

FROM THE undergrowth

FEBRUARY 2011



Welcome back. You didn't miss much in the markets, though it's fair to say that January 2011 felt more positive than January 2010 and a darn sight better than January 2009. Your investments did relatively well last year and they've started the new year in good shape. It doesn't feel like we're in for a shoot-the-lights-out year, but I reckon you'll enjoy the coming twelve months, because the world is definitely getting better by the day.

Our Portfolios

What has been going on since we last spoke?

At a glance

As at 31 January 2011

Unit Prices (\$)

NZ Growth Fund	3.1530
Australian Growth Fund	2.4589
International Growth Fund	1.2308
Fledgling Fund	1.1349
KiwiSaver Growth	1.1567
KiwiSaver Conservative	1.0384
Infrastructure Fund	1.2753
Trans Tasman Fund	1.4220

Performance (January 2011)

NZ Growth Fund	1.7%
Australian Growth Fund	-0.9%
International Growth Fund	3.4%
Fledgling Fund	1.7%
KiwiSaver Growth	1.2%
KiwiSaver Conservative	0.6%
Infrastructure Fund	0.0%
NZ50 Gross index	0.9%
S&P/ASX 300 (\$NZ)	-1.5%
MSCI Global Small Cap Index	2.0%

You may not remember the mood of markets this time last year. Suffice to say it was negative – President Obama had made speeches about how the US banks were responsible for the financial crisis and he was going to hold them to account and impose new rules so they couldn't get into trouble again. The markets didn't like this rhetoric because they recognized that if the banks were curtailed and didn't start lending, the economic recovery would never come. At the same time, China was proving to be a concern as the Chinese government lifted interest rates to slow growth (so that inflation didn't take hold) leaving investors wondering where global economic growth would come from since China was our one real hope.

The negative mood largely continued until April because on top of US and China concerns, markets had to contend with geopolitical issues and the bailing out of countries that looked likely to drown under extreme debt burdens. There was plenty of negative news throughout 2010 with high unemployment, falling house prices and the lack of consumer spending being common themes around the world.

But interspersed with the negative news there were positive snippets, and by the end of the year, there had been enough positive developments to swing market sentiment towards optimism, albeit cautious optimism. Certainly at the corporate level, the news was almost universally positive. The company

recapitalizations and failures that had been a feature of 2009 were replaced with positive earnings results, merger and acquisition activity, a strengthening of corporate balance sheets and stoic performance by management teams as they adjusted their strategies for the 'new' economic environment. Sentiment certainly improved in August after Ben Bernanke said that he was prepared to indulge in another round of quantitative easing.

“Every third year of the Presidential Cycle since 1939 has been positive which makes it likely that 2011 is an up year as well.”

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By year end, there was enough evidence of an improving trend to lead the majority of commentators to call for another positive year in 2011, featuring double-digit market returns around the world driven by continued profit growth and merger and acquisition activity.

It is customary in the first newsletter of the year to make predictions and there have been lots of forecasts made by esteemed experts that we could draw on. However, we know better than to stick our necks out because in financial markets, anything

Have you joined KiwiSaver yet?*

Your Portfolios (cont.)

can happen, any time. Looking back at consensus views in January 2010, the four key predictions were that economic growth would be slower, interest rates would rise, China would outperform the US and share market returns would be low, in the order of 4-5%. One of the most respected investment managers in the world, Bill Gross of PIMCO, coined the phrase 'the new normal' and he surmised that growth, profit margins, and asset returns would all be smaller than in decades past so investors should prepare for "half-size returns".

As it happens, Gross proved too pessimistic as did the consensus view. US GDP grew at 2.7% in 2010 which is not too far below the long term average of 3% for the economy. The Chinese share market fell 14% during 2010 making it one of the world's worst performing stock markets. US company profit margins expanded, interest rates didn't increase and investors enjoyed super-size returns with the S&P 500 Index returning 11% in the 2010 year.

So, our word of warning ... ignore the forecasts and just be prepared for whatever might come your way in 2011. One of the keys to successful investing is possessing the wisdom of knowing what we don't know. You'll be sick of hearing this but we think we know our investments well, and we spend all our efforts trying to know a little more than the average investor. We have picked stocks that we think represent good value and companies that we think have the ability to manoeuvre their way through what will no doubt be another tricky year. Perhaps not quite as tricky as last year, but challenging nevertheless. The early stages of an economic recovery often feature clear winners and losers, as some businesses emerge faster or in better shape than others. We have recently seen this in the retail sector where in January Michael Hill and Kathmandu announced 10% and 25% earnings upgrades respectively while at the same time The Warehouse and Hallenstein Glassons announced earnings downgrades of 10% and 12% respectively. 2011 is going to be a stock pickers dream. This is our turf.

So, our word of warning ... ignore the forecasts and just be prepared for whatever might come your way in 2011. One of the keys to successful investing is possessing the wisdom of knowing what we don't know.

You'll be sick of hearing this but we think we know our investments well, and we spend all our efforts trying to know a little more than the average investor.

New Zealand

The gross portfolio return of 1.9% for January was ahead of the NZ50G Index which lifted 0.9% for the month. **Mainfreight** and **Ryman** were again the mainstays of this positive return, along with a useful rebound in the **NZX** share price. Interestingly, **Kathmandu** posted the largest percentage share price gain in the NZ50G in January, and **Pumpkin Patch** the biggest decline. **Michael Hill** announced a strong Christmas sales period so performed well during January, just as it did a year ago. Jewellery is clearly a popular Christmas gift, and rightly so!

Australia

Performance for the month was 0.4% ahead of the benchmark, but negative in an absolute sense, falling 0.9% in January.

In terms of specific attribution, leading the portfolio on the positive side was the currency hedge we put in place earlier in the year. It proved particularly useful in protecting the portfolio from the rise in the New Zealand dollar post the Queensland floods. **Centrebet** (+10.9%) rose as the market reappraised the likely positive outcome of Project Rocket and reversed last month's sell off. **RP Data** (+62.3%) was the third largest contributor to returns on the back of a takeover offer. On the negative side was **Pharmaxis** (-11.7%) which slipped on the delay to licensing of Bronchitol for Cystic Fibrosis in Europe. Also falling over the month was **WHK Group** (-2.8%) for no reason other than investor apathy – we have been enthusiastic buyers of the stock over past months.

International

We outperformed our benchmark again in January and believe that our investment picks, based on some longstanding underlying themes, are right on the button. We bought **Fook Woo**, the largest recovered waste paper collector and recycled tissue paper manufacturer in China. They are the leader in an emerging and fast growing market. With high barriers to entry thanks to an established collection network and a low cost product offering due to vertical integration, Fook Woo is well positioned to grow.

We bought shares in **Asahi**, Japan's leading bicycle retailer. Besides having a unique offering at their retail outlets they also have their own private brands which now comprise more than 50% of sales (and possess higher margins). They currently have 215 stores throughout Japan which is enough scale to embark upon their first nationwide marketing campaign. Our research indicates this campaign will be a success and Asahi will continue to grow the number of stores towards 500 in years to come.

We sold our shares in **Zhuzhou CSRTimes Electric** and **Advent Software**. Both have been superb investments but the valuation more than reflects this – everything has a price! We also sold our holding in **Bawang** after they had issues with one of their products and we believe this will not only impact current earnings but also the probability of success of new product rollouts and future earnings growth.

Infrastructure

The Infrastructure Fund had a flat performance during January with a return of 0.02%, underperforming the fund benchmark. Transportation infrastructure, where we are heavily invested, was a relative underperformer within the broader sector but we will continue to benefit from a slow stable recovery in economic growth. We increased our holdings in **Vienna Airport** as the price retreated from the highs of December and in **Fedex** on weakness during market nervousness over tensions in Egypt.

2011 is going to be a stock pickers dream.
This is our turf.

A bird's eye view

This month we share some thoughts from two respected investment professionals. University of Chicago Professor Robert Aliber foresaw the Asian crisis in 1998, and the recent housing bubble and has a very upbeat view on the US economy for 2011. Jurrien Timmer is the portfolio manager of the Fidelity Dynamic Strategies Fund.

Professor Aliber predicts that the US economy will grow at between 4.5% and 5% this year; the stock market will gain 15%; unemployment will fall into the 7% range; and threats like state and municipal debt crises and remaining toxic debt from the housing crisis will be dealt with. "We will have restored our confidence in the resiliency of the American economy. Some people are still hurting, but it's almost as if there are two economies. The cruise lines are full, the airplanes are more or less full ... the auto market is picking up and the restaurant industry is picking up. A number of historically reliable indicators are pointing towards growth."

Timmer says "I'm bullish because I see a scenario unfolding over the next six months that echoes that of 2009. Recall that in March 2009, the markets were pricing in Armageddon, a severe depression. Instead, the Federal Reserve intervened with its quantitative easing, and the recovery began. Fast forward to 2010. In the spring of last year, fiscal stimulus was on the wane. The drivers of the recovery were ebbing just as the European debt crisis was threatening to spread contagion to the US financial system. We had a mid-cycle slowdown, and the market started to fear a double-dip recession. But the Fed stepped in with QE2 and injected \$600 billion into

the financial system. I'm looking for this process to continue in the first half of 2011. We're getting an organic economic recovery plus aggressive Fed monetary stimulus. So it's like the market is running on twin turbos."

"It's been a challenging time for stock pickers of late, because almost everything has gone up or down together. However looking ahead, I don't think the market will continue to exhibit such high correlations. Once you have more dispersion in returns – when investors start to make the distinction between good companies and bad ones – I believe the market will favour stock pickers again."



Your questions

This month we've had several questions from investors along similar lines:

Q: How do you switch off and think unemotionally about your investments? I feel devastated when I lose money!

A: Even seasoned investors struggle to view their investments unemotionally ... it is human nature. If we invest well, we feel proud and give ourselves a pat on the back for being so clever. If our investments fare badly, we kick ourselves and sometimes look for others to blame too – our broker, the markets, the company, whoever! But it is important to view our investments without emotion. One of our best techniques is to routinely rate each of our holdings relative to our other holdings, and also relative to prospective investments. Each month we score each investment according to the strength of the business, the track record, earnings history and earnings outlook and price. If we just looked at each stock on its own, we might be less inclined to downgrade it, but when we compare it to others in the portfolio and consider where we want to invest our next \$1,000, we can remove some of the emotion of the decision. Economist Adam Smith once said "a stock doesn't know you own

it". The stock doesn't know if you bought it at \$10 or \$50 and it won't reciprocate the feelings you have for it. Warren Buffett has said similar things and warned investors not to get too attached to any of their investments. It is hard, but it can be done, and the more investments you have in your portfolio, the easier it becomes to look at each one dispassionately.

One of the harder aspects of investing is to view company management teams objectively. If you have invested in a stock that has performed well for many years, it is easy to put the management team on a pedestal and automatically assume that history will repeat. We find the secret is to talk regularly to the broader management team, including the board of directors, and to monitor management according to what they say they are going to do. All these measures help us to remain objective ... although we still get emotional!

Fund facts Fund Performance

Fund Net Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	3.5%	19.1%	-5.7%	0.7%	9.6%
Australian Growth Fund	19.9%	48.9%	7.9%	7.5%	9.2%
International Growth Fund	6.3%	16.5%	7.8%	na	6.6%
Infrastructure Fund	13.4%	16.8%	na	na	15.7%
KiwiSaver Growth Fund	10.7%	26.9%	8.4%	na	4.5%
KiwiSaver Conservative Fund	3.6%	na	na	na	2.3%
Trans Tasman Fund	9.9%	18.7%	8.0%	6.3%	6.5%

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

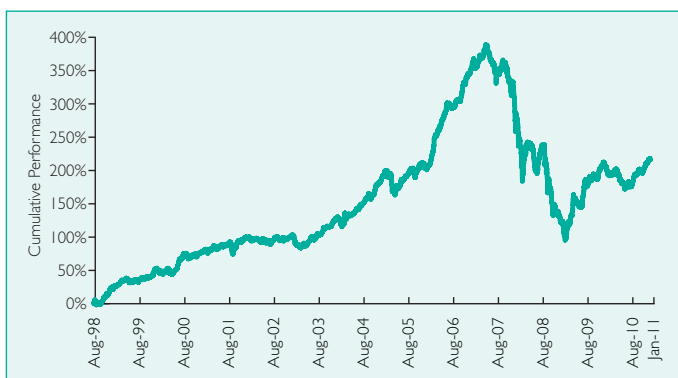
Fund Pre-tax Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	4.5%	20.4%	-4.6%	1.3%	12.3%
Australian Growth Fund	20.0%	49.3%	8.2%	7.5%	10.9%
International Growth Fund	6.3%	16.5%	7.8%	na	6.6%
Infrastructure Fund	13.4%	16.8%	na	na	15.7%
KiwiSaver Growth Fund	10.7%	26.9%	8.4%	na	4.5%
KiwiSaver Conservative Fund	3.6%	na	na	na	2.3%
Trans Tasman Fund	9.9%	18.7%	8.0%	6.3%	6.5%

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	5.5%	9.7%	-3.1%	-0.1%
90day bank bill	3.0%	3.0%	4.8%	6.1%
S&P/ASX300 (Calculated in \$NZ)	11.3%	23.4%	3.0%	7.0%
MSCI Global Small Cap Index (in \$NZ)	18.4%	14.4%	5.7%	-0.3%

January's Biggest Movers	
New Zealand	
Kathmandu	18%
Pumpkin Patch	-15%
NZX	14%
Abano Healthcare	5%
Australia	
RP Data	62%
Vision Group	13%
Pharmaxis	-12%
Centrebet	11%
International	
Interactive Intelligence	26%
Raffles	21%
Wasion	-20%
Wirecard	16%

New Zealand Growth Fund



Fund Inception August 1998

Portfolio Holdings – Abano Healthcare, Delegates, Fisher & Paykel Healthcare, Freightways, Infratil, Kathmandu, Mainfreight, Metlifecare, Michael Hill, NZX, Opus International, Pumpkin Patch, Ryman Healthcare, Tower Limited, Wakefield Health.

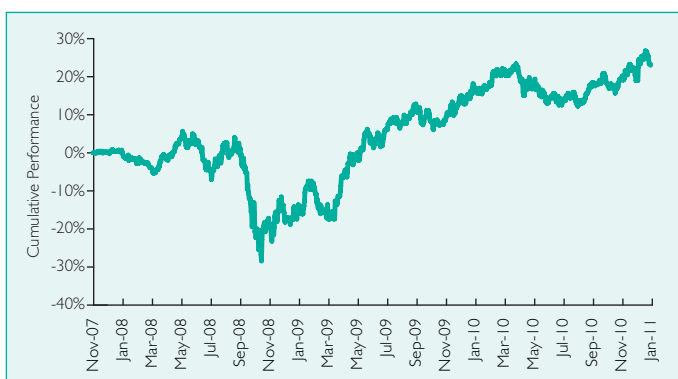
Australian Growth Fund



Fund Inception June 2005

Portfolio Holdings – Austbrokers, Bravura, Centrebet, Credit Corp, Dart Energy, DWVS Solutions, McMillan Shakespeare, Nanosonics, Nick Scali, Oakton, Pharmaxis, Reckon, RP Data, Toxfree, Treasury Group, Universal Biosensors, Vision Group, WHK Group.

International Growth Fund



Fund Inception October 2007

Portfolio Holdings – Actelion, Advent Software, Asahi Co Ltd, Autodesk, Biotest, Brembo, China Automation, City Telecom, Conceptus, Equinix, Fook Woo Group, Gameloft, Hanger Orthopedic, Hansens Natural, Horiba, Hsu Fu Chi International, Hyflux Limited, Icon PLC, Interactive Intelligence, Jumbo, Midas, Nokian Renkaat, O2 Micro, Okano Valve Manufacturing, Orthofix, Ports Design, Prestige International, Qiagen, Raffles Education, Sarin Technologies, Shinko Plantech, Stratec Biomed, Telvent, Torishima Pump, Travelsky, Wasion Holdings, Wellstream, Wirecard.

Infrastructure Fund



Fund Inception December 2008

Portfolio Holdings – Flughafen Wien AG, Fraport AG, Norfolk Southern Corp, TNT N.V., Flughafen Zuerich AG, Asciano Group, Union Pacific, Auckland Airport Bonds, Contact Bonds, Genesis Bonds, Meridian Energy Bonds, NZ Post Bonds, Vector Bonds, Wellington International Airport, Fedex.

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