

“Do you know the only thing that gives me pleasure? It’s to see my dividends coming in.”

- John D Rockefeller, American Industrialist, Philanthropist and Founder of Standard Oil Company, 1839-1937.

WHY DIVIDENDS?

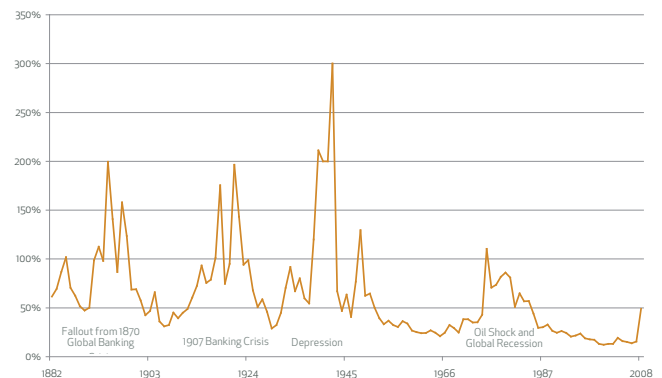
As the world de-leverages, it is likely we will enter a prolonged period of low economic growth. In such an environment, share price appreciation is likely to be minimal. While the banking crisis made headlines in 2008, the impact of the credit crunch on the consumer and the economy has not yet been fully felt. Companies will now have problems accessing credit – especially for larger, growth-orientated projects. Without increasing investment in assets, earnings growth becomes stunted; and it is earnings growth which is the primary driver of long-term sustainable share price appreciation, as opposed to leverage or multiple expansion.

It is also likely global capital markets face a future of declining new stock exchange listings and corporate takeovers – two important drivers of shorter-term share price appreciation. This is not to say the investment opportunity in shares is bleak. Following the global equity markets’ dramatic declines in 2008, values have improved significantly. Investors who adopted a strategy that matches the global investment environment can expect to be amply rewarded.

In an environment of limited economic growth, dividends become a powerful driver of return. The importance of dividends has been diminished by a prolonged period of share price appreciation. From 1984-2000, the S&P500 returned 16.5%pa. Dividends contributed only 18% of the total return, or around 3%pa. However, following significant financial dislocations, such as the current credit crisis, dividends have historically dominated the total return from equities. At present, Tweedy Browne’s portfolio of high dividend-paying shares yields roughly 5% (with an additional 3% currently being realised through hedging this exposure back to New Zealand dollars), sufficient to generate equity like returns without the dependence on capital appreciation.

During equity market dislocations such as those of 1897, 1921, 1941, 1973 and 2008, the dividend yield is – on its own – unlikely to offset declining share prices. But when combined with NZ Funds’ capital preservation strategy, which seeks to protect investors from a prolonged decline in the broader market, it creates an investment proposition with the dual aims of preservation of capital and the potential to generate positive returns in a falling market.

DIVIDENDS AS A PERCENTAGE OF TOTAL RETURNS (rolling 10-year returns)



Source: R Shiller, S&P.

For example, should markets decline 20% this year, an unhedged dividend-orientated portfolio might decline by (only) 15%, as high dividend yields help offset the losses caused by share price depreciation. In and of itself, such a return would be disappointing. Yet, when these returns are combined with a capital preservation strategy that compensates investors for the full 20% decline (despite having only suffered a 15% loss), the net result is a positive return of 5%. In short, an outcome from which the founder of Standard Oil Company might derive some pleasure.

TWEEDY, BROWNE COMPANY LLC

Nobel laureate Milton Friedman postulated in a series of essays entitled *Capitalism and Freedom* (1962), that a state cannot offer its citizens personal freedom and the opportunity to pursue happiness without also offering economic freedom. This is because a state that seeks to control the flow of capital must ultimately also control its citizens. As a result, he advocated capitalism and a free market. At its heart, capitalism assumes that, over time,

the market will allocate resources more accurately than any state could hope to.

In practice, the market is made up of thousands of independent organisations, each allocating their (or their investors') capital to the areas of the economy where they feel the need is greatest and the resulting reward the highest. Over time, those who perform this role with competency flourish, while those who do not are penalised with economic losses and must ultimately exit. In the current environment, the assumption of rational capital allocation is contentious. However, over long periods the proof is irrefutable, as is Tweedy Browne's track record as an investment organisation. Tweedy Browne epitomises all that is good about the legacy of Wall Street and its role in correctly allocating capital over the past century that, in turn, has led to an unprecedented period of American prosperity.

BACKGROUND

Tweedy Browne's origins are as a privately owned New York brokerage firm that was founded in 1920. For many years, in addition to its broking activities, Tweedy Browne invested its own capital in the equity markets. Over time, this activity came to dominate Tweedy Browne's business and the company evolved into an investment manager. Initially, Tweedy Browne's investment management was restricted to internal funds, but, in 1968, it offered its investment services more widely.

In 1979, it introduced an account focused on the dividend-paying abilities of companies and, in September 2007, this was formally launched as the Tweedy Browne Worldwide High Dividend Yield Value Fund, a US-based registered investment company only available to US residents. To this day, Tweedy Browne's principals manage their personal wealth (which has snowballed to become some US\$638 million) in the same funds as external investors, resulting in a strong alignment of incentives.

Tweedy Browne's investment philosophy is founded on its interaction with one of Tweedy Browne's earliest customers, Benjamin Graham. Graham was an influential economist and New York-based professional investor. He

has become known as "the father of securities analysis" and is the author of several books on the topic. He is widely considered the first proponent of 'value' investing, an investment approach he began teaching at Columbia Business School in 1928. One of his students was Warren Buffett, who – after graduating with an A+ – joined Graham's investment company.

Tweedy Browne's philosophies today are very much based on Graham's value-orientated investment approach. Such an approach advocates investing only when there is a sufficient margin of safety to protect against long-term capital loss. Tweedy Browne utilises the simple and trustworthy valuation methods espoused by Graham. Like Graham, Tweedy Browne does not constrain itself by only investing in specific sectors. However, it does place significant emphasis on investing in companies with transparent business models, where the economics of a given company's contribution to society are easily identifiable.

As of 31 December 2008, the firm managed approximately US\$7.6 billion for individuals, institutions, partnerships, offshore funds and three mutual funds of a registered investment company (which are available to US residents only) – the Tweedy Browne Global Value Fund, the Tweedy Browne Value Fund and the Tweedy Browne Worldwide High Dividend Yield Value Fund. These funds are invested across approximately 200 global companies, which meet Tweedy Browne's investment criteria.

INVESTMENT PERSONNEL

Central to Tweedy Browne's success has been the tenure and experience of its people, in particular the investment team. Tweedy Browne's relatively small investment team is made up of 5 managing directors, all of whom have an ownership interest in the firm and have tenures ranging from 18 to 40 years.

This group is supported by 7 analysts, who have been with the firm for between 6 and 22 years. In its entire history, Tweedy Browne has had only 11 principals, 5 of whom are currently active:

Christopher H Browne joined Tweedy Browne in 1969. Browne is a graduate of the University of Pennsylvania. He places significant emphasis on how behavioural psychology affects financial decisions and has spoken frequently on this topic in his former role on the faculty advisory committee of Harvard's John F Kennedy School Government programme in Investment Decisions and Behavioural Finance.

William H Browne joined Tweedy Browne in 1978. Browne holds the degrees of a BA from Colgate University and an MBA from Trinity College in Dublin, Ireland.

Thomas H Shrager joined Tweedy Browne in 1989. Shrager had previously worked in mergers and acquisitions at Bear Stearns and as a consultant for Arthur D Little. He holds a BA and a Masters in International Affairs from Columbia University.

John D Spears joined Tweedy Browne in 1974. Spears formerly studied at the Babson Institute of Business Administration, Drexel Institute of Technology and the University of Pennsylvania – The Wharton School.

Robert Q Wyckoff (Jr) joined Tweedy Browne in 1991. Wyckoff received a BA from Washington & Lee University and a JD from the University of Florida Law School.

At no time has a managing director or former general partner left Tweedy Browne to join another investment firm.

INVESTMENT PHILOSOPHY

Tweedy Browne is proud of its absolute adherence to Graham's original doctrine. In essence, Tweedy Browne capitalises on the principle of buying stocks at bargain prices during periodic market shakeouts when everyone decides that all is lost, making Tweedy Browne one of the few buyers. More specifically, Tweedy Browne aims to buy the stocks of companies selling at just under two-thirds of net current assets (reduced by all future charges that may arise) and then sell them again at 100% of net current assets.

Tweedy Browne's global high-dividend-yield portfolios follow a value-oriented philosophy. However, they do not require as large a discount as two thirds (of net current assets) and have the additional criteria of insisting on an above-average dividend yield. Two specific investment opportunities Tweedy Browne screens for are companies with growing dividends and companies with above-average dividends where expectations have been low but are improving. Presently, approximately US\$280 million is managed using the dividend-orientated investment style.

INVESTMENT PROCESS

Tweedy Browne's dividend yield investment process starts by screening an internal database of thousands of international investment opportunities the firm has come to know over the years. The initial screen is for higher-than-average dividend yields. Following this, the firm looks for 'good companies' – being those that have a history of increasing earnings and dividends. This step eliminates companies that appear overvalued or have poor balance sheets. The remaining stocks are subject to intensive fundamental analysis. Finally, all purchase and sale decisions based on the results of the prior screening process will be jointly made by the investment committee, made up of the five managing directors.

On an individual investment basis, the ability of a company to pay cash dividends to its investors provides a true and timely indication of the financial health of the organisation. This is thanks to the fact that cash flows cannot be manipulated in order to pay out dividends – the money needs to be there! Companies with above-average or growing dividends will generally have a fairly solid or improving set of fundamentals.

Investments are generally sold if they meet one of the strictly set sell criteria. These include where an investment reaches the estimate of fair value; where an investment's prospects become uncertain; where a more attractive investment is discovered; and where there is a deterioration in an investment's fundamentals that could lead to a reduction in its future dividends. The average investment is held for three years, before the capital and profits are re-allocated to more rewarding sectors of the global economy.

PORTFOLIO CONSTRUCTION

Tweedy Browne's strategy is relatively concentrated with its portfolios tending to hold between 30 and 40 different stocks. No one company makes up much more than 5% of the portfolio. The portfolio also aims to avoid investing in companies that are highly cyclical or have sector-related problems.

Portfolios remain diversified with a wide range of sectors. Of the 15 main categories that currently make up a portfolio, Consumer Staples, Consumer Discretionary and Financials are the largest. It is important to note that Tweedy Browne's global high-dividend-yield strategy only has a 4.7% exposure to Financials, which differs greatly from the Morgan Stanley Capital International (MSCI) that is dominated by the financial sector. Additionally, portfolios are diversified by country and region.

COUNTRY ALLOCATION (as at 28 february 2009)

Country	Benchmark	Tweedy Browne
Developed markets	100.0%	81.8%
United States	51.4%	38.4%
Japan	12.3%	-
Great Britain	9.7%	11.5%
Germany	3.8%	1.4%
France	4.9%	9.9%
Canada	4.2%	-
Hong Kong	1.0%	-
Belgium	0.4%	-
Finland	0.6%	-
Italy	1.7%	2.3%
Netherlands	1.2%	12.7%
Norway	0.3%	-
Portugal	1.6%	-
Spain	2.0%	2.5%
Sweden	0.9%	-
Switzerland	3.9%	3.0%
Ireland	0.2%	-
Emerging markets	0.0%	6.7%
South Korea	-	0.2%
Mexico	-	6.5%
Cash	0.0%	11.5%
TOTAL	100.0%	100.0%

Source: Tweedy Browne.

SECTOR ALLOCATION (as at 28 february 2009)

Sector	Benchmark	Tweedy Browne
Financials	18%	8%
Materials	5%	4%
Energy	12%	12%
Utilities	6%	0%
Telecommunication Services	5%	7%
Information Technology	11%	0%
Health Care	12%	6%
Consumer Discretionary	9%	12%
Consumer Staples	11%	31%
Industrials	11%	9%
Cash	-	12%
TOTAL	100%	100%

Source: Tweedy Browne.

The current dividend yield of the portfolio is 5.8%, compared with a dividend yield of 3.2% on the MSCI. Hedged back into New Zealand dollars, this equates to an approximate yield of 8.3%.

INVESTMENT RETURNS

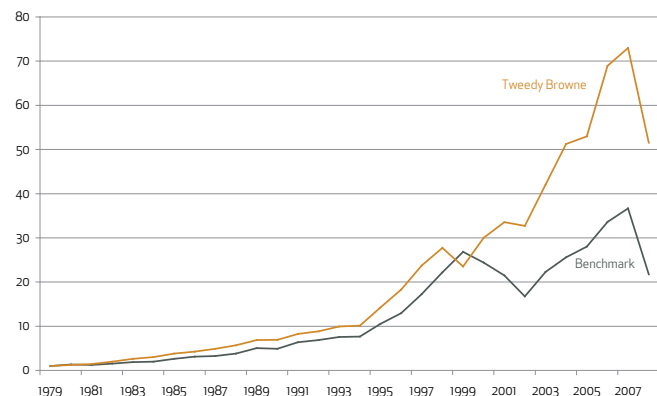
"We were nominated for mutual fund managers of the year by Morningstar, an acknowledgement we would have gladly exchanged for positive returns in our funds."

Source: Tweedy Browne – Investment Adviser's Letter, 15 January 2009.

Tweedy Browne's global high-dividend-yield portfolios have enjoyed a 20-year compound growth rate of above 15%, deducting all expenses (but before tax), making it an extraordinarily rewarding investment operation.

Since 1979, the Tweedy Browne Worldwide High Dividend Yield Composite (comprised of its investment funds using that strategy) has outperformed its benchmark by 4%pa. More importantly in times like these, it has only displayed 72% of the volatility of the S&P500. In particular, the dividend yield portfolio tends to outperform the market by a significant margin when overall investment returns are negative.

TWEEDY BROWNE VERSUS BENCHMARK



Source: Bloomberg, Tweedy Browne. Benchmark is S&P 500 Index (1980-2002) and MSCI World Index (2003-2008).

TWEEDY BROWNE'S PERFORMANCE DURING WORST SIX YEARS SINCE 1980

Year	Benchmark	Worldwide High Dividend Yield Value Portfolio	Outperformance
2008	-40.7%	-29.3%	11.4%
2002	-22.1%	-2.5%	19.6%
2001	-11.9%	12.0%	23.9%
2000	-9.1%	27.3%	36.4%
1981	-4.9%	13.0%	18.4%
1990	-3.1%	0.8%	3.9%

Source: Bloomberg, Tweedy Browne.

OUTLOOK

In recent times, Tweedy Browne has undergone a period of 'pruning and planting' – a process that has left the firm quietly confident about the outlook for its portfolios. This is in sharp contrast with the fear and uncertainty that has come to dominate much of recent investment thinking.

Tweedy Browne's enthusiasm is based on the following observations:

First, Tweedy Browne still has cash reserves of between 10% and 20% across all its portfolios. These reserves can be used to take advantage of pricing opportunities and should reduce volatility.

Second, Tweedy Browne has the ability to invest globally, enabling it to seek opportunities in parts of the world that may be less affected by the credit crisis.

Third, the high degree of diversification (be it by country, industry, issue or market capitalisation – although the High Dividend Yield Value Fund does tend to consist of primarily larger cap issues) minimises the probability of a sustained loss of capital. Furthermore, with the exception of Nestlé and Heineken in the Global Value Fund, there are no other individual securities with a position size greater than 5% at cost.

Fourth, while there may be some individual securities in the portfolios where the underlying intrinsic value has contracted, the overall discount from the estimate of intrinsic value has grown across all funds in the past six months. This provides new investors with an increased margin of safety.

Lastly, Tweedy Browne believes the top 25 holdings in each of its portfolios consist of companies with strong balance sheets, durable competitive advantages and relatively predictable earnings power. For the most part, these companies are underleveraged and may enjoy net cash positions. Virtually all have investment-grade ratings. Tweedy Browne feels companies such as these should be able to see their way through a recession and come out the other side stronger and more valuable.

For our own part, we draw comfort from something less tangible. As an organisation, Tweedy Browne has not only survived 89 years of market volatility, it – together with its clients – has flourished. We leave the final thought to Christopher, William, John, Thomas and Robert:

"We have always been risk averse. After all, we are not only charged with investing our shareholders' money, but we are significant investors ourselves. Currently, we believe our portfolios hold a much greater 'margin of safety' than they did a year ago and these are the bases from which we have enjoyed our greatest gains in the past. This time should be no different."

Source: Tweedy Browne – Investment Adviser's Letter, 28 October 2008.

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