

FROM THE undergrowth

JUNE 2011



Sometimes you get forgettable months, and May was definitely one of them. It wasn't a particularly nasty month but there was just nothing to get too excited about. The Budget came and went, the dollar had a mind of its own, economic news was positive one day and negative the next, and the weather gradually deteriorated. Yep, I think we'll just forget May 2011.

Our Portfolios

What has been going on since we last spoke?

At a glance

As at 31 May 2011

Unit Prices (\$)

NZ Growth Fund	3.3861
Australian Growth Fund	2.2347
International Growth Fund	1.1984
Fledgling Fund	1.2157
KiwiSaver Growth	1.1362
KiwiSaver Conservative	1.0641
Infrastructure Fund	1.2886
Trans Tasman Fund	1.4509

Performance (May 2011)

NZ Growth Fund	1.5%
Australian Growth Fund	-12.0%
International Growth Fund	-3.9%
Fledgling Fund	1.4%
KiwiSaver Growth	-4.3%
KiwiSaver Conservative	0.3%
Infrastructure Fund	-0.8%
NZ50 Gross index	0.8%
S&P/ASX 300 (\$NZ)	-6.3%
MSCI Global Small Cap Index	-3.7%

In a continuation of last month's trend, currency was the name of the game in May. And what a vicious game it has been for anyone with international assets and those exporters trying to make a crust from selling New Zealand products offshore. During May, the New Zealand dollar hit its highest point relative to the US dollar since the currency floated 25 years ago. This had the effect of making your investments in the International and Infrastructure funds less valuable. The New Zealand dollar also hit a four-month high against the Australian dollar, which took around 4% off the value of Australian investments, though our currency hedge helped to limit the impact in our Australian fund.

All sorts of explanations have been provided as to the factors driving the New Zealand dollar skywards, ranging from our improving economy, rising commodity prices and improved business confidence, to the Chinese buying New Zealand assets and hedge funds and speculators jumping on the New Zealand dollar as the currency du jour. None of the explanations completely explains the dollar's strength, because the movements have been as much about what's happening to the opposite currencies (the US and Australian dollars) as they have about New Zealand's fortunes. Most commentators, including our own Prime Minister, agree that the New Zealand dollar is now higher than it should be, based on historical averages and economic relativity, but there is less of a consensus

around what the dollar will do from here. There is nothing on the short term horizon that looks likely to weigh on the New Zealand dollar and reduce its popularity, neither is there anything looming that will make the US dollar popular again. But then, currency is a fickle thing and we'll only know after the event what the catalyst is for restoring our New Zealand dollar to its more 'normal' valuation. Ultimately currency relativities will be restored and our overseas investments will enjoy a lift in value, but in the meantime we must endure this unpleasant volatility which we could well do without.

"Our greatest glory is not in never falling, but in rising every time we fall."

Confucius

Another unpleasant feature of the month for our Australian funds was the surprise announcement from portfolio company **Pharmaxis** that it had failed to win approval from the European Medicines Authority to market its drug Bronchitol in Europe. The announcement was a surprise because the company had been making good progress in its approval process in a number of markets. The market reaction to the news was swift and severe with the Pharmaxis share price falling 70% on the day of the announcement, before recovering slightly

Have you joined KiwiSaver yet?*

Your Portfolios (cont.)

to end the month 60% lower. This fall, together with the currency and a softer Australian share market overall, left our Australian Growth Fund unit price 12% lower for the month. It is frustrating and annoying to have had six months of gains wiped out, and the only small comfort we can take is that the portfolio gains we enjoyed last year mean that the fund is still 9% ahead for the year to May.

It would be poor form to minimize the negatives by overplaying the positives, but the New Zealand Growth Fund does need an honourable mention. The fund ended the month 1.4% higher, bringing its year to date performance to +9%. What is particularly pleasing is that this performance has been achieved from a variety of portfolio companies including **NZX** (up 60% year to date), **Mainfreight** (up 27%), **Kathmandu** (up 27%), **Ryman** (up 18%) and **Opus** (up 13%). Of course not all portfolio stocks have been positive contributors, but our largest holdings have been, and our most negative contributor, **Pumpkin Patch** (down 31% year to date) is now a very small portfolio holding. What is especially pleasing is that our two core portfolio companies, Mainfreight and Ryman have continued a positive performance trend over the last four years without doing anything rinky-dinky, but rather just sticking to their strategic growth plans. The New Zealand portfolio is often overlooked in favour of the 'lucky country' but sometimes slow and steady can be worth having.

We probably need one more positive to avoid this newsletter becoming a dirge, so we'll choose a gratuitous one, the Rugby World Cup that is now within kicking distance. In just under three months, the Rugby World Cup will bring much needed tourists (with a willingness to spend money and have a good time) to New Zealand. Maybe this will be the catalyst we've been waiting for to kickstart retail sales, build consumer and investor confidence, and get New Zealand back firmly on its growth path. Stranger things have happened.

New Zealand

The New Zealand share market continued to buck the global trend, lifting 0.8% in May and extending its gains for the year to date. The main focus for the month was the Budget which contained no real surprises and resulted in the ratings agencies leaving their ratings of the New Zealand economy unchanged. A number of companies reported profit results for the period to March and our fund enjoyed the price reaction to good results from **Mainfreight** (+8.1%) and **Ryman Healthcare** (+6.7%) in particular. The New Zealand Growth Fund outperformed the market for the month, lifting 1.4% thanks to Mainfreight, Ryman and **NZX** whose share price ended the month 10% higher following the Budget which confirmed the likelihood of partial privatizations of three SOEs which will provide a fillip for the stock exchange.

Australia

As mentioned above, the Australian fund had an awful month, ironically due to last month's best performing stock **Pharmaxis**. The unit price ended the month down 12% versus the ASX Small Industrials Index which fell 6% in New Zealand dollar terms. The broad Australian share market also fell 6% during May as data released during the month painted a picture of a slowing economy with weaker retail sales, company profits and private sector housing approvals. This data impacted the currency as New Zealand's data looked better (improving business confidence, positive Fonterra payout guidance and strong terms of trade) and the New Zealand dollar rallied 4.6% against the Australian dollar. Aside from

Pharmaxis, the other company news during the month was the takeover offer for **Centrebet** from **Sportingbet** after a protracted sale period. We intend selling our shares into the offer. It was a well signalled takeover so there was not a massive price reaction during May, although the stock is up 36% since the start of the year, compared to the market which is down 0.8% year to date.

International

The International Fund ended the month 3.9% lower which was slightly behind the MSCI Small Cap Index (in NZD) which fell 3.7% during May. Currency had an impact but overall global markets struggled to make headway last month as investors grappled with continued European woes (will Greece fail or not?), inflation and debt concerns, and economic data which had markets vacillating between optimism and pessimism all month. A number of our portfolio companies released profit results during May and on the whole the results were strong with the exception of the Japanese companies. The result commentaries are perhaps typified by those of Carl Bass, the CEO of Autodesk who said "Overall we are pleased with the solid start to the year. The better than expected start, coupled with a more positive outlook for the rest of the year has allowed us to raise our expectations about revenue and margins for the full year. It's clear that we are participating in the general market recovery. But it's also clear the rate of recovery differs by geography and by industry".

In company news, another of our companies, **Telvent** received a takeover offer from Schneider Electric via a tender offer in mid June. Given that the largest shareholder has already agreed to tender its shares, we expect the offer will be successful. The offer represents a 50% premium to the price of Telvent shares at the beginning of 2011. Telvent is a relatively small holding at 1% of the portfolio.

Infrastructure

The Fisher Morrison Infrastructure Fund returned -0.82% during May, whilst the global infrastructure and utility sector returned 1.05%. The underperformance was mainly due to the strengthening New Zealand dollar against global currencies. We introduced three new positions into the portfolio, which are attractive opportunities within the global ports, energy generation and transmission sub-sectors and which increases our relative exposure to emerging markets. We sold out of our position in **Asciano** (the completion of a partial sell-down from earlier in the year) and also from our position in **Fraport**.



A bird's eye view

This month we provide a summary of the key points of interest for investors from Bill English's Budget.

The objective of the Budget was to reduce the amount the government is borrowing to fund private savings, and drive a larger share of contributions from members and employers. The net effect is an increase in national savings. The Budget targeted KiwiSaver rather than PIEs and other traditional savings and investment products.

The main changes to KiwiSaver are as follows:

- The Member tax credit will be halved from \$1 to 50 cents for every \$1 contributed by members, up to \$521 per year – half the current maximum – from 01 July 2011.
- The minimum employee and employer contribution rate will rise from 2% to 3% from 01 April 2013.
- The tax-free status of employer contributions will be removed. These will be taxed at the employee's marginal tax rate.

The \$1,000 kickstart that all members receive for joining has been left unchanged.

What do we like about the changes? We like that there were no real surprises and that strong incentives still remain for people to join and make ongoing contributions to KiwiSaver. It is still the most attractive retirement savings vehicle available to New Zealanders. We also like that the implementation timeframe gives employees and employers time to adjust to the changes in their take home pay and the remuneration paid to employees. The Budget also creates a more sustainable KiwiSaver into the future. The National Government is committed to savings in the future and ensuring individuals save for their retirement, and of course the Labour party introduced KiwiSaver and remains committed to it.

While we would have preferred the Government not to have tinkered with KiwiSaver as it undermines confidence, we acknowledge the need for New Zealanders to save for their own retirement rather than rely on overseas borrowing. We are pleased that the tinkering has left KiwiSaver as a very attractive and compelling savings vehicle.

Your questions

We share our response to one of the questions asked by investors during the month:

Q: You said in your Pharmaxis announcement that you were intending to exit. Surely this defies logic – you've already taken a hit, why compound it by selling at the share price lows?

A: We have learned over the years that a selling discipline is as important as a buying discipline. It's all very well buying into a stock at the right price and enjoying the gains as the share price rises, but it is equally important to know when to sell a stock so that investment returns can be protected from share price falls. In the case of Pharmaxis, the surprise announcement last month has led to a breakdown in the investment case, at least for the meantime. The company did not get European approval for their cystic fibrosis drug, Bronchitol, and while there is a possibility that the company will be successful in appealing this decision, there can be no certainty. At the very best, their appeal will be successful in November, but in the meantime there are no significant catalysts to drive the share price upwards. Rather, the share price will reflect the opinions of traders who will trade the stock during this information void. If the appeal is successful, the share price will likely rise, however if it fails, the share price will likely fall. We don't want to expose our investors to that sort of binary outcome. While we have advised the market of our intention to exit, we are managing our exit to ensure that we can benefit from price rallies that arise during this period of speculative trading.

It might be useful to consider a similar situation that we encountered in 2007 when a core portfolio stock, Credit Corp made a surprise announcement resulting in a 47% share price fall. We immediately reduced our position by around 15%, and when a second profit downgrade announcement followed three months later, we cut our position a further 23%. We maintained a small holding as the company appointed a new CEO who went on to produce improved financial results. We gradually increased our position as the investment case improved with a restoration of profitability, and have continued to build our position over the past three years enjoying a 300% gain on that holding. While the Credit Corp share price is still not back to its 2007 levels, we have monitored the business and rebuilt a holding as the fundamentals have improved, thereby increasing portfolio returns. Our buying and selling decisions have been made in the context of how we view the company and its fundamental value, i.e. the investment case, rather than being based on share price. We will take the same approach with Pharmaxis.

Fund facts Fund Performance

Fund Net Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	18.4%	15.3%	0.2%	-2.0%	10.0%
Australian Growth Fund	9.0%	21.0%	5.0%	2.7%	7.0%
International Growth Fund	0.3%	9.0%	5.1%	na	5.2%
Infrastructure Fund	9.9%	13.8%	na	na	14.6%
KiwiSaver Growth Fund	8.1%	15.0%	6.9%	na	3.5%
KiwiSaver Conservative Fund	5.8%	na	na	na	3.2%
Trans Tasman Fund	18.3%	18.0%	3.4%	5.5%	6.5%

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

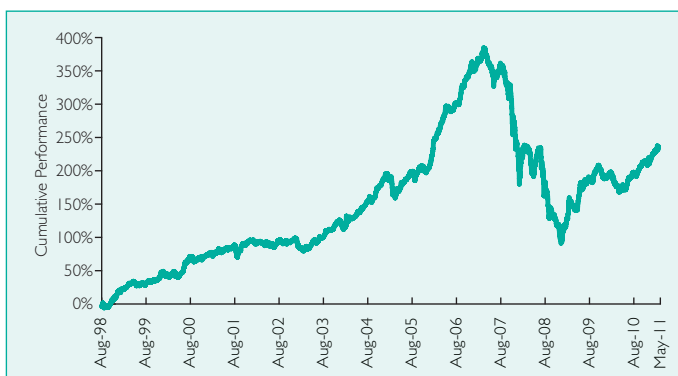
Fund Pre-tax Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	19.6%	16.5%	1.3%	-2.1%	12.6%
Australian Growth Fund	9.1%	21.1%	5.3%	2.7%	8.5%
International Growth Fund	0.3%	9.0%	5.1%	na	5.2%
Infrastructure Fund	9.9%	13.8%	na	na	14.6%
KiwiSaver Growth Fund	8.1%	15.0%	6.9%	na	3.5%
KiwiSaver Conservative Fund	5.8%	na	na	na	3.2%
Trans Tasman Fund	18.3%	18.0%	3.4%	5.5%	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	15.9%	13.3%	-0.7%	-0.4%
90day bank bill	3.1%	2.9%	4.2%	5.8%
S&P/ASX300 (Calculated in \$NZ)	15.8%	17.8%	0.3%	5.0%
MSCI Global Small Cap Index (in \$NZ)	11.4%	16.0%	3.1%	-1.9%

May's Biggest Movers	
New Zealand	
Wakefield	11%
NZX	10%
Pumpkin Patch	-9%
Kathmandu	-9%
Australia	
Pharmaxis	-62%
Universal Biosensors	-25%
Centrebet	25%
Retail Food Group	-17%
International	
China Automation	-20%
Conceptus	-19%
UFP Technologies	-19%
Orthofix	18%

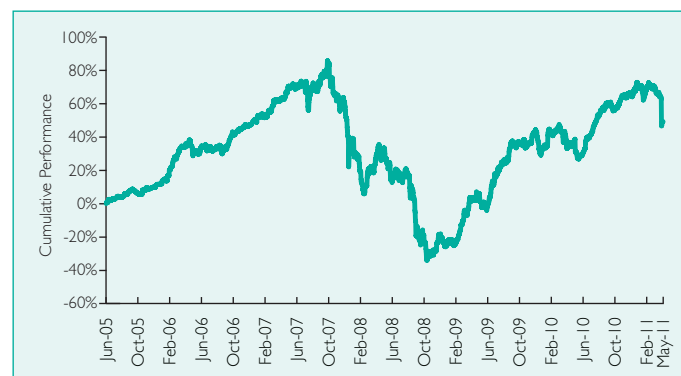
New Zealand Growth Fund



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.

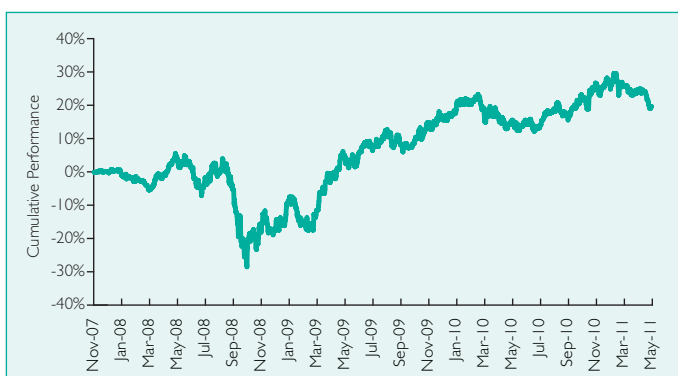
Australian Growth Fund



Fund Inception June 2005

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

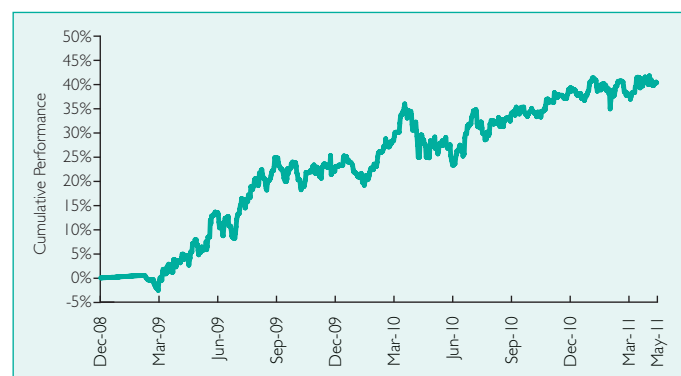
International Growth Fund



Fund Inception October 2007

Portfolio Holdings – 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, 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, UFP Technologies, Wasion Holdings, Wirecard.

Infrastructure Fund



Fund Inception December 2008

Portfolio Holdings – Flughafen Wien AG, Fraport AG, Norfolk Southern Corp, TNT N.V., Flughafen Zuerich AG, 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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