

FROM THE undergrowth

JULY 09



I don't know about you, but I would be quite happy if I never heard another economic statistic or confidence survey. While I know that the news is old news by the time I hear it, and it is rarely a huge surprise, I'm still impacted by it and it can definitely affect my mood and my outlook. Just as I've always preferred to drive using the windscreen rather than the rear vision mirror, I think the only way we investors are going to steer through the current environment is to focus on what lies ahead.

Your Portfolios

What has been going on since we last spoke?

At a glance

As at 30 June 2009

Unit Prices (\$)

NZ Growth Fund	2.4522
Australian Growth Fund	1.5054
International Growth Fund	1.0260
Fledgling Fund	0.9056
KiwiSaver Growth	0.8570
Infrastructure Fund	1.1024

Performance (June 2009)

NZ Growth Fund	-3.7%
Australian Growth Fund	-1.3%
Intl Growth Fund	1.8%
Fledgling Fund	-3.4%
KiwiSaver Growth	-0.2%
Infrastructure	3.1%
NZ50 Gross index	1.2%
S&P/ASX 300 (\$NZ)	3.7%
MSCI Global Small Cap Index	0.1%

We talked last month about the dangers of generalisations and trying to interpret conflicting economic news. At least during June the economic news was broadly consistent – while there were still a lot of negatives, the data confirmed a tough first six months of 2009 and signs of an improving second half of the year. Most importantly, confidence appears to be improving, albeit tentatively, with businesses and consumers looking to the future with a little more optimism than was evident at the beginning of the year.

World share markets ran out of puff in June, after an amazing three month run. While markets ended the month on a positive note, there didn't seem to be a lot of conviction behind the gains, particularly in the latter part of the month. Investors began to look a little more critically at data releases as they tried to gauge the sustainability of the market's rebound, and the embryonic economic recovery underpinning it. At the time of writing, the latest payroll data was released in the US (with unemployment reaching 9.7%) causing the S&P500 to fall 2.5%.

It feels like we might remain in a broad sideways market for a few months – there will be days when the market falls a few percent, and other days with equivalent bounces, but we could find ourselves in three months time with market indices pretty close to where they are today. This is not a bad thing and there will still be opportunities to make money – it is just a different market environment to the up

down, down up market that we've experienced over the past twelve months (pew, I hear you say!). As always, individual company performances will determine share price performances, and perhaps there will be a higher than usual correlation between company profit results and share prices in the upcoming reporting season. All investors want to be sure that they are exposed to the first companies out of the starting block when economic growth (and therefore profit growth) returns. And those companies that don't look like they are going to improve any time soon might find themselves friendless in this early part of the new cycle.

“The function of economic forecasting is to make astrology look respectable.”

John Kenneth Galbraith, economist

International companies will start to release their quarterly profit results in the coming two weeks, and local companies are releasing annual reports and will be speaking at annual shareholder meetings in the next couple of months. While sometimes annual shareholder meetings can be quite dull affairs as the official business is worked through, the comments from the Chairman and Chief Executive often provide a great indicator of how the company is faring right now, and what it is

Have you joined KiwiSaver yet?*

Your Portfolios (cont.)

expecting in the months ahead. They also provide shareholders with a once-a-year opportunity to meet the executives and the directors of your companies.

New Zealand

June was a very quiet month for our New Zealand portfolio, in fact judging from our daily conversations with share brokers, it was a pretty quiet month for the entire market. Corporate news was thin and the market understandably failed to get excited by the various discussions about the regulatory regime for telecommunications, airports, and electricity distribution.

The most interesting news for our portfolio came from Pumpkin Patch who announced the closure of 20 of their 35 US stores. The market responded favourably to this partial exit from the US market which has been problematic for the company and has overshadowed the good performance achieved by Pumpkin Patch in other geographies. Not only is the company reducing its exposure to a difficult market, it is doing so at less cost than most analysts expected by utilising Chapter 11 provisions in the US for the affected stores (that are a bit like a company going into receivership in New Zealand). The company has now surprised the market, positively, on several fronts – debt reduction, inventory management and now strategic positioning. To quote one share analyst “we believe the removal of the loss-making US stores marks the transformation of Pumpkin Patch into a considerably different investment story. The reduction of losses, clarity around the future US strategy, and to some extent, renewed confidence in management by investors, serves to de-risk the company.”

Our New Zealand portfolios hold around 6% in Pumpkin Patch and it was our best performer during June, rising 17% for the month. Notwithstanding this contribution, the unit price fell during June as NZ Exchange gave back some of its strong performance from May, and the Metlifecare share price fell 10% on relatively light volume (note, it has bounced 3% since the end of the month).

Australia

June unfortunately saw an end to our run of both strong absolute and relative performance (or of course, it might just be a pause!). The portfolio ended the month 1.2% lower with both Arrow Energy and Pharmaxis being a drag on performance after being strong contributors in May. In the case of Arrow, there is no obvious fundamental explanation as the news flow over the month was positive with Shell's plans for a Gladstone LNG facility being granted significant project status by the Queensland Government. The newsflow from Pharmaxis was also positive, but the market may have been suffering indigestion following the company's \$47m equity placement (which we participated in) early in the month. The NZ\$/AU\$ cross rate was essentially flat over the month so the currency had little impact on the portfolio's return for the month.

International

June was also a quiet month for the international portfolios and the NZ dollar was virtually unchanged so had little impact. A new company, Biotest, was added to the fund during June. Biotest is a pharmaceutical and diagnostic company based in Germany. It specialises in processing blood and extracting plasma for use in treatment of diseases. Biotest has a strong presence in Europe and has recently expanded into the US. Ken is halfway through a two-week visit to China and Singapore, so will be in a good position to provide an update on our Asian companies and their outlook, in next month's newsletter.

Infrastructure

During June the Infrastructure Fund increased 3.1%, outperforming the UBS 50/50 Infrastructure/Utility Index which increased by 0.8%. The Manager made some portfolio changes in the month, selling two stocks, Burlington Northern, a US railroad, and ITC Holdings, a US electricity transmission target. Both had reached fair value due to price increases. One stock was acquired; Fraport, a German airport, which is one of the main European hub airports, with Lufthansa as its main airline.

The Manager continues to focus on a high yield low risk strategy, with three infrastructure bonds now in its portfolio.

Your questions

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

Q: What effect do you think peak oil will have on share markets and the future retirement savings of New Zealanders?

A: Peak oil is a label used to describe the depletion of energy resources, or more specifically, the peak in global oil production. World discovery of oil peaked in 1964 and has been declining ever since, despite considerable improvements in technology, and there is no prospect of any significant new large discoveries. We are currently consuming more than four barrels of oil for every one discovered. This doesn't mean that the world is running out of oil, but we are running out of cheap oil.

It is widely believed that we are now approaching world peak oil. Globally, it is thought that approximately half of all oil that was laid down in the earth has been extracted. So peak oil really means that there will be a

gap between supply and demand – there will be less to go around, just when more and more countries want more to grow their economies. The decline in oil availability would in theory lead to a rising oil price and ultimately lower economic growth because an economy cannot grow without a growth in energy.

To answer a question about the effect of peak oil requires a turbo-charged crystal ball, but we are happy to make a few observations.

The period from 1973-1982 featured both high inflation and slow growth (stagflation) as a result of a quadrupling in oil prices triggered by OPEC.

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.

Private hospitals to play greater role – The Government announced last month that private hospitals are to be given a greater role in carrying out taxpayer-funded elective surgery. Prime Minister John Key said health boards would be allowed to enter long-term contracts with private hospitals for elective surgery, rather than turning to them as a “last resort”. This is great news for our portfolio company Wakefield Health which operates New Zealand’s largest private hospital Wakefield Hospital in Wellington, along with Bowen Hospital in Wellington and Royston Hospital in Hawkes Bay. Wakefield announced a 27% profit lift in May but noted that elective surgery performed under contract from DHBs “remained unpredictable both in regard to its extent and timing”. The Government’s announcement last month would be music to the ears of the Wakefield team. The Wakefield Health share price lifted 2% during June.

Metlifecare opens Takapuna village – Portfolio company Metlifecare, featured in a business story during June about the opening of its newest retirement village in Takapuna, “three quarters empty”. The story reported that the first stage of the \$100 million village was to open with only 20 of the first 78 apartment units sold. The company attributed the lack of sales activity mainly to buyers’ inability to see

apartments until the last few weeks (as it was still under construction). ‘Institutional investors’ were quoted as saying that the Takapuna site’s tight size and its price might have forced the business to build too intensively to appeal to older people. “The property downturn may have also dashed people’s expectations of house values, leaving them unable to afford to move to Metlifecare”. The company later reported that it was delighted by the overwhelming interest shown on the day with more than 800 people going through the village in just over two hours. They said that sales executives were very busy as a result, and in our conversations with the company since then, we know that the sales executives have indeed been very busy. They have had back to back appointments with potential purchasers every day since the open day, and the company is delighted with the number of sales and imminent sales as a result. The Metlifecare share price fell 10% in June.

Beware relying on recommendations – Two recent sharebroker reports from Australia provided a timely reminder that investment recommendations should not be taken at face value. One report was titled “Well positioned” and recommended the stock as an Outperform saying the company was “an excellent play on the high levels of oil and gas activity expected ... over the medium term”. The share price at the time of the report was \$A1.83. In spite of his glowing language, the analyst valued the stock at just \$A1.43 – 1.57 and suggested a 12-month target price of \$1.57! In the second example, the analyst described the difficult environment which was taking its toll, but said he had retained his HOLD recommendation. The current share price was \$A0.59 but his report said “we would be sellers at share price levels above \$A0.54. That four-letter recommendation should have been replaced with another one beginning with S and ending with L.

Your questions (cont.)

The damaging effects on company profits of slow growth and spiralling wages saw share markets perform very poorly. For example, it took about 10 years for the Dow Jones Industrial Index to trade consistently above the level that prevailed before the first oil shock of October 1973.

Uncontrolled inflation is not good for share markets or for people’s retirement savings, as it impacts investment returns and lowers the spending power of savings.

However, we believe economies are more flexible today than they were in the 1970s and central banks are certainly more responsive. It is therefore less likely that an uncontrolled spiral in prices will develop if oil prices return to peak levels. This was demonstrated in recent years where as oil prices rose between 2002 and 2008, the share market produced winners (energy companies) and losers (energy-reliant companies) but did not result in an across-the-board erosion of company profitability.

We are currently consuming more than four barrels of oil for every one discovered

On balance, therefore, if oil prices were to return to peak levels (and this is by no means likely given slow global economic growth post the global financial crisis) then we would not expect to see a repeat of the 1970s when rampant inflation significantly damaged the real value of retirement savings.

Fund facts

Fund Performance

Fund Net Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	-18.3%	-27.4%	-14.2%	0.3%	8.6%
Australian Growth Fund	-19.4%	-23.1%	-9.1%	na	0.1%
International Growth Fund	4.6%	na	na	na	1.6%
Fledgling Fund	-15.7%	-23.2%	-12.9%	-3.0%	-1.0%
KiwiSaver Growth	-3.9%	na	na	na	-8.5%

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	-17.4%	-27.2%	-15.0%	3.3%	11.4%
Australian Growth Fund	-19.0%	-23.7%	-7.0%	na	1.2%
International Growth Fund	4.6%	na	na	na	1.6%
Fledgling Fund	-14.9%	-23.2%	-11.7%	-0.4%	-0.3%
KiwiSaver Growth	-3.9%	na	na	na	-8.5%

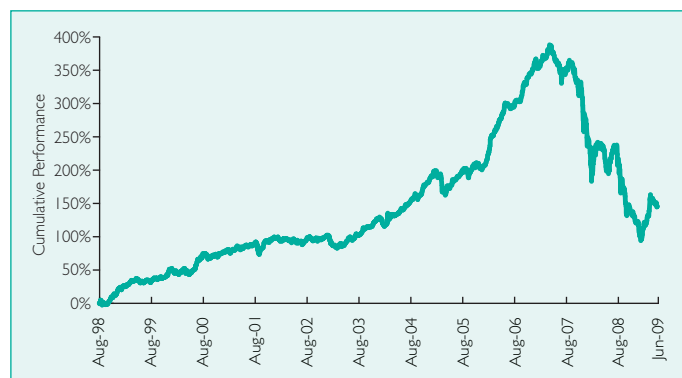
NB... annualised returns before tax and after fees. They differ from actual returns experienced during these periods.

Market Indices	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ50G	-12.5%	-18.7%	-8.0%	0.7%	
90day bank bill	6.2%	7.6%	7.7%	7.5%	
S&P/ASX300 (Calculated in \$NZ)	-20.9%	-11.6%	-3.2%	9.5%	
MSCI Global Small Cap Index	-15.2%	-16.1%	-12.7%	-1.1%	

June's Biggest Movers

Country	Company	Change
New Zealand	Opus Intl	-19%
	Pumpkin Patch	17%
	Metlifecare	-10%
	NZ Exchange	-9%
	Australia	
Oakton	29%	
Nick Scali	27%	
Centrebet	-13%	
Vision Group	10%	
International	O2Micro	23%
	Raffles Education	-20%
	Midas Holdings	16%
	Sarin Technologies	-14%

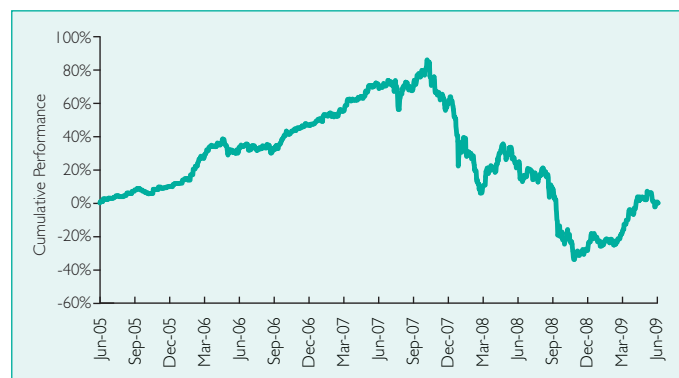
New Zealand Growth Fund



Fund Inception August 1998

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

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