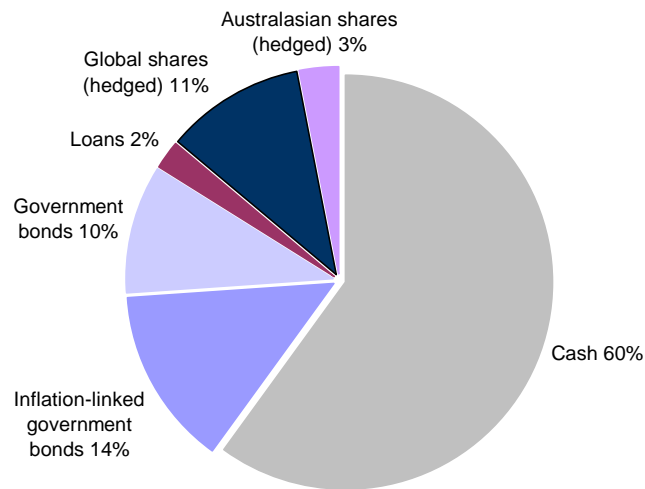
Mid Term Growth Portfolio

Asset allocations

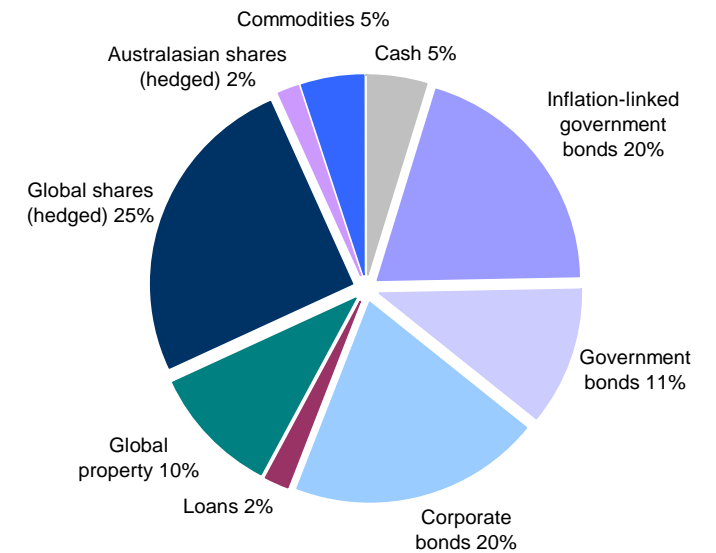
January 2008



January 2009



November 2009



Mid Term Growth Portfolio



Complete portfolio as at 30 November 2009

Portfolio summary

Yield ¹	5.7%
Income strategies (before share hedge)	58%
Growth strategies (before share hedge)	32%
Currency strategies	0%
Total economic exposure	100%

Strategy / Security	Manager	Asset class	Portfolio value	Proportion of portfolio	Yield ¹
Income strategies				73.1%	
Bank deposits	NZ Funds	Cash	\$1,785,986	3.6%	2.5%
Bank bills	NZ Funds	Cash	\$627,663	1.1%	2.7%
Inflation-linked government bonds	NZ Funds	Government bonds	\$11,794,031	20.0%	5.3%
Investment-grade corporate bonds	PIMCO	Corporate bonds	\$5,967,588	10.1%	7.8%
Investment-grade corporate bonds	iShares	Corporate bonds	\$5,852,580	9.9%	8.4%
High-quality government bonds	NZ Funds	Government bonds	\$3,371,139	5.7%	5.8%
Global government bonds	Franklin Templeton	Government bonds	\$3,123,242	5.3%	6.3%
Loans (via Private Loan Trust)	Fidelity	New Zealand direct loans	\$1,527,305	2.0%	7.3%
Share hedge ²	NZ Funds	Cash	\$8,987,612	15.3%	2.5%
Growth strategies				26.9%	
Global property	Challenger/Resolution/NZ Funds	Global property	\$6,094,845	10.4%	4.7%
Global shares - Core	Lazard	Global shares	\$4,199,314	7.1%	5.4%
Global shares - Growth	T Rowe Price	Global shares	\$3,920,509	6.7%	5.2%
Global shares - High dividend yield	Tweedy Browne	Global shares	\$3,734,961	6.3%	6.8%
Global shares - Utilities	NZ Funds	Global shares	\$2,993,835	5.1%	7.1%
Commodities	S&P Goldman Sachs	Commodities	\$2,983,763	5.1%	n/a
Australasian shares - High dividend yield	NZ Funds	Australasian shares	\$906,117	1.5%	7.1%
Share hedge ²	NZ Funds	Global shares	-\$8,987,612	-15.3%	2.5%
Currency strategies					
Foreign currency exposure	NZ Funds	Fully hedged	\$0	0.0%	n/a
Total economic exposure			\$58,882,878	100.0%	5.7%

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. 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. ² 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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