

Manager insight – 31 December 2009

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).

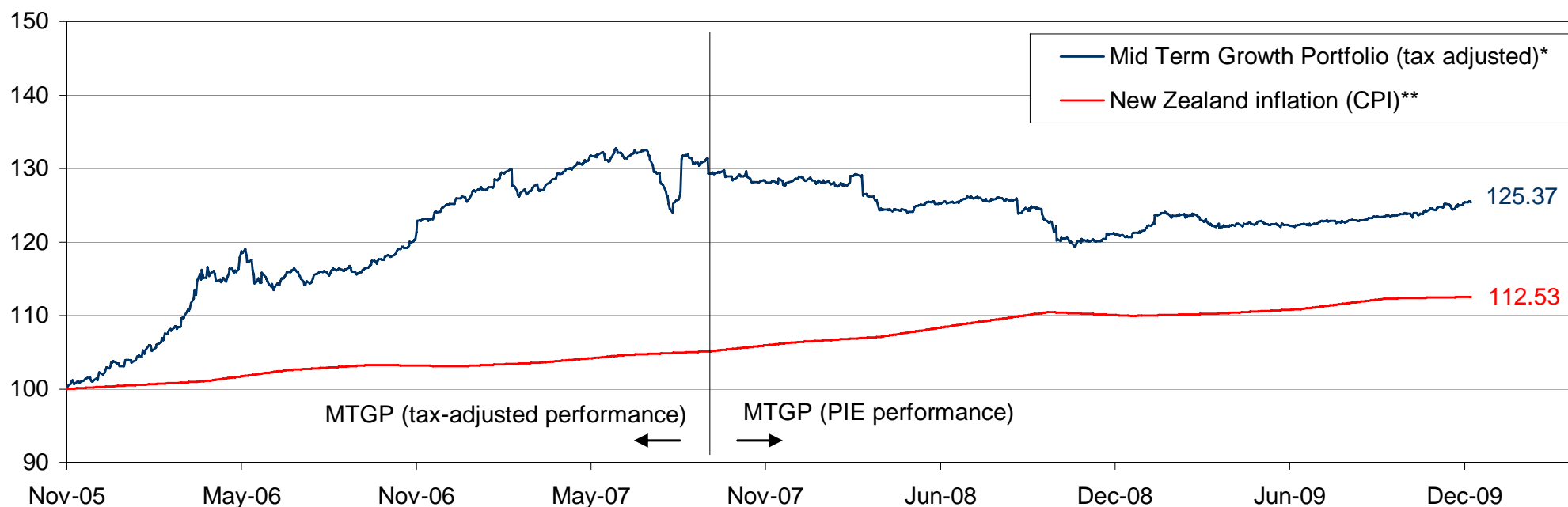
¹ Returns are stated after Portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns. ² Source: Bloomberg.

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.

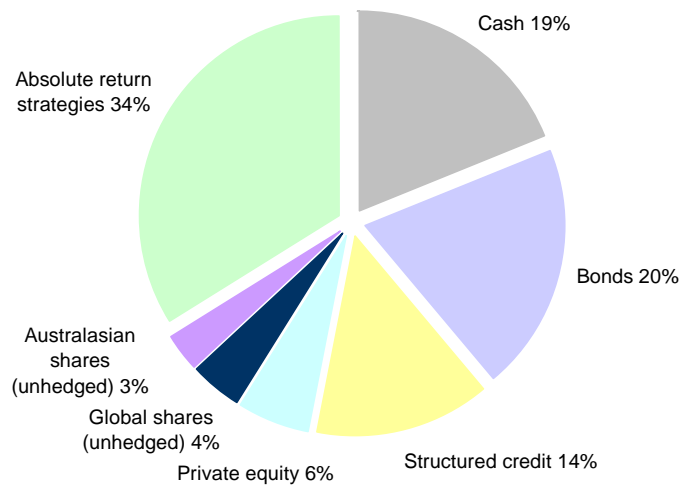
Maximum drawdown

- × 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.

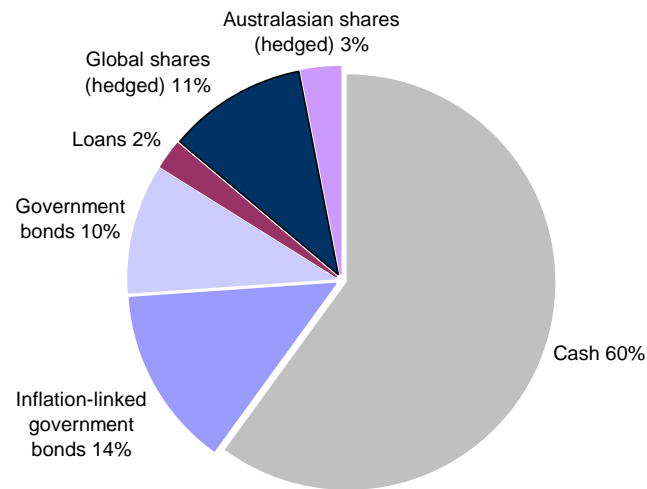
Mid Term Growth Portfolio

Asset allocations

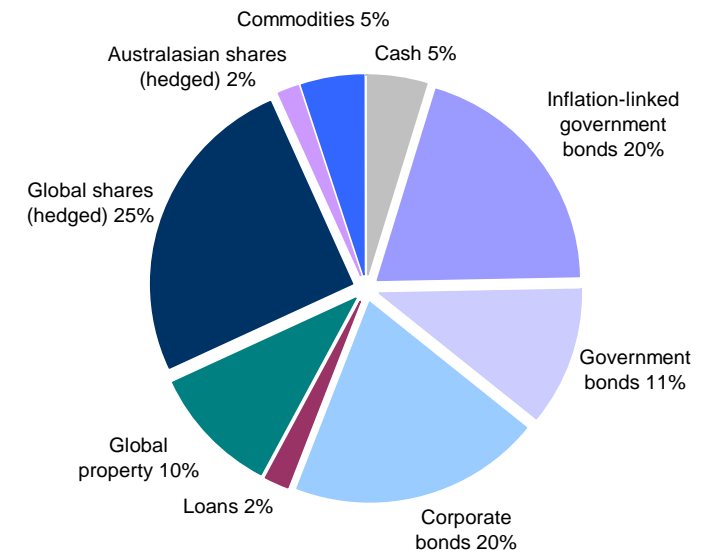
January 2008



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.

DISCLAIMER: These Portfolio Insights have been provided for information purposes only. The content of this document is not intended as a substitute for specific professional advice on investments, financial planning or any other matter.

While the information provided in this document is stated accurately to the best of our knowledge and belief, New Zealand Funds Management Limited, its directors, employees and related parties accept no liability or responsibility for any loss, damage, claim or expense suffered or incurred by any party as a result of reliance on the information provided and opinions expressed in these Portfolio Insights except as required by law.