FROM THE undergrowth

APRIL09

I have never before experienced so many people, from different walks of life, becoming so interested in the day to day goings-on in financial markets. Discussions about this week's Dancing with the Stars are intermingled with conversations about the US auto industry, the G20, the direction of the New Zealand dollar and fixed versus floating interest rates. I'm not sure it's a good thing that we are so focused on each new announcement or price movement, but at least in March, they resulted in a positive outcome.

At a glance

As at 31st March 2009

Unit Prices ($)

NZ Growth Fund	2.1639
Australian Growth Fund	1.2573
International Growth Fund	0.8258
Fledgling Fund	0.8161
KiwiSaver	0.7224

Fund Sizes ($m)

NZ Growth Fund	63.7
Australian Growth Fund	56.4
International Growth Fund	4.8
Fledgling Fund	2.2
KiwiSaver	54.3

Performance (March 2009)

NZ Growth Fund	6.7%
Australian Growth Fund	7.4%
Intl Growth Fund	-4.5%
Fledgling Fund	5.9%
KiwiSaver	1.7%
NZ50 Gross index	2.7%
S&P/ASX 300 ($NZ)	4.6%
MSCI Global Small Cap Index	-3.5%

Your Portfolios

What has been going on since we last spoke?

It was wonderful to finish March on a positive note after what has been a historic first quarter. The first three months of 2009 were so extreme, they featured both a bear market and a bull market – moves that normally take years to unfold. Each month of the quarter was remarkable for Wall St (and therefore for all world markets) – The Dow Jones Industrial Average had its worst January ever and worst February since the Depression, then in March, turned in its best month in six years. From the second week of the year to early March, the Dow Jones index lost more than a quarter of its value, plunging from just over 9,000 to below 6,550. Then came a rally that had the Dow soaring 21% in just 13 trading days, bouncing back almost to 8,000. The renewed sense of confidence has continued beyond the end of March with the Dow at the time of writing hovering around 8000 following a positive outcome from the G20 meeting.

So why the optimism now? And will it last? The short answer is that nobody knows for sure, but at least part of the answer is that a number of corporate and economic news releases have not been as bad as expected – not necessarily good, but less bad. If this trend continues so that investors and policy makers begin to believe that the recession is turning around, or at least stabilizing, there is no reason why confidence (which is the missing ingredient for a sustained market improvement) shouldn't continue to grow. That's not to say that it will be plain sailing from here – investors remain skeptical and nervous of each new release of information. Just a quick Google search demonstrates how divided views are – a "Dow 5000" search yielded 3.8 million results and a "Dow 10000" search yielded nearly the same at 3.9 million results! (In the interests of balanced reporting, we should admit that we had a quick look at "Dow 2000" and were horrified to find 15 million results… but most of them were a long time ago!)

> "For the first time in a long time, economic and corporate news is starting to come in better than expected. And most important, the new administration is instilling confidence on Wall St and Main St."
>
> The Wall St Journal

New Zealand

Volatility aside, March was a good month, not least because all our portfolios performed well. For the New Zealand portfolio, March was the first positive month after a painfully long six months of negative returns. We were pleased that a number of our holdings which have been oversold or overlooked in the past twelve months attracted some buying interest. The performances during March had far more to do with market dynamics – more buyers emerging and few sellers prepared to sell at low prices – than anything specific to the companies. It is worth pondering this phenomenon. For every transaction on the share market each day, there is a seller who is prepared to sell at a certain price, and a buyer who is willing to buy at that price. If the sellers are eager to sell their shares but the buyers are reluctant to pay up, or if there are more sellers than buyers, the price will be forced down until a transaction can be effected. That is really what 2008 was all about. Of course, there will come a point (and for a number of our portfolio companies this point came during March) when there will be more buyers than sellers, or the buyers will be keen to buy but the sellers are unwilling to sell unless they receive a higher price. Renewed enthusiasm for **Rakon** saw its share price lift 73% during March, **NZ Exchange** lifted 24%, the **Mainfreight** share price rallied 19% and **Ryman Healthcare** finished the month 11% higher. This was during a month when the broad market lifted just 3%. The main stocks to detract from our performance during March were **Michael Hill** which fell 12% (along with most retailers, in response to dismal retail sales data) and **Metlifecare** which fell 5% as it successfully completed a $38 million capital raising. And speaking of capital raisings, we were pleased to have avoided the debacles around Nuplex and F&P Appliances, which are not in our portfolio as they do not meet our investment criteria.

Australia

Our Australian portfolio had its second strong month – do two months make a trend?! The main portfolio news during the month came from **Arrow Energy** with the conclusion to the takeover battle for Pure energy. Arrow withdrew gracefully, pocketing $200 million which takes Arrow's cash reserves to over $700 million, leaving them well capitalized for the next phase of business development. It is worth noting that although the performance of the Australian Growth Fund has been disappointing because it has been negative, and a big number at that, the fund has actually outperformed the Australian Small Industrials index by a whopping 15% over the last twelve months. If we can achieve the same outperformance once the markets start rising, we'll all be well pleased.

International

Our International portfolio finished lower in March, but we are still going to claim it as positive because our underlying stocks performed very well. Unfortunately those returns were cancelled out by currency losses as the New Zealand dollar soared 10% against the US dollar. There was little in the way of corporate news from our companies. We will be getting quarterly profit results from our international companies during April, so can give you an update in our next newsletter. Ken has spoken with all his companies recently and is pleased that in all cases, conditions have at least stabilized. All the chief executives are focused on getting through the next three to six months, which is a very short-term focus, but a necessary one given the uncertain environment in which we are all operating. Most importantly, Ken has used his discussions with his companies to double-check that their long term business strategies are intact, and they have all scored well in this regard. Ken introduced the 31st company to the international portfolio during March – a Japanese maintenance company called **Shinko Plantech**. The company provides maintenance services for plants in Japan, with a concentration on the oil refining and petrochemical sectors. They have the leading market share in both sectors where growth has been driven by the ageing of the infrastructure, which requires increased maintenance and repair.

Infrastructure

And speaking of infrastructure, we now have six holdings in our new Infrastructure fund – two in each of our preferred sectors of freight, transport and energy. The fund has a bias towards higher-yielding infrastructure assets and has also invested in several preferred corporate bonds to achieve our targeted 5% net yield. The infrastructure fund also lifted in March – up 1% for the month – which was slightly behind our equity funds, but exactly what we would expect of a lower risk, income-oriented fund. With another interest rate cut announced in March and more expected by year-end, this infrastructure fund might be worth considering (albeit as a slightly higher risk option) for those who want an alternative to bank deposits that are becoming increasingly uncompetitive.

Your questions

This month we have reproduced a response provided by Mary Holm in the NZ Herald, as we believe this question, and the answer, will be of interest to our investors.

Note: this is an abridged version, but you can check out Mary's website at www.maryholm.com.

Q: Looking at the experience of the Dow Jones index after 1929, it is quite conceivable that it will take another 20–plus years until stocks get back to 2007 levels. Advising people to "hold on" seems to be reckless and should only apply to people in their 20s and 30s.

A: Firstly, you should be careful not to judge what happens to shares by what happens to the Dow Jones index. That index includes just 30 of America's biggest companies, and it doesn't include dividends. If you were buying a rental property, would you forget about rent in your calculations? Ignoring dividends is just as silly. This is particularly true with New Zealand shares, because our companies tend to pay higher dividends than in most other countries. Since 1962, if you invested $1,000 in New Zealand shares, excluding dividends, it would have grown to $15,000, says Russell Investments. But if you included reinvested dividends, it would have grown to $210,000 to the end of February this year, before tax and ignoring imputation credits. That's 14 times as much. Even in the US, dividends make a huge difference. The S&P 500 Index, which includes 500 US shares and includes dividends, tells quite a different (and better) story.

You start your comparison from the peak of the late 1920s share market boom. From there, a big fall was pretty likely. The same could be said for

A bird's eye view

Providing a different perspective

It takes a bit of effort to think differently to others – try doing your first cryptic crossword! We believe there is value in scratching beneath the surface, to find the hidden gems. Here is a selection of stories from the past month that might have more to them than meets the eye.

Hallenstein Glasson's half year result down 40% and "the retail environment is exceptionally difficult". Some investors read this result and assumed that Pumpkin Patch must similarly be struggling. Not so, in its result for the same period Pumpkin Patch noted that profits from its Australasian operations were in fact up 16%, with its USA & UK operations pulling down the overall result to a fall of just 8%. To us, this confirms the relative superiority of Pumpkin Patch as a strong brand and well-managed retailer.

KiwiSaver became more affordable from April 1st with the minimum contribution reduced from 4% to 2%. We think these changes are great as more people can now consider becoming KiwiSaver members and build a nestegg for their future. Others greeted the changes optimistically but for a different reason – they could now contribute less each month and use the balance to help them through these difficult times. For a 30-year old on the average wage, the reduced contribution would give you an extra $19 each week. This extra amount is not going to change your lifestyle, but if you kept your contributions at 4%, you could potentially increase your nestegg from $375,000 to $512,000 (assuming a 6% net return) by the time you retire.

Fletcher Building raises $505 million in a placement, with demand evident for twice the shares on offer. The successful placement was clearly a vote of confidence in the company and many have praised Fletcher Building for being proactive and managing the placement well, particularly compared with the likes of Nuplex and F&P Appliances. The placement should also give investors confidence because there was demand for between $500 million and $1 billion of shares in a well-managed business, irrespective of the rest of the market, or the volatility on Wall St, or the fact that Fletcher Building was slashing its dividend. This demand may not have existed six months ago, and reinforces our view that when good quality businesses are for sale at cheap prices, buyers will emerge.

2007 – a fall was quite likely too, and it happened. Now that the markets have plunged, it's much less likely that they will fall a long way further. And that is what is relevant now. A Bloomberg article said that just 17 months ago, an investment in US shares since 1979 would have grown to more than twice as much as an investment in US government bonds. But since then, bond returns have leapt and shares have plunged to the point that the investments since 1979 would now be equal. Does that mean shares have had their day? History suggests the opposite. Nobody's doubting that world economies will take a while to come right. But – precisely because we all know that – it may already have been fully reflected in share prices, and possibly over-reflected. That's certainly happened before.

> Does that mean shares have had their day? History suggests the opposite.

Another important point: While there's risk in holding on to shares, there's also risk in selling now. Those who bail out of share investments are making their loss real. They lose the chance to regain what they've lost. And that leads to another question: What else should people do with their savings? Property may not be much less risky. And if you borrow lots to invest in property – which most people do – it's quite likely to be riskier than shares. Going into bonds is risky in another way. There's been a fair bit of talk about the possibility of inflation soaring. If that happens, bond holders can be left way behind, in terms of what their investments will buy. And that's what matters. You might be right – shares might go down much further, and take ages to recover – but after weighing it all up, I'm not only keeping most of my retirement savings in share funds but continuing to feed money into those funds every month. And I'm not quite in my 20s or 30s!

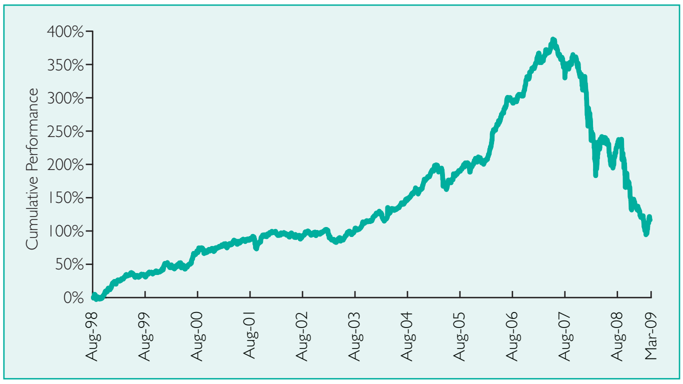
Fund facts

Fund Performance

Fund Net Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	-31.4%	-31.7%	-14.6%	-0.8%	7.5%
Australian Growth Fund	-24.1%	-27.2%	-13.9%	na	-4.5%
International Growth Fund	-16.5%	na	na	na	-12.8%
Fledgling Fund	-27.0%	-26.9%	-13.2%	-3.6%	-1.7%
KiwiSaver	-16.2%	na	na	na	-19.5%
NB… annualised returns, after tax and fees.					
Fund Pre-tax Returns					
NZ Growth Fund	-30.6%	-32.1%	-15.3%	2.6%	10.3%
Australian Growth Fund	-24.1%	-27.6%	-12.0%	na	-3.5%
International Growth Fund	-16.0%	na	na	na	-12.8%
Fledgling Fund	-26.2%	-27.7%	-12.0%	-1.9%	-1.4%
KiwiSaver	-16.2%	na	na	na	-19.5%
NB… annualised returns before tax and after fees. They differ from actual returns experienced during these periods.					
Market Indices					
NZ50G	-25.4%	-20.6%	-11.2%	0.0%	
90day bank bill	7.7%	8.2%	8.1%	7.6%	
S&P/ASX300 (Calculated in $NZ)	-25.4%	-15.7%	-5.5%	6.9%	
MSCI Global Small Cap Index	-21.9%	-21.4%	-16.6%	-2.1%	

March's Biggest Movers	
New Zealand	
Rakon	73%
NZX	24%
Mainfreight	19%
Ryman	14%
Australia	
Treasury Group	68%
Pharmaxis	46%
Oakton	32%
Credit Corp	30%
International	
02 Micro	47%
Ultimate Software	33%
Gameloft	29%
Hongguo	-28%

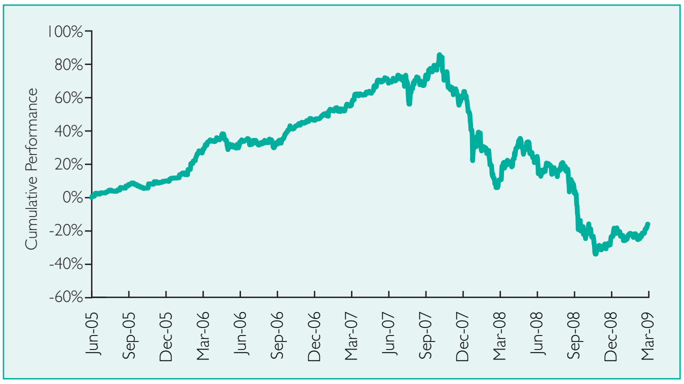
New Zealand Growth Fund



Fund Inception August 1998

Portfolio Holdings – Abano Healthcare, Comvita, Delegats, Freightways, Infratil, Mainfreight, Metlifecare, Michael Hill, NZX, Opus International, Pumpkin Patch, Rakon, Ryman Healthcare, Wakefield Health.

Australian Growth Fund



Fund Inception June 2005

Portfolio Holdings – Aevum, Arrow Energy, Austbrokers, Bravura, Centrebet, Credit Corp, DWS Solutions, McMillan Shakespeare, Nick Scali, Oakton, Pharmaxis, Pipe Networks, Reckon, Toxfree, Treasury Group, Vision Group, WHK Group.

International Growth Fund

Fund Inception October 2007

Portfolio Holdings – Advent Software, Brembo, Celera, China Automation, City Telecom, Conceptus, EBIX Inc, Equinix, F5 Networks, Gameloft, Hansens Natural, Home Inns, Hongguo, Hyflux Limited, Icon PLC, Jumbo, Midas, Nokian Renkaat, O2 Micro, OSI Pharma, Ports Design, Qiagen, Raffles Education, Roth & Rau, Sarin Technologies, Shinko Plantech, Stratec Biomed, Times Electric, Ultimate Software, Wellstream, Wirecard.

Fledgling Fund

Fund Inception December 1999

Portfolio Holdings – Abano Healthcare, Delegats, Freightways, Infratil, Mainfreight, Metlifecare, Michael Hill, NZX, Opus International, Pumpkin Patch, Rakon, Ryman Healthcare, Wakefield Health.

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