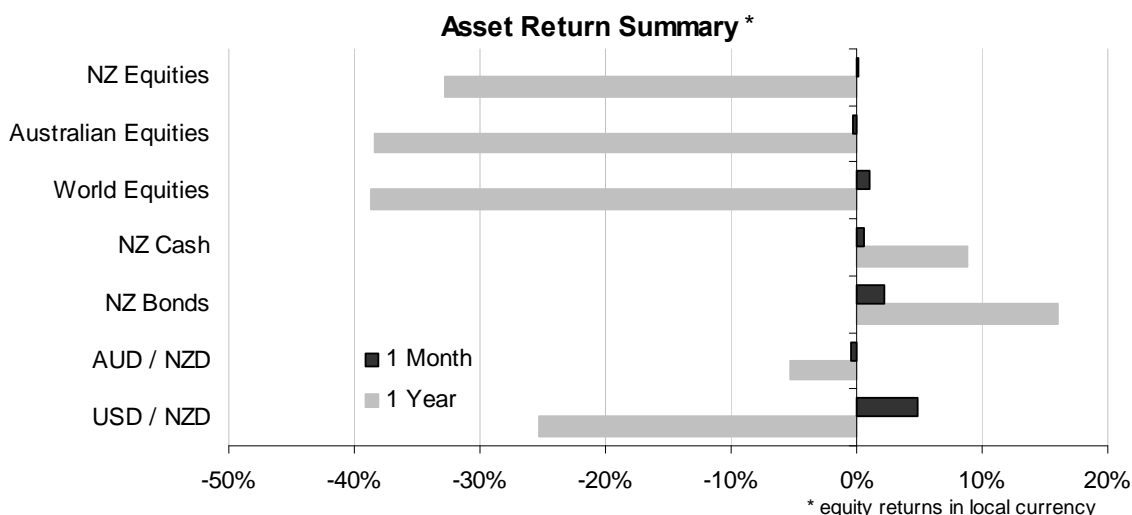


Hāhāea nga ripa o te pō, kia whiti ake ko te māramatanga
 (Shred away the darkness, let there be light)

TMF Limited: Monthly Market & Sector Review – December 2008

Market Overview

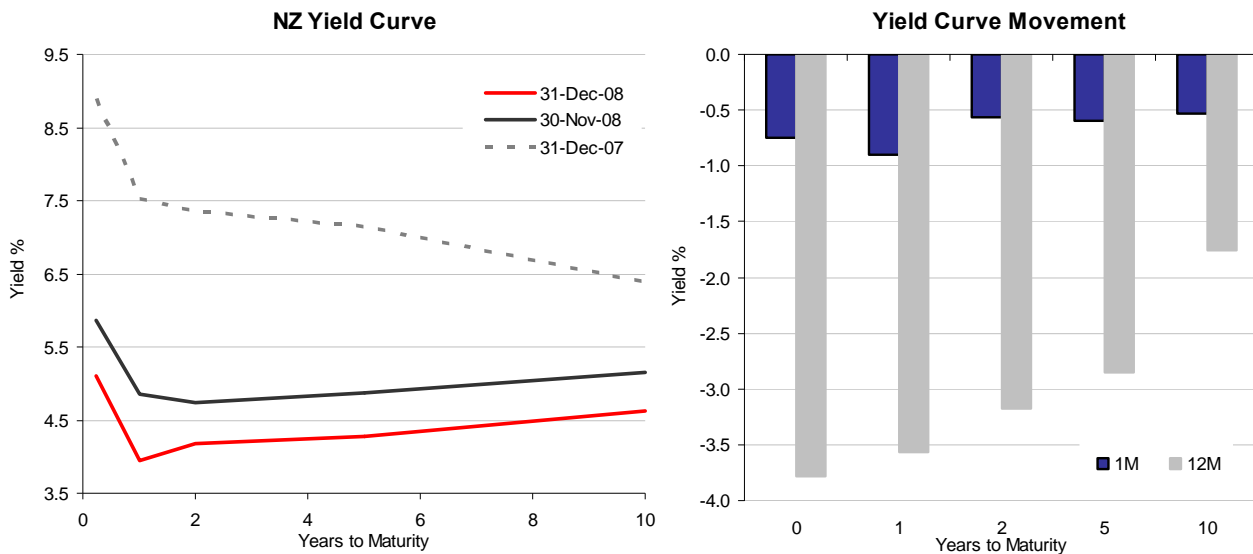


- The failure of Lehman Brothers in late September unleashed a crescendo of fear and panic, which reached its peak in mid-late October.
- November, and especially December, saw a variety of measures of volatility and fear subside from the extreme levels earlier in the quarter, with massive coordinated easing of monetary policy settings being an important factor.
- By the end of the quarter, the focus had begun to shift from liquidity and funding risk to how deep and long-lasting the global recession will be in 2009, and whether deflation will take hold.
- Against this backdrop, the bond market was by far the best performing asset class. NZ bonds (Composite A-Grade Index) returned 6.07% in the quarter and 15.98% in the year. NZ cash returned 1.9% in the quarter and 8.8% in the year.
- The performance of equities was truly dismal. NZ equities fell by 12.1% in the quarter and 32.8% in the year; global equities fell by 19.3% and 35.6% in the quarter and year, respectively, in their local currency terms. The weakening NZD offset some of this agony, with hedged world equity returns being -9.6% in the quarter and -21.1% in the year.
- Commodity prices plunged during the quarter as anecdotal evidence accumulated of real economic activity falling off a cliff and the USD strengthened on the back of global deleveraging and a flight to liquidity. The benchmark copper price fell from US\$2.89/lb to US\$1.39/lb and WTI oil fell from US\$100.60/bl to US\$44.60/bl. Gold was the exception, rising slightly from US\$871/oz to US\$882/oz.

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- A remarkable flight from risk saw the US ten-year bond yield fall from 3.83% to 2.25% over the quarter, while three-month US T-bill yields briefly dipped below 0.0%, which obviously only makes sense if deflation is expected.
- Globally, monetary authorities took unprecedented steps to try to stem the panic in their financial markets and economies. Key moves over the quarter included the Fed Funds target being cut three times from 2.0% to a range of 0.0–0.25%, the ECB cutting its refi rate from 4.25% to 2.5%, the Bank of Japan cutting its overnight rate target from 0.5% to 0.1%, the RBA cutting its cash rate target from 6.0% to 4.25% and the RBNZ cutting the OCR target from 7.5% to 5.0%.

NZ Cash & Fixed Interest



The key event of the month of December was undoubtedly the 4 December Monetary Policy Statement (MPS), which saw the Reserve Bank of New Zealand (RBNZ) cut its Official Cash Rate (OCR) target from 6.5% to 5.0%. This was largely expected by the market. The RBNZ is expected to lower the OCR further. The next interest rate announcement by the RBNZ is on 29 January.

The 90 Day Bank Bill rate declined from over 8% at the end of September to 5.12% at the end of December. Term deposit rates fell noticeably between late October and early December reflecting the moves in the Official Cash Rate.

The ongoing fall in government bond yields reflects an ongoing flight to safety. The NZ 10-year government bond rate fell 46 basis points in December and 106 basis points for the December quarter to 4.63%.

NZ Equities

While the NZ equity market decline of 12.1% for the quarter was dismal, it was far better than declines posted by global equities in their local currency terms. This reflects the lower volatility nature of the NZ market and its relative absence of financial and resource stocks. However, on a fully hedged basis the weakening NZD offset some of the losses.

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In looking at the constituents of NZ equity market performance, a mere five companies delivered a positive gross return during the quarter. The standout was The Warehouse's 19.3% return, attributable chiefly to their decision to abandon The Warehouse Extra format. This, coupled with subsequent comments by the Commerce Commission, led to hopes that corporate activity might be revived. The Warehouse also benefited in relative terms from a degree of 'trading down', although there is some potential impact on margins from the weakening NZD during the period.

The other key standout performance was Fisher & Paykel Healthcare's 10.1% return. Their underlying performance was solid but this share price movement was almost all about the positive impact of the weaker NZD.

The negative performers during the quarter are too many to discuss in extended detail but there were several key themes which were shared to varying degrees:

- 1) Plunging commodity prices: NZ Farming Systems, Pike River Coal.
- 2) Earnings warnings/downgrades on the backing of a slump in global and domestic economic activity: Nuplex, Rakon, Tourism Holdings, Mainfreight, Pumpkin Patch, PGG Wrightson, GPG et al.

Australian Equities

The ASX 200 fell by a modest 0.3% in December. This was a significant improvement from the prior three months, which returned an average of -10% per month. Lower volatility was partly attributable to holiday trading conditions. But there were also tentative signs of stabilisation in investor risk appetite (e.g. slight narrowing of credit spreads from extremely high levels). Notable outperformers during December were the information technology sector.

Gold prices continued to rise over the month as investors sought a hedge against deleveraging and central bank money printing. As a result, gold miners outperformed. In contrast, REITs (real estate investment trusts) performed very poorly. Banks also underperformed, on concerns about rising bad debts (e.g. in the REITs sector), and also capital raisings.

Offshore Equities

The major development in December was the US Federal Reserve's rate decision to drive long-term yields down. The decision to slash the Fed Funds Rate to a target of 0-0.25% somewhat surprised markets, but reflected the difficult times the US economy is facing.

Over the quarter some government and monetary authorities took significant steps beyond lowering interest rates. In the US this involved a US\$350 billion allocated to direct equity infusions into troubled financial institutions as well as numerous other measures directed at stabilising the economy. China announced a US\$586 billion fiscal package in November.

Economic data filtering out of the US continued to dampen sentiment. Activity indicators such as the ISM manufacturing index fell to multi decade lows, while U.S. weekly jobless claims and unemployment figures continued to soar. Not helping markets was the continued debate on a bailout package to the struggling automakers. And with US auto sales sliding around 30% on a year ago, the negative sentiment was reflected in automakers across the globe. But investors started to warm to the substantial interest rate cuts by central banks later in the month. Investor sentiment was also buoyed by US President-elect Barack Obama's plan to boost infrastructure and public works. The plan aims to create nearly 3 million jobs over the next two years.

Monthly Market Insight

NZIER Quarterly Survey of Business Opinion

Goldman Sachs JB Were analyst Shamubeel Eaqub comments on the latest release of NZ business opinion.

NZIER QSBO

Key Data	Dec-08	Sep-08	Long term average
Business Confidence (sa):	-77.4	-24.6	-8.4
Experienced activity (sa):	-44.1	-32.2	12.6
Expected activity (sa):	-42.8	-13.2	15.0
Capacity utilisation:	88.8%	90.8%	88.9%
Skilled labour shortages:	19.9	-4.9	-17.6
Pricing intentions:	-3.2	28.1	33.9
Hiring intentions:	-32.4	-7.5	-1.3
Investment intentions:	-38.7	-15.7	-1.3

Source: NZIER

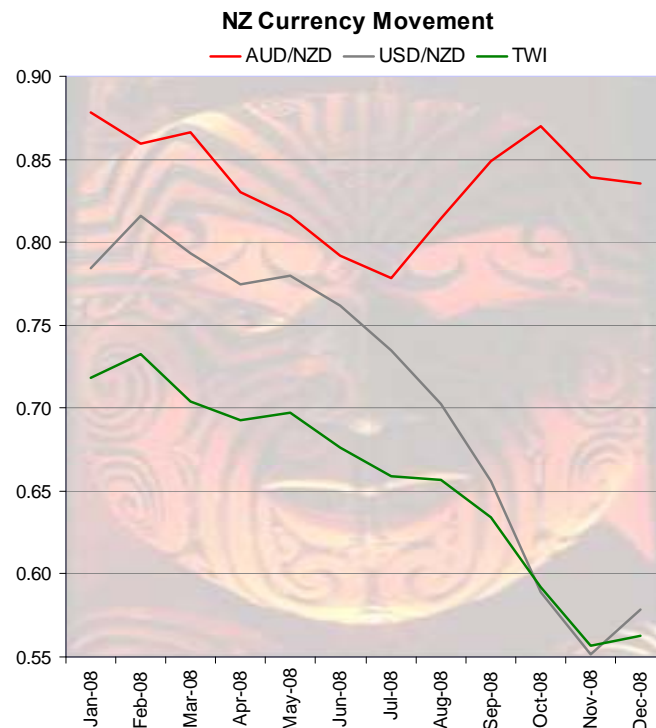
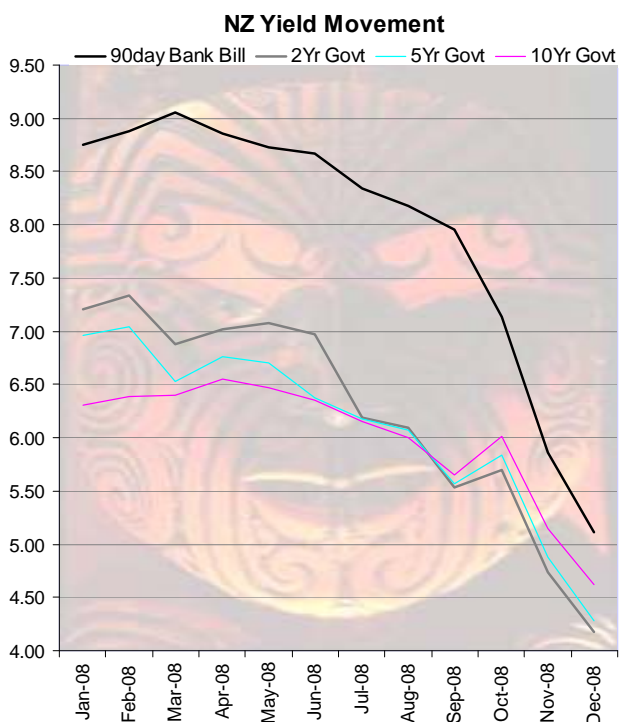
The 4Q NZIER QSBO was bleak and corroborated other leading indicators. The weakness in indicators was widespread, with adjusted confidence plunging from -24.6 to -77.4. More importantly experienced activity plunged (from -32.2 to -44.1) to the lowest level since records began in 1970.

Rapidly freeing slack in the economy and falling commodity prices mean inflationary pressures are dissipating quickly. This was neatly captured in pricing intentions falling into negative territory (-3.2 from 28.1) for the first time since 4Q98.

The survey shows an economy clearly in the grip of a severe recession. Weakness in leading indicators seen earlier in 2008 is clearly spilling over to the real economy and in particular jobs. We expect the next 6-9 months to be the most challenging for the economy requiring outright easy monetary policy from the RBNZ (versus around neutral now). We expect a 75bp OCR reduction on 29-Jan, but a larger move may be necessary.

Market Data Summary

Equities (gross return)	Level	1M	3M	6M	1Y	3Y	5Y	10Y
NZX50	2,716	0.2%	-12.1%	-15.0%	-32.8%	-6.9%	2.1%	5.3%
ASX200 (Local)	24,801	-0.3%	-18.3%	-26.8%	-38.4%	-3.9%	6.9%	7.4%
ASX200 (NZD)		0.1%	-17.0%	-30.6%	-35.0%	-0.4%	7.8%	7.7%
MSCI World (Local)	1,584	1.0%	-20.6%	-29.7%	-38.7%	-9.5%	-0.9%	-1.1%
MSCI World (NZD)		-1.6%	-11.3%	-12.7%	-20.7%	-2.9%	2.0%	-1.6%
NZX50 / ASX200(NZD) comp		0.1%	-14.5%	-22.8%	-33.9%	-3.7%	5.0%	6.5%
Bonds (gross return)	Level	1M	3M	6M	1Y	3Y	5Y	10Y
NZX 90 Day Bank Bill	544.90	0.6%	1.9%	4.1%	8.8%	8.3%	7.6%	6.7%
NZX Govt Bond Index	1,064.72	2.3%	6.0%	10.5%	15.8%	7.8%	7.2%	6.7%
NZX Composite A Grade	2,895	2.3%	6.1%	10.3%	16.0%	7.9%	7.2%	6.7%
Property (gross return)	Level	1M	3M	6M	1Y	3Y	5Y	10Y
ASX200 Property (Local)	18,007	-10.5%	-32.9%	-33.7%	-54.0%	-17.3%	-3.5%	2.7%
ASX200 Property (NZD)		-10.2%	-31.8%	-37.2%	-51.4%	-14.3%	-2.6%	3.1%
Currencies (% change)	Level	1M	3M	6M	1Y	3Y	5Y	10Y
AUD / NZD	0.8356	-0.4%	-1.5%	5.5%	-5.3%	-3.6%	-0.9%	-0.3%
USD / NZD	0.5785	4.9%	-11.8%	-24.1%	-25.3%	-5.3%	-2.4%	0.9%
NZ TWI	56.3	1.1%	-11.2%	-16.7%	-21.7%	-7.3%	-2.9%	0.0%
Interest Rates (basis points)	Level	1M	3M	6M	1Y	3Y	5Y	10Y
90 Day NZ Bank Bill	5.11	-75	-285	-356	-378	-257	-24	20
10 Year NZ Govt Bond	4.62	-53	-103	-173	-176	-105	-131	-82
10 Year US Govt Bond	2.25	-68	-160	-174	-179	-214	-202	-240
Commodities (% change)	Level	1M	3M	6M	1Y	3Y	5Y	10Y
Oil Prices (US\$/WTI)	44.60	-9%	-56%	-68%	-54%	-10%	7%	14%
CRB Index	229.5	-5%	-34%	-50%	-36%	-12%	-2%	2%



Sources: ANZ National Bank, First NZ Capital, TMF Limited.

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