Contents

Investment Market Review

From global financial crisis to natural disasters and sweeping political change in the Middle East, the seemingly relentless pace of unexpected events of the past few years continued into 2011 unabated.

The year started on a generally positive note with markets moving up in January and February, reflecting expectations of solid, if unspectacular, economic activity in the year ahead. Markets then fell heavily as news of the Japanese earthquake was beamed around the world and investors took fright at the unfolding economic disaster. This was compounded in no small part by the effects of rising oil prices fuelled by political and social upheaval in North Africa.

The scale of the human suffering in Japan, and Christchurch, has been heart wrenchingly difficult to watch. But whilst the earthquakes exacted a dreadful toll in human lives, and the effects on global markets was sharp, they were also relatively short lived.

By the end of March lower unemployment, new job growth and higher production figures out of Europe and the US, allowed markets, Japan excepted, to recover most of the initial losses.

History shows, at least in economic terms, that the impact of natural disasters is usually relatively short lived. Indeed, when government and corporate rebuilding efforts (and insurance pay-outs for Cantabrians) hit full steam economies can experience a net economic benefit.

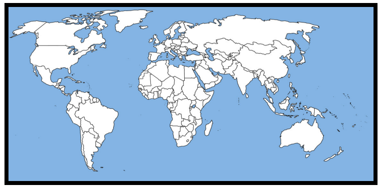
By the end of the March this longer term perspective was reflected in markets and it was pleasing to see all asset classes we follow posting positive returns for the quarter as a whole.

NZD Returns to 31 March 2011

	3 months	1 year	5 year (p.a.)	7 year (p.a)
International Shares				
Australian Core Equity	5.5%	10.2%	n/a	n/a
Australian Large Companies	6.8%	7.8%	6.6%	12.3%
Australian Value Companies	5.1%	7.9%	8.0%	13.5%
Australian Small Companies	4.6%	22.5%	11.5%	15.5%
Global Core Equity	8.3%	7.6%	n/a	n/a
Global Core Equity (NZD Hedged)	4.8%	13.8%	n/a	n/a
Global Large Companies	7.4%	5.7%	(2.5%)	3.1%
Global Value Companies	9.7%	7.5%	(2.7%)	4.4%
Global Small Companies	9.0%	16.5%	(1.2%)	5.7%
Global Real Estate	8.2%	13.7%	n/a	n/a
Emerging Markets Companies	3.4%	10.8%	6.6%	14.5%
Fixed Interest				
Diversified Fixed Interest (NZD class)	0.8%	6.1%	7.4%	7.0%
NZ Bond Fund PIE	2.4%	6.8%	n/a	n/a
New Zealand Assets				
NZ Share Portfolio	3.4%	4.2%	(0.3%)	5.9%
NZ Property Companies	2.3%	8.6%	2.1%	6.4%

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



Natural disasters dominated the quarter: the Queensland floods, the Christchurch earthquake and then the earthquake and tsunami in Japan. Japan is one of New Zealand's top five trading partners (9.1% of NZ exports in 2009) and now contributes approximately 6% of global economic output, half that of China or the Euro zone.

The Tohoku region is the area most directly affected by the earthquake and contributes 5.5% of Japan's Gross Domestic Product (GDP). With Japan's economy operating below peak capacity prior to the earthquake, the impact on Japan's GDP will be reduced.

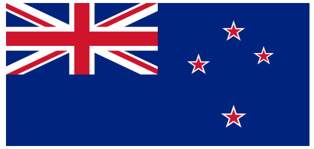
Notwithstanding the financial setback of Japan, the global economic recovery is expected to gain in strength in 2011 and 2012 with the International Monetary Fund (IMF) expecting growth in world GDP of approximately 4.5% in both years. On average, real GDP is expected to expand by 2.5% and 6.5% for developed and Emerging Markets economies respectively.

The risks of 2010 remain; unemployment (Australia excepted) is persistently high, fiscal and current account imbalances pervade, inflationary pressure continues to build and overheating in Emerging Markets remains a risk. They have been joined by 2011's own risk; overheating commodity prices.

Financial conditions remain fragile and while central banks and overextended governments may continue to be very accommodating in the short term, in the medium term growing inflationary pressures and government indebtedness will need to be addressed. The inflationary pressures building in Emerging Market economies are becoming of particular concern and will likely be the regions to lead the ultimate cyclical rise in interest rates that can be expected in the future.

For investors, the potential for higher inflation poses the risk of eroding the real value of portfolios. As always, the best way to protect the future value of your spending dollars is having exposure to growth assets.

Economic Review: A New Zealand Perspective



We opened our last Economic Review of New Zealand with reference to the earthquake that struck Christchurch on 4th September last year and how fortunate the region was to have suffered no loss of life. Regrettably, we now know all too well of the dreadful loss of life in Christchurch in the earthquake that struck on 22nd February. Like all kiwis, we have been affected by the tragedy and deeply touched by the outpouring of support from around New Zealand and the world.

The scale of the economic impact of the disaster, the total cost of rebuilding Christchurch has been placed at somewhere between $10 billion and $15 billion, resulted in a swift monetary policy response from the Reserve Bank which cut the Official Cash Rate (OCR) from 3.0% to 2.5%.

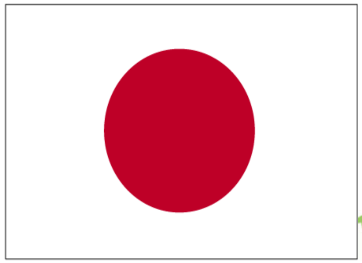
The Reserve Bank was pessimistic about the economic outlook for 2011 before the earthquake in Christchurch. The economic impact of the earthquake caused it to revise down its projection for GDP growth in 2011 to 0.9%, below its previous projection of 1.7%.

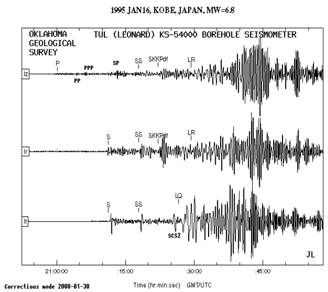
2011 began with signs that the economy was beginning to recover, these have been more than offset by the Christchurch earthquake. GDP growth is expected to be particularly weak through the first half of 2011. This is likely to gradually improve as the very large reconstruction programme required in Christchurch commences. Reconstruction is expected to take some years and result in quite strong economic growth from 2012 onwards.

The direction of future monetary policy changes will be heavily dependent on emerging economic data. However, once the rebuilding phase begins in earnest in Christchurch, it is expected that the current very accommodating interest rate policy will have to be tightened. This could take some time.

Lessons from Kobe

The aftermath of the 22nd February Christchurch earthquake will continue to affect the daily lives of thousands of Cantabrians for a long time to come. Reflecting on the rebuilding experience of the 1995 Kobe earthquake may provide some insight to what lies ahead and the financial ramifications that are still being calculated.

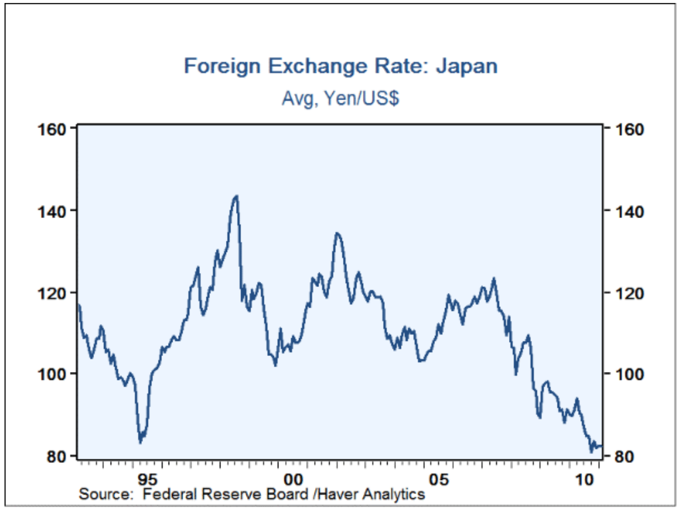




It was a 7.3 magnitude earthquake that struck Japan on 17th January 1995 causing widespread destruction to Kobe, home to 1.3 million people, a major port and industrial centre. At the time this was the biggest earthquake to hit Japan for 72 years. More than 120,000 structures fully or partially collapsed and a further 7000 burned. As in Christchurch, utility services suffered major damage with sewage taking the longest, at four months, to restore.

In Japan the insurance industry was heavily regulated, with relatively little overseas reinsurance and only about 7% of homeowners carrying earthquake insurance at all.

The graph below shows the impact on the Yen, rising strongly against the USD as funds were repatriated from overseas to Japan in the months immediately following the quake. Similarly, the Christchurch earthquake, has not preceded a fall in the NZD, on the contrary, after some initial weakness the Kiwi dollar has traded strongly – in part reflecting actual and anticipated reinsurance monies pushing up demand for NZ dollars.



The cost to the Japanese government in terms of stimulus packages and supplementary budgets for reconstruction was a massive 2 trillion Yen. Whilst economic activity suffered initially, rebuilding through the later part of 1995 and into 1996 pushed economic growth up by 6% p.a.

By 1999, just four years post the event, Kobe's economy had recovered 75% to 90% of pre-event capacity depending on the sector. Today, it is a modern city built to a much enhanced earthquake code and few physical reminders of the 1995 event.

Left Side: Kobe Immediate after 1995 earthquake

Right Side: Kobe after rebuilding program

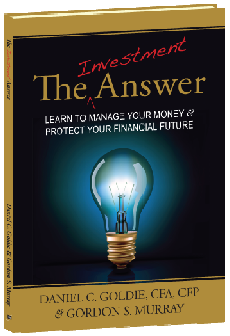
The human spirit is resilient. People in Christchurch, like they did in Kobe, are showing their courage in dealing with adversity and the tenacity of purpose to strive for a better tomorrow. Communities working together with some assistance from fellow citizens outside the region display some of the finer character traits of people in their concern for one another. The efforts of individuals aided with a degree of initial central government support will translate into entrepreneurship and business will thrive again.

The Kobe case study is an encouraging example of this economic recovery, which bodes well for Christchurch.

The Investment Answer

First editions of a recently self-published investment advice book, ‘The Investment Answer’ sold out of most major US bookstores.

In the US, the book may be resonating with people in part because one of the co-authors, Gordon Murray is seen as an insider-turned-informant on Wall Street. He worked on Wall Street for 25 years, predominantly for Goldman Sachs, Lehman Brothers and Credit Suisse First Boston. The fact that after such a stellar career, Murray knew very little about basic asset allocation among shares and bonds and other investments, is surprising. He claims to have learned more once outside the Investment Banking and fund management industry than he did in 25 years working as an active manager!



When diagnosed with a brain tumor in 2008, Murray decided to share his knowledge of the benefits of using a good financial adviser and sticking to a common sense approach to investing.

Editing assistance came from a who’s who of the financial world and includes, Engene Fama Sr, professor of finance at the University of Chicago Booth School of Business and proponent of the efficient markets hypothesis, Harry Markowitz, father of modern portfolio theory and Ken French, professor of finance at the Tuck School of Business at Dartmouth College, among others.

Whilst Murray says he continues to be astounded by people’s ignorance of basic financial planning, the book is not a do-it-yourself manual. In fact their message is relatively straightforward. Firstly, the authors strongly recommend hiring a good financial adviser who earns fees only from you and not from commissions paid by funds and companies with whom you invest. Then divide your money between shares and bonds, both large and small, and value and growth companies. Further subdivide between local and foreign assets.

The decision between investing in actively traded or passively managed funds is a no-brainer according to the authors, since no one can predict the future with any regularity, why would one think that active fund managers could beat the market over time (and in fact many studies prove that they don’t). The book’s final piece of advice is to rebalance your portfolio by selling your winners and buying more of the losers. This is the most difficult aspect, as they note that most people can’t bring themselves to do this, even though it improves returns over time.

(Copies of this book can be ordered via the Axiome website: www.axiome.co.nz)