Investing Insights

JUNE 2012

Each month NZ Funds Management publishes a document entitled Portfolio Insights which provides a detailed analysis of each Portfolio's holdings and performance along with some brief commentary. The following commentaries are selected from the May 2012 publication. Each briefly discusses a topical investment issue. The full length version of the Portfolio Insights is available at www.nzfunds.co.nz

GLOBAL INCOME PORTFOLIO

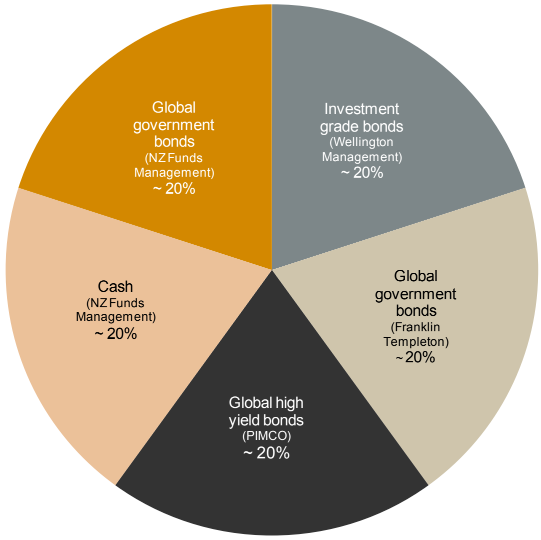
The appointment of a new manager – Wellington Management

On 15 May 2012 one of the Portfolio's investment managers was changed. Boston based Wellington Management replaced fellow United States bond manager PIMCO as the Portfolio's global investment grade bond manager. The decision to change manager reflects the Portfolio's active investment management approach. Interest rates are at generational lows throughout the world. This means not only are the returns from fixed interest investments low, but that there is a risk that interest rates may rise at some future point. If an investor locks in today's low rates, then that investment will be worth less if interest rates rise. The phenomenon of low interest rates saw Warren Buffett repeat in a recent Fortune article an old saying by Shelby Davis that "bonds promoted as offering risk-free returns are now priced to deliver return-free risk!"

The PIMCO Global Investment Grade Credit Fund was managed to a benchmark which on average purchased 6-year fixed interest bonds. This means PIMCO locks in today's interest rates for the next 6 years. The Wellington Management fund is managed to a much shorter-term benchmark which means Wellington locks in today's rates for typically around 2 years. Apart from this difference, the managers are very similar, with both funds being widely diversified across a range of global investment grade bonds. PIMCO remains a manager within the Portfolio, overseeing the Portfolio's global high yield bond exposure.

The selection of different investment management approaches as interest rates change is designed to increase the probability that the Portfolio meets its investment objective over its recommended timeframe of 2 (or more) years.

ESTIMATED GLOBAL INCOME PORTFOLIO CONSTRUCTION AFTER 15 MAY 2012



SOURCE: NZ FUNDS MANAGEMENT.

PROPERTY INFLATION PORTFOLIO

Much has been written about China's emerging middle class. There are now more billionaires in China than in New York. Much of that wealth has come through an admirable work ethic and a culture of saving over spending. But there is a darker side to China's rising wealth: speculation.

Speculation can be defined as the purchase of an asset for resale and not for use. For example, the "use" of a share might be to prosper from the gradual (and at times faltering) growth of the global economy. As the world grows decade after decade this eventually translates into higher share prices for global share markets. Share ownership also offers participation in annual profits through the receipt of dividends. These attributes make shares one of the largest allocations in the developed world's pension funds.

In contrast, the growing trend amongst China's emerging middle class is to purchase apartments as "investments" without ever intending to occupy them, or even lease them. The apartments are left bare, without fittings or furniture, ready for the next speculator (or greater fool) to acquire them at a higher price. On a recent trip to China one of our managers counted an estimated 300,000 such unoccupied apartments during the half-hour taxi ride from the airport to town.

The trouble with purchasing an asset purely for capital gains is that at some point in time the number of greater fools will be exhausted. An asset that is not producing an income may not have the support of a valuation floor when times necessitate a sale.

China exhibits all the characteristics of a property bubble which may ultimately end with a property crash. Consequently, the Portfolio's global property manager, Resolution, has built a portfolio with limited exposure to the Chinese property market.

CORE GROWTH PORTFOLIO

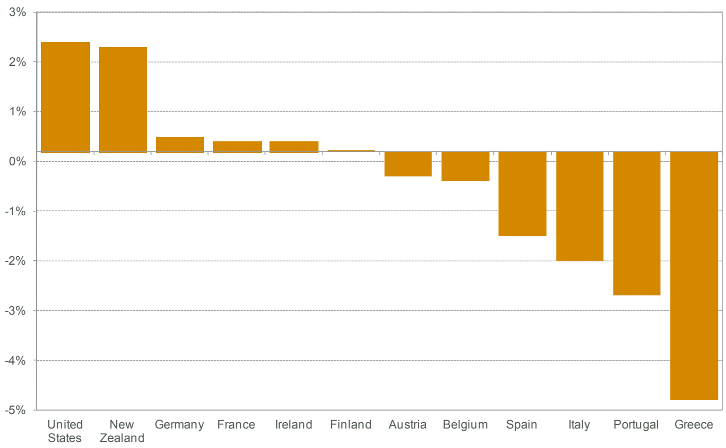
Regional exposure can make a difference

Concerns with Europe and a possible slowdown in China continue to make headlines. Yet these are just two of the many regions an investment manager can invest in. The Portfolio has around a 120% exposure to shares and this exposure is weighted towards those regions where economic growth is expected to be the strongest. At the time of writing, around 43% of the share exposure is to the United States market – one of the economies expected to experience the strongest growth over the next year. 14% of the share exposure is to Australasia. The Euro-zone region is the third largest exposure at 12% but this exposure is predominantly to the 50 largest multinational companies in the Euro-zone. The United Kingdom and Canada are the fourth and fifth largest regional exposures at 10% and 7% respectively.

The Portfolio has limited direct exposure to emerging countries. This reflects the view of the Portfolio's international share managers (Tweedy Browne and Magellan) that exposure to large multinational companies such as Procter & Gamble and Nestle, which operate across the globe including the emerging countries, is a better way to access emerging market growth.

As events evolve the regional exposure in the Portfolio may change. By altering the regional exposure, the Portfolio can focus on the higher growth economies and reduce exposure to the countries which are in the headlines as Europe and China are at present.

THE PORTFOLIO IS CURRENTLY FOCUSED ON STRONGER GROWING ECONOMIES - ESTIMATED GDP GROWTH RATES 2012



SOURCE: IMF, GOVERNMENT OF GREECE AS OF JANUARY 2012, NZ FUNDS MANAGEMENT CALCULATIONS.