

FROM THE undergrowth

MAY09



Fear and greed are the two emotions that are synonymous with the share market. We have become very familiar with the effects of fear, having seen across the board selling of shares, month after month, for what seems like forever. It has therefore been very pleasant to have had two 'greedy' months, where increasingly optimistic investors have been prepared to pay higher prices for shares that have become too cheap.

At a glance

As at 30th April 2009

Unit Prices (\$)

NZ Growth Fund	2.3708
Australian Growth Fund	1.4494
International Growth Fund	0.9717
Fledgling Fund	0.8832
KiwiSaver	0.8205

Fund Sizes (\$m)

NZ Growth Fund	69.3
Australian Growth Fund	64.4
International Growth Fund	5.7
Fledgling Fund	2.3
KiwiSaver	63.3

Performance (April 2009)

NZ Growth Fund	9.6%
Australian Growth Fund	15.3%
Intl Growth Fund	17.7%
Fledgling Fund	8.2%
KiwiSaver	13.6%
NZ50 Gross index	5.8%
S&P/ASX 300 (\$NZ)	10.0%
MSCI Global Small Cap Index	15.1%

Your Portfolios

What has been going on since we last spoke?

We said in last month's newsletter that "if investors and policy makers begin to believe that the recession is turning around, or at least stabilising, there is no reason why confidence (which is the missing ingredient for a sustained market improvement) shouldn't continue to grow." The key word in that phrase was *believe* and the strong market that we experienced during April was all about belief – a growing belief that things might get better in the future. In April, investors didn't insist on tangible evidence of improvement, either in the economy or in corporate results; rather they were content in believing that things are not quite as bad as they had imagined they could be. Call it green shoots or a bottoming process or a bear market rally, whatever it is, the fact that we are experiencing strong price gains despite very ordinary economic and corporate news illustrates the forward looking nature of share markets.

Every share market investor invests with an eye to the future – you buy shares in companies that you hope will increase profits, knowing that ultimately their share price will also increase. You invest on the basis of information you have today, and you make assumptions about what the future will hold. Investment theory talks about markets being efficient, because they incorporate all the information there is to know about a stock into its share price – so if a company is expected to do well in the future, its share price will rise, and vice versa. But markets are not efficient. Some information is

priced in and some is not, and some is priced in far too much (when investors become too optimistic or too pessimistic). The market's behaviour over the past month corrected some of the overreaction of the past year – markets had priced in a doomsday scenario, and last month investors realised that things might not get that bad.

"Many an optimist has become rich by buying out a pessimist."

Robert G. Allen, best-selling US author

Another part of investment theory talks about what sort of information gets incorporated into share prices, and economist John Maynard Keynes suggested many decades ago that information other than the facts (or the 'fundamentals' about a stock) often gets priced in. He likened the share market to a beauty contest where people choose a winner. People don't just bet on the 'beauty' of the contestant (i.e. the fundamentals) as much as who *everyone else thinks* is most 'beautiful'. Nobody wants to be wrong, so they follow everyone else, to the point where the 'beauty' becomes largely irrelevant and groupthink becomes the driver. We have some very attractive "contestants" in our portfolios but for all their grooming and well-chosen outfits, they didn't win any sashes last year. We scored well though during March and April, so maybe 2009 might be the year that sees us regain the crown!

Have you joined KiwiSaver yet?

Your Portfolios (cont.)

New Zealand

There was news flow aplenty during April with mixed economic news, a larger-than-expected cut in the OCR together with a warning that it will stay low until late 2010, and a number of capital raisings that had investors putting their hands in their pockets and happily investing more in their favoured stocks, at discounted prices. Fletcher Building, Freightways, Sky City Entertainment and Kiwi Income Property Trust all raised equity during the month, none of them having any difficulty in doing so. In the year to date, more than \$3 billion of capital has been raised on the NZ Exchange, more than that raised for the whole of 2008.

We were pleased with all the news from our companies during April, with the standout company being NZ Exchange. It announced its first quarter profit result (up an impressive 40% on last year), it had an upbeat annual shareholders meeting, and it purchased The Marketplace Company (M-Co) which runs trading platforms with some success in the electricity and gas markets. NZX has been achieving growth in profitability by diversifying away from share market trading into funds management, a carbon registry, information services and other trading platforms. Contrast their profit growth with other regional stock exchanges that have reported decreasing profits in the past two months – Hong Kong down 17%, Singapore down 46%, and Malaysia down 63%.

Freightways released its earnings for the nine months to March 2009, with net profit after tax up 13% which is excellent in a recessionary environment. Ryman Healthcare reiterated their second half profit guidance to be at least as good as the first half, which was up 10%; and Michael Hill produced a solid March quarter sales result with Australia marginally ahead and NZ and Canada slightly lower.

Australia

We flippantly asked last month whether two strong months for our Australian portfolio made a trend. With a strong April to add to the tally, we think we can safely say our performance is about more than just good luck. Without wanting to take anything away from the strategy employed by Frank and Terry, small companies in Australia performed very well in April, with the Australian Small Industrials index having its best monthly

performance since records began in 1991, up 14% for the month. Over the last couple of months, Frank and Terry have built an extensive database to complement their stock analysis and help screen the market for new investment ideas. This database has thrown out some interesting information, one aspect of which is very supportive of our portfolio. It shows that when ranked according to the difference between share price and fair value, the better opportunities in the Australian share market exist in smaller companies. The smaller companies in our analysis are the cheapest and the largest companies are the most expensive. This alone does not explain our strong performance in April – both Arrow and Pharmaxis continued their positive information flow and Oakton and DWS enjoyed strong share price re-ratings.

International

Small was the name of the game in our International fund also, with Global small cap stocks outperforming large cap stocks by more than 5% during April. We had a number of profit results from our US companies which were positive overall, though as Ken pointed out, with expectations falling so much in the last year, the bar for profit growth has become so low that companies can step over it relatively easily! General commentary reiterated how tough the environment is, that there is no visibility for the future, and that cost control and tight management remains the order of the day. We added a new stock to the fund – **Wasion Meters**. They are the leading energy measurement systems provider in China. Their core competency is automated meter readers and data collection terminals for the gas, electricity and water industries. The Chinese government has committed to spending RMB80 billion (appx NZ\$21 billion) over the next 5 years to upgrade to electric meters.

Infrastructure

It was reasonably quiet for the Infrastructure fund during April, though still positive with a monthly gain of 2.5%. With the portfolio now comprising six infrastructure stocks and two corporate bonds, the base portfolio is in place to achieve the targeted 5% net yield together with some capital growth. The Morrison & Co team focused their efforts on assessing two corporate bond issues during April, rejecting both as not offering a sufficiently attractive yield for the risk associated with the offering.

Your questions

We share our response to some of the questions received from you during the month.

Q: In one of your newsletters last year you suggested that international shares were good for diversification. From what I've seen, international shares have been the worst place to be, and they are certainly more volatile than the New Zealand share market. Are you still optimistic about international shares?

A: International shares have traditionally been used as a way to diversify share portfolios, and thus reduce the risk of losing money. But in a share market cycle where everything falls, there is no place to hide, so diversification doesn't work quite as well as it should. What has been unusual, and unsettling, about this downturn is that global share markets have become very closely aligned and events in the US have had a significant impact on markets on the other side of the world. Global share markets have never been so interconnected as today, and they have all halved in the past 18 months.

In spite of this, New Zealand investors have still benefited from including international shares in their portfolios. The most obvious benefit has come from currency – while currencies can be scary because they are so volatile, there have been opportunities to make currency gains over the past eighteen months. If you had invested \$1,000 in our International Growth fund in December 2007, your \$1,000 would have bought 770 US dollars. If we assume that the fund remained flat during that time then those US dollars would be worth around \$1,350 today, representing a 35% gain.

A bird's eye view

Providing a different perspective

We believe there is value in scratching beneath the surface of news stories, 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.

Lion Nathan and the Halo effect – much was written during the month about the takeover offer for Lion Nathan by Kirin, with most commentators surprised at the offer given that Kirin has been happy to sit on their 46% stake in Lion Nathan for ten years without buying the balance. What was interesting about the bid was the Halo effect whereby the bid immediately prompted analysts to have a closer look at the real value of Lion Nathan, as well as the potential value of other beverage companies should they be subject to a takeover bid. You will be pleased to know that were Deleat's to trade on the same earnings multiple as suggested by the Kirin bid, its share price would be a whopping 192% higher than the current share price!

Swine flu – in a classic illustration of the need to read beyond the headlines, the announcement of the swine flu saw the share prices of US airlines and hotels fall by 15% and 13% respectively; and the share price of Smithfield, the world's largest pork producer, fell 12% in a day (even though swine flu is not transmitted through pork meat). In the following ten days as the frenzy calmed down, hotels and airlines more than regained their losses and Smithfield is now trading 8% higher than before the flu news hit. This trading pattern was very similar to that following SARS and illustrates that the share market looks through short-term events to focus on strategic and structural issues. There were few long-term winners or losers from SARS and there will



unlikely be from the swine flu. One short-term winner was Australian company Biota, who created anti-infection drug Relenza which is one of only two recognized drug treatments for swine flu. Its share price soared 77% at the height of the swine flu frenzy and has now settled down at 25% higher than before the flu news. We have had a similar experience with our Australian portfolio company, Pharmaxis, only we expect them to be a long-term as well as a short-term winner. The company announced in early May that a Phase III clinical trial of its drug Bronchitol had produced positive results and its share price immediately lifted 15%. This gain was a welcome addition to the 100% share price lift that we'd already had from late February to late April.

Your questions (cont.)

Unfortunately, our International Growth Fund has not remained flat, it has fallen, but it has fallen relatively less than our New Zealand and Australian funds, illustrating the benefit of global diversification. Part of the reason for this outperformance is that our international fund is exposed to different countries and economies that, while correlated with the US, have their own unique characteristics. You will have heard us talk about our expectations for growth in Asia, and in China in particular. We are clearly not alone in this view as we have seen strong performances from some of our Chinese companies, even on the days when other world markets are falling. Similarly, our international fund gives you access to sectors and industries that are not represented in New Zealand, and that can have a low correlation with other sectors. For example, our train companies in China have given us a performance boost, prompted by an infrastructure spending programme announced by the Chinese government. And our healthcare companies in the US and Europe have proven far more resilient than say the US and European financial or auto sectors.

An undeniable benefit of international shares is that they open the doors to a vast investment universe and a world of investment opportunities.

If you just focused on headlines over the last little while, it would be easy to assume that international diversification hasn't worked. But it has worked, and we expect it to continue to work over time. An undeniable benefit of international shares is that they open the doors to a vast investment universe and a world of investment opportunities. The New Zealand share market represents a relatively small (but still important) part of the global share market, and we know that many growth opportunities lie outside our national boundaries – which is why so many New Zealand growth companies feel the need to develop an international presence. As investors, we need to find ways to capture these opportunities, and investment through our International Growth Fund seems a fairly logical one.

Fund facts

Fund Performance

Fund Net Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	-30.5%	-29.0%	-13.0%	0.4%	8.4%
Australian Growth Fund	-18.6%	-22.7%	-10.6%	na	-0.8%
International Growth Fund	-4.1%	na	na	na	-1.9%
Fledgling Fund	-26.3%	-24.4%	-11.6%	-2.5%	-0.9%
KiwiSaver	-8.9%	na	na	na	-11.8%

NB... annualised returns, after tax and fees.

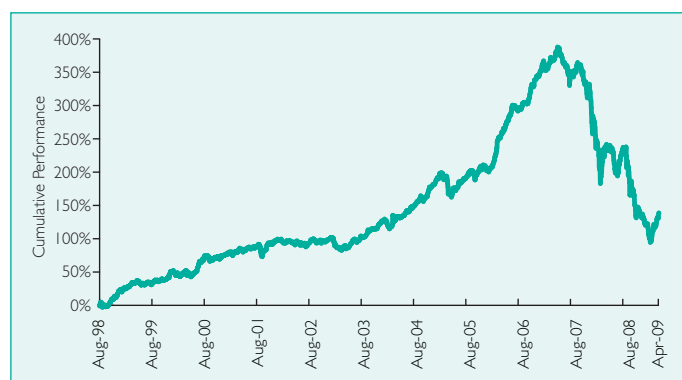
Fund Pre-tax Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	-29.5%	-29.2%	-13.8%	3.6%	11.2%
Australian Growth Fund	-18.5%	-23.2%	-8.8%	na	0.2%
International Growth Fund	-4.1%	na	na	na	-1.9%
Fledgling Fund	-25.5%	-24.6%	-10.6%	-0.8%	-0.5%
KiwiSaver	-8.9%	na	na	na	-11.8%

NB... annualised returns before tax and after fees. They differ from actual returns experienced during these periods.

Market Indices	1 Year	2 Years	3 Years	5 Years
NZ50G	-24.4%	-19.1%	-10.3%	0.8%
90day bank bill	7.2%	8.0%	8.0%	7.6%
S&P/ASX300 (Calculated in \$NZ)	-24.4%	-12.5%	-4.0%	9.0%
MSCI Global Small Cap Index	-13.9%	-15.5%	-12.3%	0.3%

April's Biggest Movers	
New Zealand	
Metlifecare	39%
Opus	13%
Pumpkin Patch	11%
Comvita	-12%
Australia	
Oakton	69%
Pharmaxis	28%
DWS	31%
Arrow Energy	19%
International	
China Automation	57%
Gameloft	54%
Brembo	46%
Home Inns	40%

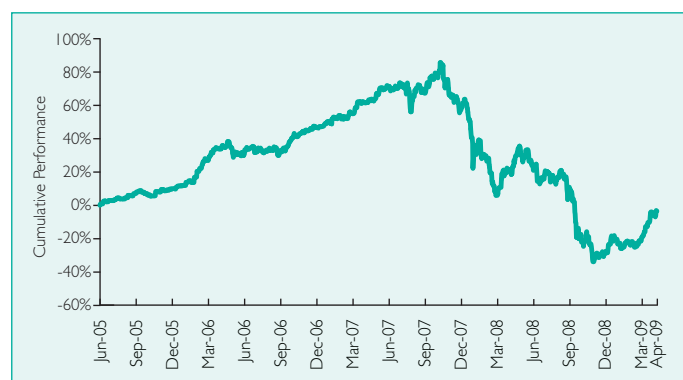
New Zealand Growth Fund



Fund Inception August 1998

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

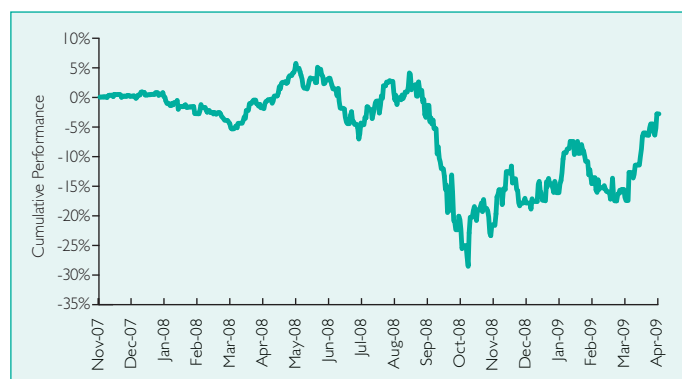
Australian Growth Fund



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, Sarin Technologies, Shinko Plantech, Stratec Biomed, Times Electric, Ultimate Software, Wasion Holdings, 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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