



Diversified INVESTMENT STRATEGIES LIMITED

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DIVERSIFIED'S VIEW

February, 2009

"[Govt] play[s] a support role, a regulatory role, but fundamentally it is the judgement of individual men and women that generates the wealth of nations." Australian past-PM, Dr John Howard, at Bond University, 13th February, 2009.

Investors did not have to lose money in 2008. Diversified Wealth Management's 'Balanced' Fund has a gain of +3.73% between its inception at March 31st and January 30th, 2009. The PIE fund follows Diversified's core investment strategy, which has been running for 15 years. Diversified Investment Strategies Limited also advises The Law Retirement Plan on its KiwiSaver Scheme. Investment Statements for both funds are available on our website or from our offices, and should be consulted prior to investing.

Summary

- The anticipated bounce in financial markets delivered in *Diversified* portfolios, delighting investors most recently - especially in NZ dollar terms. While annual returns are positive or nearly so, we do not perceive global financial market volatility to be over.
- We now find preliminary signs of stability returning to some sectors, markets and economies, following the extreme of distressed selling of Oct/Nov 2008. Emerging Markets are leading, with China's growth and reflation well ahead of that of any Developed Economy.
- Key commodities are basing. Prices are at or near fundamental cycle lows - though no catalyst for resurgence is yet evident. Conversely, house-price bubbles have so far only corrected in the USA. The Australia and New Zealand housing markets are sufficiently precarious to constitute an economic threat.
- The finance sector may need another down-leg to induce accountability and contrition. Most of the perpetrators of current problems – and their failed regulators - are still engaged, collecting their emoluments and praying for the 'good times' to return. New leadership would advance confidence.
- We are less persuaded big government bail-outs are the cure-all for global economic ills. Beyond spending on infrastructure (for which they will enjoy the utility), governments do future tax-payers a disservice in debt-funding to cover others' poor investment decisions. Bailouts of decadent or inefficient industry will probably prolong the recession.
- For investors, fundamentals (never neglected by some), are back in vogue. Operating earnings, conventional industries, dividends and orthodox accounting remain worthy. Gearing earnings with debt creative accounting and notional re-valuation gains (e.g. property) taken to earnings, are unsustainable.
- Good, solid, systematic diversification across recognized asset classes, with tactical positions or omissions and disciplined rebalancing, has demonstrably served long-term investors well.
- We expect de-leveraging will be a continuing investment force, corporately and privately. Leverage masquerading as 'infrastructure funds'; proprietary trading as 'hedge funds', and mysterious Private Equity, face prolonged head-winds.
- *Diversified* is very proud of our 15-year record of superior strategies. That wealth has been preserved over a tumultuous 2008 is particularly gratifying, and this from long-only, basic portfolios. Our promise has never been one of 'absolute' gains, irrespective of markets. Clearly some purporting that elixir were found wanting in 2008.

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An Adviser Disclosure Statement is available on request and without charge, or may be accessed via our website.

DIVERSIFIED INVESTMENT STRATEGIES LIMITED

Website: www.diversified.co.nz

Expertise You Can Trust for Private Client Portfolios and Trustees

New Zealand – Iceland → Ireland → N.Z. ?

Our New Zealand economy will not escape the global downturn. Delayed maybe, but the coming recession is likely to be more severe here. Far from rebounding soon – much as stretched property speculators may dream – economic commentators are competing to revise deeper, their estimates of the length and intensity of the looming downturn.

Politics is subject to economic realities. Fiscal largesse, and even effective stimuli only offer salve, while over-priced housing, low-quality spending, poor productivity and burgeoning Current Account Deficit, need correcting. ANZ's projections below for NZ's recession echoes *Diversified's*. Inflation is predicted to remain elevated, even amidst a contracting economy.

Salient NZ Economic Projections

	March 09	Dec. '09	March 2010
GDP % yoy	-2.2	-1.1	+0.5
CPI % yoy	3.0	2.5	2.7
Unemployment	5.1	7.0	7.1
Curr. Acct % of GDP	-8.8	-6.5	-6.5
OCR %	2.75	2.5	2.5

Sources: ANZ Market Focus 15th February, 2009.

Kiwi's concern for America's economic travails, or even Europe's, may be endearing but is misdirected. Even the usually optimistic, Macquarie Research Economics depicts a NZ's recession will be deeper and longer than elsewhere (see below).

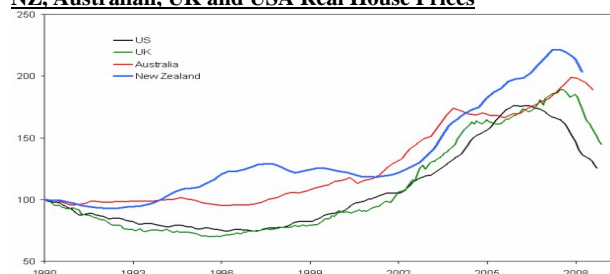
NZ, Australian & USA GDP Outlooks – annual average

	NZ GDP	Aust GDP	USA GDP
4Q 08	+0.3%	+2.3%	+1.3%
1Q 09	-0.7%	+1.6%	+0.1%
2Q 09	-1.5%	+0.9%	-0.8%
3Q 09	-1.7%	+0.6%	-1.3%
4Q 09	-1.2%	+0.5%	-1.1%

Source: The Macquarie Weekly, February 13th, 2009.

New Zealand house prices have risen more than in Australia, UK or USA over the past decade, and have corrected least.

NZ, Australian, UK and USA Real House Prices



Source: RBNZ Gov, Dr Bollard Speech of 30 Jan, 2009.

The potential for a disorderly retreat from precarious house prices, constitutes an economic risk. In that event, public sentiment and consumer confidence would be further devastated. Mortgage funds, creditors and finance companies may face losses ahead. Insolvencies will rise.

NZ's recession, falling Official Cash Rate and lagging economic recovery, combine to weaken the NZ dollar. Eventually growth will return; probably when wealth creation, farming, industry, commerce, value adding and resource utilization have been rehabilitated to respectability, rather than tolerated and burdened. But discovery of market clearing prices, and realignment of economic priorities looks to pre-occupy our one-year to 18 month, tactical horizon.

Diversified's model strategies are currently underweight NZ assets, including the currency.

Australia – Still lucky, but with downside risks

Australia, through its massive resource complex, offers either a leveraged play on global economic reflation, or potential market and currency aversion if the global downturn intensifies. *Diversified* cautiously favours the former possibility, perhaps buoyed by China's infrastructure building with its need for bulk commodities. Australia's housing market too is 30% above 'fair value' by some measures, and constitutes an economic risk. A pull-back of that magnitude would threaten Australia's much lauded banks - with their 30% of assets tied up in housing – with solvency issues akin to problems besetting USA, European and UK banks now.

In event of a lingering recession, and to support a precarious housing market, Australia's Official Cash Rates could be cut to 1.5%. A lower OCR trough may weaken the A\$ exchange rate against global currencies, but with similar events would likely be parallel to NZ.

Key Economic Forecasts – Australia

	2009	2010
GDP % p.a.	+0.1	+1.91
CPI % p.a. (headline)	+3.0	+3.0
Unemployment %	5.4	6.8
Curr. Account (% GDP)	-4.9	-6.6

Source: ANZ Economics Weekly, Feb 12th, 2009.

In its determination to avert a recession, fiscal stimulation by the Australian government aggregates A\$65 billion of new spending, or 5.6% of GDP, since October 2008.

Our model strategies continue to advocate a neutral allocation to Australia.

International – A world becoming egalitarian?

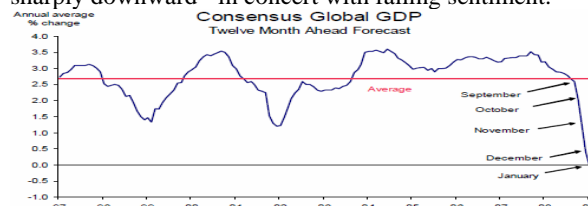
The current sharp downturn should not obscure the success of capitalism and freer trade globally in alleviating poverty over the preceding decade. Over half the world's population has been elevated to 'Middle Class'. Those classified as 'Middle Class' in Emerging Markets rose by 60% from 2000, to 400 million souls in 2005, and is projected to swell to 1.2 billion by 2030.

Developed World:

There is now no doubting the debt super-cycle is over – at least outside of governments. The West has rediscovered saving, frugality and debt reduction.

High-profile, government 'bail-out' programmes will not resuscitate the debt super-cycle. Further, to the extent banks insolvency is tolerated, bad loans are camouflaged and CDS losses hidden, or inflated prices are supported, governments may be complicit in prolonging the downturn. President Obama's US\$790 billion package is dominated by the above and pork-barrelling, with less than US\$100 billion directed to true 'infrastructure' spending [source: American Society of Civil Engineers].

Western dominated global forecasts for aggregate global economic growth have been most recently been revised sharply downward - in concert with falling sentiment.



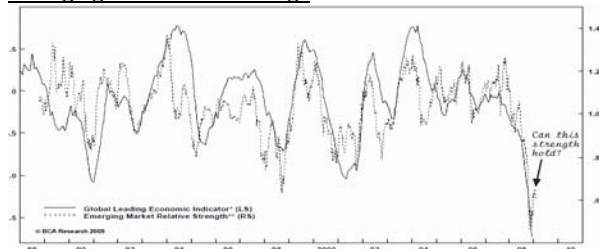
Source: Philip Houghton-Brown, ING Roadshow, Feb 2009

Europe's profligate, problem children of **P**ortugal, **I**taly, **G**reece & **S**pain, form an unfortunate acronym.

Emerging Markets:

Even as Global Leading Economic Indicators continue downward, there are signs Emerging Markets may be turning the corner.

Emerging Markets Bottoming?



Sources: BCA Research weekly of Jan 30th, 2009

China is a world leader in economic performance and stewardship. A 50% national savings rate, and US\$2 trillion in official reserves, clearly distinguish China from the excesses of the debt super-cycle. Responding swiftly to collapsing exports markets, China's stimulus package has been fast and effective. Over 1000 new mega-projects – new highways, railways, canals or nuclear power-stations – have commenced since November 2008. Growth has 'slowed' only to +6.8%, and should accelerate this year. Bank-loan growth is rising quickly, steel production is already re-accelerating and domestic retail sales are soaring. With per-capita income of only US\$2,500, China's growth pace and economic trail-blazing can continue for decades.

Diversified perceives the aggregate global economy may be close to bottoming. Financial markets will most certainly pre-empt economic recovery, while sentiment, headlines and statistical confirmation will as surely lag.

Key Global & Regional Economic Forecasts (GDP Growth %)

	2009	2010
World PPP	+1.0	+3.3
China	+6.9	+8.5
Other Asia	+0.4	+4.4
Japan	-1.5	+1.0
Dev. Europe	-1.2	+0.7
USA	-1.6	+2.0

Source: ANZ March Quarter, Economic Outlook, 2 Feb, 2009

We are optimistic economic stability will emerge as 2009 progresses, and believe patient investors should be cautiously positioned accordingly.

Diversified was an early convert and has long advocated strategic inclusion of the high-growth areas of the World, including Asia and Emerging Markets

Fixed Interest – “It is interesting that [Banks] invented new ways to lose money, when the old ways seemed to be working just fine.” John Stumpf, CEO of Wells Fargo. July 2008

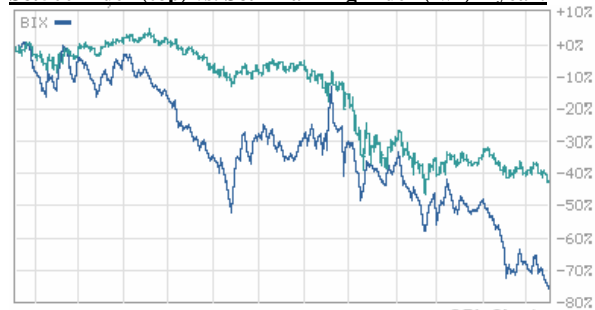
Accountability and contrition in the finance industry is lacking. Interbank distrust will persist while liabilities are deliberately obscured. Disturbingly, Executives who presided over the creation of current problems, cling determinedly to their stations. Trite apologies and deferring of future bonuses are short of that required.

ANZ & ING (NZ) misrepresented the risks of their ‘Structured Fixed Interest’ products, misled in offering docs, and have mismanaged funds since trapping investors in March 2008. ANZ Bank – with or without ING - should make whole their wronged clients and investors without further delay.

Equities – Economics presents Opportunities.

Some positive signs exist. Most USA sharemarket components range between slowed rates of descent, and base-building, while the Financials sector is still deteriorating.

S&500 Index (top) vs. S&P Banking Index (lwr) 1-year:



Source: BigCharts

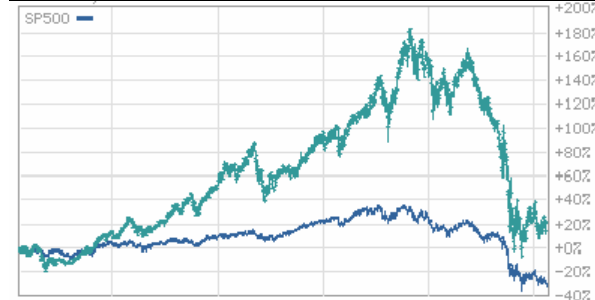
Adjusting the aggregate S & P 500 Index above for its weaker financial components, reveals such as basic industries rallying. The Toronto Stock Exchange's bellwether Metals & Mining Index, jumped an impressive 75% from its nadir on October 27th 2008 to year-end.

Diversified's selection outperformed broad markets, with good gains on international equities amplified in NZ\$-terms. January 31st found all model portfolios restored to profitability for the year prior.

Looking ahead, we fully expect continuing volatility, but with gains hopefully dominant, and with historically good dividend yields on current prices.

Initially resilient, as Western financial problems unfolded, Emerging Markets were irrationally liquidated by foreign investors beset by the October 2008, panic sell-off. Intrinsic value has scarcely changed, though the Emerging Market Index was suddenly hammered to levels of four years ago.

MSCI Emerging Markets, vs US S&P500 Index (in US\$) 5-yrs.



Source: BigCharts

Fortunately *Diversified* fared a little better via defensive investment selection, and from having trimmed model allocations progressively over the preceding years. At this stage, we continued to advocate a significant allocations to global Emerging Markets, as well as to the Asian region specifically.

With history as a guide, sharemarkets will rally as a harbinger of global economic recovery, ahead of any catalyst being recognized.

Property – Correction not over yet

As noted above, we find a real risk Australasian house prices could retreat by up to 30%. *Diversified* maintains its zero weighting to Property as an asset class.

Commodities – Bottoming?

Such has been the severity of the Commodity price collapse, we now find the asset class broadly has lost all froth and travelling at sound fundamental value.

Commodity Research Bureau Index



Source: Stockcharts.

Theory determines that commodity prices will fall to the marginal cost of a new entrant at cycle lows. Our research shows that the marginal costs to find, develop and extract Oil to be around US\$40/bbl; copper around US\$1.50/lb; gold around US\$750/ ounce troy and nitrogen fertilizer around US\$250/tonne. In most all instances, industrial commodities have tumbled to levels at which risk is minimal, though without any compelling reason to commit funds to the asset class broadly. While possible, further reduction in general price levels will curtail production.

Diversified advocates only gold (held as money rather than a commodity), and a small allocation to Oil recently introduced in model strategies.

Gold – target revised

When the allocation to gold was introduced to *Diversified's* model strategies in December 2004, (gold at NZ\$600/ounce), the target price of US\$1,000 or NZ\$2,000 per ounce, seemed ambitious. With the price now over NZ1,800/oz, we have revised our expectations, and recommend retaining a full position.

Gold is money more than anything else. The allocation has been an outstanding store of value in portfolios amidst financial system strains – which are likely to abate only slowly. Further, gold as an asset class stands to benefit from either deflation or inflation ahead.

Price of Gold Bullion – in NZ\$



Source: *Diversified's* research.

Sustained higher gold prices will eventually cause re-valuation of major gold company's in situ reserves. *Diversified* model strategies now marginally favour producer's shares over Bullion.

Currency – NZ\$ correction incomplete

Irrespective of the tumble to date, *Diversified* anticipates further depreciation of the New Zealand Dollar's exchange rate, within our one-year to 18 month tactical horizon. .

NZ\$ Exchange Rate Forecasts

	Feb '09	Sep '09	Dec '09	Sep '10
US\$	0.52	0.43	0.41	0.44
A\$	0.80	0.77	0.76	0.76
Euro	0.41	0.36	0.36	0.42
GBP (£)	0.37	0.33	0.33	0.35
Japan ¥	547.6	36.6	34.9	39.6
NZ\$ TWI	52.9	45.5	44.3	48.3

Source: *Rounded from ANZ Market Focus, 16 February, 2009.*

The fallacy of hedging a variety of offshore currencies all back to the frail NZ dollar, has recently been discovered by poorly advised fund managers, and their hapless investors. *Diversified* continues to shun all investments engaged in hedging to NZ\$.

Salient Rates, Indices, & Exchange Rates

Following are the January 30th 2009 rates and selected equity market indices, relevant currencies, with their percentage gain or loss from that of three months, six months, and one year earlier. Figures are before taxation, fees or any impact from NZ currency.

ACTUAL	30/01/09	3 Months	6 Months	One year ago
Prevailing Monetary Conditions Index.	-813	+122	+865	+1310
Prevailing NZ Cash Rate (90-day)	3.71% pa	7.14% pa	8.36% pa	8.75% pa
Prevailing 2011 NZ Gov't Stock Yield	3.35% pa	5.72% pa	6.15% pa	6.93% pa
Prevailing 2015 NZ Gov't Stock Yield	4.03% pa	6.01% pa	6.13% pa	6.44% pa
CHANGE	Value	Gain or loss since ...		
NZX NZ Gov't Stock [Bond] Index	1087.36	+8.9%	+11.6%	+16.8%
NZSE 50 (Gross)	2774.14	-1.7%	-16.8%	-24.4%
NZSCI (Gross)	16383.79	-15.6%	-27.2%	-30.8%
S&P/ASX200 (Australia) *	3540.00	-11.9%	-28.9%	-37.3%
MSCI World Index (Capital)*	838.83	-12.4%	-39.0%	-42.8%
Dow Jones (USA) *	8000.86	-14.2%	-30.9%	-35.7%
NASDAQ*	1476.42	-14.2%	-36.5%	-38.2%
FTSE 100 (UK) *	4149.64	-5.2%	-23.4%	-28.9%
Nikkei DJ (Japan) *	7930.46	-11.3%	-40.6%	-41.7%
Hang Seng (Hong Kong) *	13091.65	-7.3%	-42.6%	-44.3%
NZD/USD	0.51	-13.5%	-30.8%	-34.5%
NZD/AUD	0.80	-8.4%	2.6%	-9.2%
NZD/JPY	45.73	-21.1%	-42.3%	-47.4%
TWI	51.60	-12.7%	-21.5%	-28.1%
Gold (US\$ / oz., troy)	925.90	25.4%	3.1%	0.5%
Crude Oil (WTI, US\$/bbl)	41.58	-38.4%	-66.0%	-54.6%

*Indices, figures and performances in respective local currencies unless otherwise stated.

NORMAN W. STACEY, INVESTMENT ANALYST – Corporate and individual Investment Adviser Disclosure Statements are available free of charge, or may be viewed on our website: www.diversified.co.nz