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Investment Market Review

September has traditionally been a weak month for share markets, but this time around the clairvoyants were proved wrong with the Dow Jones Index enjoying its best September since 1939. The good news was not confined to the US with most markets, including the large European share markets, moving higher.

Closer to home, the NZSX50 was up almost 7% for the quarter and the S&P/ASX200 rose 8%. However, in New Zealand dollar terms the S&P/ASX 200 returns were closer to 16% as the Australian Dollar appreciated strongly against the Kiwi and most other major currencies.

The positive upward momentum during the quarter was not shared by all. Ireland had its share of problems, as the cost of bailing out its banking sector continues to rise. But arguably the biggest disappointment to markets has been Greece. Over the past 12 months the Greeks have seen their stock market halve in value – whereas most of the rest of the world has enjoyed returns of 5% to 10% over the same period.

The overall rebound in share markets during the previous quarter has been pleasing, but the annual returns mask the stuttering progress made since the end of the Global Financial Crisis. However, only the very optimistic were expecting a smooth transition back to normality and it seems that the path will be as rocky as most had predicted.

In this environment we remain confident that a diversified investment strategy with minimal stock specific risk, that follows a strategic asset allocation, continues to be the best strategy for investors.

The following table illustrates how share markets around the world have performed over the three months to 30 September and the annualised returns over the past one, five and seven years.

NZD Returns to 30 Sept 2010

	3 months	1 year	5 year (p.a.)	7 year (p.a.)
International Shares				
Australian Core Equity	3.7%	5.7%	n/a	n/a
Australian Large Companies	2.9%	5.6%	(3.5%)	11.3%
Australian Value Companies	3.5%	4.0%	8.9%	13.2%
Australian Small Companies	6.3%	5.6%	7.9%	11.3%
Global Core Equity	(3.3%)	(5.0%)	n/a	n/a
Global Core Equity (NZD Hedged)	(2.8%)	4.3%	n/a	n/a
Global Large Companies	(2.0%)	0.3%	0.4%	1.5%
Global Large Companies (NZD Hedged)	9.6%	7.7%	1.5%	n/a
Global Value Companies	(2.5%)	(1.9%)	(0.6%)	3.3%
Global Small Companies	(3.9%)	4.4%	0.2%	3.8%
Global Real Estate	4.6%	16.7%	n/a	n/a
Emerging Markets Companies	2.8%	16.0%	12.2%	14.7%
Fixed Interest				
Diversified Fixed Interest (NZD class)	4.0%	10.1%	7.6%	n/a
NZ Bond Fund PIE	1.3%	7.3%	n/a	n/a
New Zealand Assets				
NZ Share Portfolio	7.9%	2.9%	0.5%	6.7%
NZ Property Companies	7.8%	1.8%	2.7%	7.0%

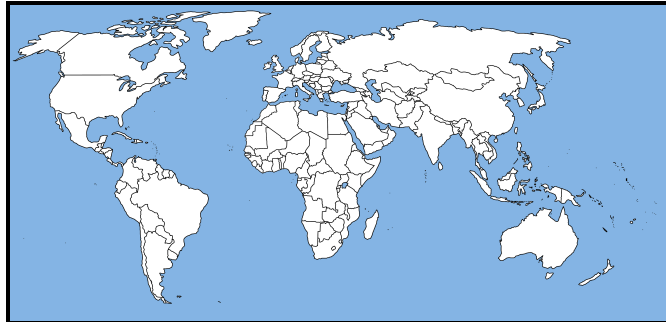
Notes:

* Returns are reported after fund management expenses and pre-tax, except NZ Bond Fund which is gross of fees and taxes.

** Past performance is not necessarily an indicator of future performance.



Economic Review: A Global Perspective



The overall economic data during the quarter was largely in line with expectations. On the plus side US corporate earnings were stronger than expected, but so far this has failed to lift the employment market as companies choose to be conservative by retaining profits in the face of an uncertain economic outlook.

This uncertainty was shown throughout markets – whilst many markets gained during the quarter there were also signs of nervousness as the traditional safe havens of gold and US Treasury Securities continued to rally.

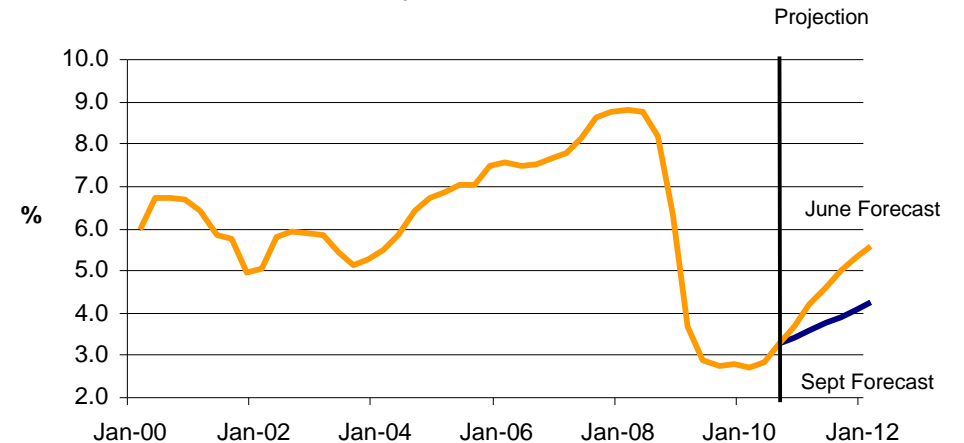
In Europe, a resurgent German economy has helped lift growth and optimism in the region and this put upward pressure on the Euro. This has heightened tensions in the region, as the so called PIGS (Portugal, Ireland, Greece and Spain) are still struggling with rising unemployment and budget deficits and would dearly like to see the Euro devalue to help rebalance their economies.

Continuing east, the improving outlook for Asia has continued to gather pace with the likes of China and India performing strongly. The Asian Development Bank has raised its forecasts of economic growth in the region for 2010 to 8.2%, from a projected 7.5% in April. One Asian economy not faring so well is Japan, which has seen its export based economy stall in the face of the Yen at a 15 year high against the US dollar.

Economic Review: A New Zealand Perspective

Closer to home, New Zealand's second quarter GDP was weaker than expected with output increasing at a modest 0.2% for the quarter, compared to forecasts of growth of 0.8%. This vindicated the Reserve Bank's decision to hold the Official Cash Rate (OCR) at 3% in September and indicate that interest rates are now unlikely to increase further until March 2011. The chart below shows the Reserve Bank's interest rate forecast made in June 2010 and the new forecast made in September 2010.

90-day interest rate



Source: Reserve Bank September 2010 Monetary Policy Statement

Retail Deposit Guarantee Scheme

The Crown Retail Deposit Guarantee Scheme, introduced during the Global Financial Crisis and covering some \$133 billion of retail deposits, expired on 12 October 2010. The extended scheme, which runs from 12 October 2010 until 31 December 2011, only covers deposits in a limited number of approved companies such as Canterbury Building Society, MARAC and Southern Cross Building Society. The extended scheme does not now cover deposits made in our banks.



Financial Lessons from the Earthquake

The 7.1 magnitude earthquake that struck in the early hours 4 September changed many peoples' lives in the Canterbury region permanently. Thankfully there was no loss of life, but property damage and business interruption is significant.



The ability for a single unforeseen event to dramatically affect one's financial circumstances is highlighted with the Christchurch quake. Local residents had the potential to have their homes, direct property investments and even their livelihoods suffer loss. Insurance does not always fully compensate for the financial cost let alone provide for the time and emotional energy required to manage the recovery and restoration process.

With investments, risk and return are related; however, not all risks are fully compensated for. Diversification reduces the risk of concentrated exposure to unforeseen events.

This is one of the key drivers behind the theory of portfolio construction. By combining assets with different risk profiles – defined by geographical location, asset class, and numbers of underlying securities – it is possible to lower the risk of the entire portfolio whilst increasing returns.

The New Zealand economy has long been thought of as vulnerable to shocks, with an earthquake or a foot and mouth disease outbreak commonly cited as latent risks. The overall economic repercussions of this event have, so far, played out differently than might have been expected. The dollar has risen rather than fallen, and the reconstruction effort is likely to be stimulatory in an otherwise sluggish economic environment. Nonetheless, these macro influences do not soften the hardship that many will be working their way through for some time to come. Nor does it diminish the lesson relevant for all observers that the benefit of prudent diversification is not just theory.

The End of an Era

The quarter has also seen the sad demise one of the South Island's most enduring brands, that of South Canterbury Finance Limited (SCF).



South Canterbury Finance

What finally caused the company to collapse is still wrapped up in some controversy. But as the private workings of a once proud company are laid bare to the public, it seems that neither the Global Financial Crisis nor an over zealous Securities Commission are entirely to blame.



The Timaru based company can trace its roots back to 1926, when it made its first loan of •30 and earned the princely sum of •5 interest over three years.

SCF originally specialised in small personal loans - a tradition that continued when Allan Hubbard became an owner in the 1950s and then a director in 1965.

Hubbard, who often completed a deal on the strength of his word and the bind of his handshake, became an enormously popular and iconic figure throughout South Canterbury. Under his stewardship, SCF grew rapidly throughout the 1990s and 2000s. In 1992 it was ranked as New Zealand's 10th largest finance company and had climbed to third by 2007, with assets close to \$2 billion. But as SCF grew, it arguably outgrew Mr Hubbard's business practices.

Paperwork and record keeping – things we now refer to as “good governance” – were never his strengths, it seems. The business traded on the image of the venerable Allan Hubbard, who was the very picture of conservative, Presbyterian frugality, and the investing public, share brokers and financial advisers alike all poured money into SCF's coffers.

As the cash rolled in from eager investors, SCF chased higher returns and took on greater risk. As we now all know the fair weather that had buoyed the company along came to a rather sudden end in 2007, with the onset of Global Financial Crisis. The cheap money dried up overnight, asset prices started to fall and fear set in.

As the economy weakened, SCF's borrowers found it increasingly difficult to repay loans and investment renewals started to fall as investors became nervous of another finance failure.

Still, SCF retained a loyal following and put their faith in Allan Hubbard, who had faced and overcome challenges before. As he had done in other crises, Allan moved bad loans to other vehicles and started making up the shortfall from his own funds.

New cash and assets were introduced to SCF to shore up its balance sheet in the belief that, with time, he could turn it around. Ultimately, in the end Allan Hubbard ran out of capital and ran out of time.

Whereas the Directors of other failed finance companies lived the high life, Alan and wife Jean led a frugal life and gave vast amounts of their wealth to good causes. But as time started to run out his actions became more desperate, seeking the big win to right the ship. For example, in 2009, just prior to being deposed as Chairman, he tried to convince the Board to invest all of SCF's cash in the share market.

Most investors, and particularly those from South Canterbury, do not doubt the intentions of Allan Hubbard and we have seen ample evidence over the years to suggest that they were better than most. We very much hope that his legacy will be the people he helped and the personal support he gave to his community. Sadly, his legacy will no longer include the growth of a successful finance company.

