Third Link News

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Investment Manager
Third Link Investment Managers Pty Limited
PO Box 1087
Sydney NSW 2001
Phone: 1300 793 855
www.thirdlink.com.au

Responsible Entity
Treasury Group Investment Services Limited
Level 5, 50 Margaret Street
Sydney NSW 2000
Phone: (02) 8243 0400

The importance of history

During the six months since our last newsletter, Third Link Growth Fund reached two historic milestones: celebrating its five year anniversary (an important point for the 'legitimacy' of any managed investment fund); and the accumulated donations to charity generated from the Fund passing $2,000,000. This is a very pleasing result, to say the least, and has been a definite win win – a win for investors and a win for the charitable sector.

When I established Third Link Growth Fund in April 2008 I always hoped that one day it would be recognised for strong investment performance. As it was a new fund without a track record, I was conscious that investors in the early years were more likely to be attracted by the 'philanthropic angle' of the fund. I committed to donating all management fees received from managing the Fund, net of expenses incurred, to the charitable sector.

Five years on from its launch, you can see over the page that the returns to investors have been excellent. Even with the toll the global financial crisis took on all investment markets, Third Link Growth Fund has generated a return after fees of 8.8% per annum compound since inception to the end of September 2013. In addition to that, investors have enjoyed the benefit of imputation credits generated from franked dividends that passed through the Fund into their hands. This return is significantly greater than the benchmark that the Fund performance was being measured against – by over 4% per annum compound after fees. This result I believe, places Third Link Growth Fund as one of the best fund-of-funds in its class.

However, the icing on the cake for this unusual Fund is that it has generated over $2,000,000 in donations to the charitable sector. As the amount given to charities is directly linked to the Fund size, this has meant the amount being donated each year has been rising. Based on the current Fund size of just over $60 million, we are now donating over $60,000 per month, placing Third Link in the top 100 charitable givers in Australia.

Thomas Jefferson once said *"I like the dreams of the future better than the history of the past".* But to me, the achievements of the past provide a reality check of whether the dreams of the future are likely to be a reality one day. I have said from the beginning of this journey that I intended to close Third Link Growth Fund to new investors when it reaches $150 million, to preserve and maintain the innovative structure. At that point I expect the Fund will be generating over $2 million a year for charity, making it a powerful grant-making machine and providing a very material benefit to Australian society. I believe that target is no longer a dream, and word of mouth should see Third Link Growth Fund get to that size within a couple of years.

Many of our investors may not be aware of the charities we are supporting. They are groups focused on helping young Australians thrive. They comprise AIME (helping Indigenous students achieve education equality), Batyr (assisting to bring young people's social and mental health issues out in the open), Beacon Foundation (helping prevent young Australians leaving secondary school from moving into unproductive or insecure pathways), National Centre for Childhood Grief (providing loving professional support and guidance for children grieving the death of a parent), Outward Bound Australia (helping young people to discover, develop and achieve their full potential), Rural Education Australia Program (helping community-based early childhood and education service providers in Australia's rural and remote communities) and of course our first-supported organisation, Social Ventures Australia (working with innovative partners to invest in social change). The 'Our Charitable Partners' section of the Fund website (**www.thirdlink.com.au**) contains more information about these groups.

So, five years on from the launch of Third Link Growth Fund, we have much to celebrate. Thank you for choosing to invest in the Fund and a big thanks to all those organisations helping to make the Fund a reality, most of whom do so on a pro bono basis.

Regards

Chris Cuffe,
Founding Director & Portfolio Manager
Third Link Investment Managers Pty Limited

Is Australia's golden age at risk of ending?

Australia has had more than 22 years of almost continuous growth in real incomes per person. Continuous economic growth over such a long timescale is the envy of most advanced countries.

This growth has been sustained in spite of external shocks like the Asian Financial Crisis, the technology share market collapse, the GFC and the deep problems in the eurozone [1]. Even the dip in real per-person incomes at the height of the GFC was modest and short-lived (see graph opposite).

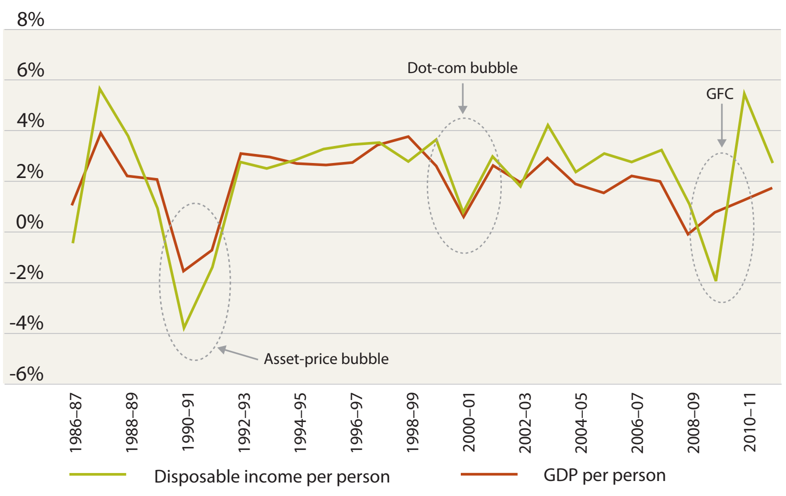
In part, we recovered so quickly from the GFC because Australian governments were able to put in place substantial discretionary stimulus in both fiscal and monetary policy, while maintaining a relatively strong fiscal position [2]. This was because they went into the GFC with a budget surplus and negative net debt. Australia also was helped by strong stimulatory action by China, which maintained the demand for our exports, particularly minerals [3].

Risks to continued growth

However, there are a number of reasons to believe that there are risks to continued growth in per-person incomes or government budgets. The main causes for concern are:

- Our productivity – growth in the value of what we produce for each hour we work and each dollar we invest – has been low over the past decade, until very recently when it rebounded somewhat. Without strong productivity growth, it is hard to sustain real wage and employment growth.
- Prices for Australian exports, particularly minerals exports, have either stabilised or reduced relative to their peak, and are expected to fall further [4].
- As our population grows older, fewer people as a proportion of the total workforce are willing or able to work. This is beginning to happen now as the eldest of the baby boomer generation reach retirement age, and will speed up in the years ahead. This reduced workforce participation means lower growth in the economy overall and lower per-person incomes.
- GST revenue, on which Australia's states and territories rely heavily, has not recovered since the GFC. This is in part because the community is saving more. While this is a good thing, it means lower revenue for the states. Also, where consumers are spending more, an increasing share of this consumption is in areas not covered by the GST, such as private health, private education, fresh food, and (less importantly) small online purchases.
- The relatively strong budget position at the Commonwealth level entering the GFC was not underpinned by sustainable expenditure and revenue arrangements. Instead, budget balances have become heavily reliant on revenue boosted by cyclical factors and the continuation of 'good times' associated with strong commodity prices [5]. With the easing of commodity prices, there is further risk to the ability of governments to bring budget deficits back into line.
- A range of expenditure commitments were entered into on assumptions of revenue streams from carbon pricing and the Minerals Resources Rent Tax, which are not likely to be met.
- Flat or volatile revenue growth at the same time as there are expectations of increased funding for critical services means that it will be hard for all levels of government to rebuild the strong fiscal position that the times call for.

Disposable income per person and GDP per person, Australia, annual % change



While assessing the efficiency of current spending and cutting wasteful spending will provide one part of the solution, it is unlikely to adequately address current, and more particularly future, deficits.

The continuation of strong real per-person income growth is critical for ensuring high living standards in the future. Although strong export prices and falling import prices have enabled real incomes to grow despite falling productivity levels, these two factors are substantially beyond our national control, being a function of global movements in prices and global minerals demand and production [6]. Commodity prices have already stalled and can be expected to fall further.

Rebuilding productivity growth

Productivity, on the other hand, is at least partly within our control. Rebuilding productivity growth through targeted reforms will help Australia cope with shocks, including from the possible decline in our export prices, and will offset the impact of an ageing population. Addressing productivity levels is critical to improved living standards and real per-person incomes, and 'in the long run, productivity growth – producing more from the same inputs – is the only sustainable way for future generations to enjoy higher living standards' [7].

Productivity improvement can be derived from a range of government and business decisions. In the long run, some of the best improvements will come from education reforms and improvements. In the short run, one of the best means to improve productivity is to exercise how the tax system impacts on the efficiency of our economy. This is a challenge for states and the federal government. ■

1 Commonwealth of Australia. 2010. *Australia to 2050: Future challenges*. January 2010. Canberra: Australia.
2 McDonald, T., and Morling, S. 2011. 'The Australian Economy and the global downturn. Part 1: Reasons for resilience'. *Economic Roundup Issue 2, 2011*. Canberra, Australia.
3 Connolly, E., and Orsmond, D. 2011. 'The Mining Industry: From bust to boom'. *Research Discussion Paper*. Reserve Bank of Australia, Sydney.
4 BREE. 2013. *Resources and Energy Quarterly*. March Quarter 2013. BREE, Canberra.
5 Maher, Sid. 2013. 'Decade of deficits' puts focus on spending cuts, says new economic modelling'. *The Australian*. 4 March 2013.
6 With high prices for minerals come incentives for mineral resources development in other countries, including developing countries. Future commodity prices are therefore expected to be directly affected as new supply comes on line.
7 Parkinson, M. 2011. 'Sustaining growth in living standards in the Asian Century'. *Address to the Seventh Economic and Social Outlook Conference*. Melbourne, 30 June 2011.

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Portfolio Update

The objective of the Third Link Growth Fund is to provide an investment in Australian listed shares. To achieve this, the Fund extensively invests in other managed investment funds run by professional third party investment managers.

As at the end of September 2013 the portfolio was invested as shown in the table opposite.

Over the last six months the changes to the portfolio have been as follows:

- we commenced investing with Greencape Capital, by way of the Greencape Wholesale High Conviction Fund;
- we commenced investing with Ophir Asset Management, by way of the Ophir Opportunities Fund;
- we added to our investment in the Bennelong Ex-20 Australian Equities Fund;
- we made a full redemption of our investment held in the Tasman Market Neutral Fund; and
- the Fund paid a distribution of income to investors in August 2013 in respect of the six months ended 30 June 2013.

As at the end of September 2013 the Third Link Growth Fund stood at $60.4m in size. During the last six months we received $5.7m in new applications and processed redemptions totalling $1.8m.

AUSTRALIAN EQUITIES			
General:			
JBWere Individually Managed Account	21.9%		
Bennelong Ex-20 Australian Equities Fund	11.5%		
Cooper Investors Australian Equities Fund	10.5%		
Greencape Wholesale High Conviction Fund	8.1%		
Goldman Sachs Premier Australian Equities Fund	5.2%		
Montgomery [Private] Fund	8.1%		
Paradice Mid Cap Fund	10.3%	75.6%	
Small Caps:			
Aberdeen Australian Small Companies Fund	5.7%		
Eley Griffiths Group Small Companies Fund	2.2%		
Ophir Opportunities Fund	3.4%		
Pengana Emerging Companies Fund	11.6%	22.9%	
Directly held securities	0.5%	0.5%	
			99.0%
CASH & CASH EQUIVALENTS			
Colonial First State Wholesale Premium Cash Enhanced Fund		0.3%	
Custody Account & Other		0.7%	
			1.0%
TOTAL			100.0%

The figures shown against each Australian equities fund listed above do not 'look through' each fund and strip out any cash component.

A description of each of the fund managers we invest with, including their funds listed in the table above, can be found on our website at **www.thirdlink.com.au** (see the section "Fund Managers We Invest With"). Each of these managers rebate their management fees and performance fees which apply to the investment of Third Link Growth Fund in their respective fund, effectively meaning they are managing the assets of Third Link Growth Fund for free. It is through this extraordinary generosity, together with that of other service providers (all listed on the Fund website), that Third Link is able to make sizeable donations to the charitable sector without diluting the returns to investors from the Fund. ■

Fund Performance

The objective of the Third Link Growth Fund is to provide an investment in Australian listed shares, with the aim of outperforming the S&P/ASX 300 Accumulation Index[1] after fees over rolling five year periods.

As at the end of September 2013, the Fund performance relative to the Fund benchmark was as shown in the table opposite.

	three months	six months	one year	two years	three years	five years	Since inception (June 2008)[3]
Third Link Growth Fund	+11.5%	+10.5%	+28.3%	+20.8% pa	+5.4% pa	+10.4% pa	+8.8% pa
Fund performance relative to its benchmark[2]	+1.3%	+3.3%	+4.6%	+2.8% pa	+1.8% pa	+3.6% pa	+4.1% pa

Returns are calculated after fees have been deducted and assuming reinvestment of distributions. No allowance is made for tax. The benefits of franking credits from dividends received have been ignored.

The Fund has produced a very satisfactory performance over the last six months, producing a return of +10.5% after fees. Four of the last six months showed positive results, making the period a very good one for your fund.

Even more pleasing is the one year performance of +28.3% after fees, particularly in the context of cash on deposit over the same period yielding just +3.1%. And in addition investors have enjoyed the benefit of imputation credits generated from franked dividends which passed through the Fund into their hands.

Over the medium term, the most likely factors to be affecting the Australian share market appear to be the following:

- Whether the economy will get significant relief from what is continuing to be a stubbornly high Australian dollar. As we have noted previously, one positive of this is that it is forcing many companies to become more efficient. However, a much greater downward movement of the Australian dollar than that experienced in the last six months would certainly provide a much-needed boost to the profitability of many of our companies.
- Whether Australian companies can start experiencing revenue growth in the year ahead, as opposed to their earnings growing primarily through increased efficiencies and cost reductions of the last few years.
- What happens with the quantitative easing (QE) program of the US Federal Reserve. Given the historically close correlation between the US stock markets and the Australian stock market, there is strong focus on the timing and extent of scaling back of QE by the US Federal Reserve (and eventual stopping of this). This is providing bouts of considerable market volatility, such as we saw in May this year. The irony of the falls that have occurred in markets when unwinding of QE is announced (or being contemplated) is that this is a sign of a strengthening US economy that needs less propping up.
- And finally, what happens in the Chinese economy. Recent economic data continued to confirm the Chinese economic cycle has stabilised, which in turn is good for Australia as our fortunes are so joined at the hip these days with China. However, a number of observers have significant concerns about the credit controls in the burgeoning Chinese shadow banking system as well as continued over supply of new housing stock. ■

1 The S&P/ASX 300 Accumulation Index covers the largest 300 shares listed on the Australian market. Being an accumulation index, it measures changes in both the value and income of the shares.

2 Before February 2012 the objective of the Fund was to provide a diversified growth-oriented investment with a bias at most times to Australian listed shares, with the aim of outperforming the returns of the Morningstar Multi-Sector Growth Market Index after fees over rolling five year periods. As such, the performance of the S&P/ASX 300 Accumulation Index in the table above for two years and longer has been shown for illustrative purposes only. The Morningstar Multi-Sector Growth Market Index is compiled by Morningstar Australasia Pty Ltd (Morningstar), a unit of Morningstar, Inc. Morningstar construct this index by reviewing the asset allocation of Australian fund managers who operate multi-sector funds and have between 61 per cent and 80 per cent of their assets in growth sectors (typically defined as equity and property asset classes) with the balance in cash and fixed income securities.

3 The Third Link Growth Fund was established on 12 March 2008 (though it was not open for investment until 10 April 2008, being the date of the first PDS). Up until the end of May 2008 it was a requirement that application monies received into the Fund were kept on deposit as the unit price was held at $1.00. This restriction was removed from the beginning of June 2008, at which time the Fund was free to invest in accordance with its objective. The performance figures shown in this column are expressed as annual compound returns.

Making quality education accessible to all

The Rural Education Australia Program responds to the ongoing need for an independent and flexible source of funding for community based early childhood and education service providers in Australia's rural and remote communities. It is run by the Foundation for Rural & Regional Renewal, and targets locally-driven projects and programs that directly benefit children, youth and their educators.

Challenges to early childhood education

In rural and remote communities access to early-years education is especially limited. There are many barriers to providing early years education including economic restructure and decline, isolation, indigenous engagement and adverse weather events.

Many families are unable to provide early learning or social experiences for their children and rely on playgroups, childcare and preschool for these vital opportunities. Playgroups help children to learn vital socialisation skills and expose them to educational toys and experiences they may not have at home.

Research has shown that the majority of early childhood services in rural Australia are delivered by not-for-profit organisations and are dependant on a large volunteer base. The research also found funding gaps, with little or no Government funding available for infrastructure and resource renewal.

The Rural Education Australia Program assists community-based, not-for-profit organisations and educators such as community playgroups, kindergartens, preschools, day care/ family centres, toy libraries and Parents & Friends groups. Funded projects seek to enhance:

- Literacy and numeracy;
- Student engagement, leadership and retention;
- Digital online learning/ technology;
- Creative and performing arts;
- School readiness;
- Professional development;
- School leadership and positive attitude to learning;
- Pathways to meaningful employment or further training;
- Communities in school/ parental learning programs.

The Rural Education Australia Program helps to ensure equity in education for students in rural and remote areas, addressing isolation and getting early intervention services to children who need them. It is a flexible program that responds to community needs and builds on what local communities ask for. By inviting smaller community based organisation to seek funding for projects, the program is able reach and assist communities who would otherwise not be able to access philanthropic resources.

Support from Third Link

Over the course of 2013, a number of Rural Education Australia Program projects have received financial support from Third Link. The projects we have helped fund include the following:

- Lake Cargelligo Community Children's Centre (New South Wales): Developing educational resources for the new long day care facility;
- Jandowae Kindergarten (Queensland): Providing outdoor musical instruments to enhance the outdoor area and provide cultural experiences for students;
- Tumby Bay Kindergarten (South Australia): Enhancing the outdoor learning area by enlarging the popular cubby house and sandpit play areas;
- Broadford Community Centre (Victoria): Installation of outdoor play equipment to create a welcoming, child-friendly space at the community centre;
- Dunolly Preschool (Victoria): Supporting communication skills at the preschool for children, teachers and parents;
- Wanslea Family Services (Western Australia): Supporting the establishment of a nature based play space at the Plantagenet Early Learning Development Centre. ■

Important Information: Investors should be aware that past performance is not indicative of future performance. Returns can be volatile, reflecting rises and falls in the value of underlying investments. Potential investors should seek independent advice as to the suitability of the Fund to their investment needs. Treasury Group Investment Services Limited is the responsible entity for the Third Link Growth Fund (the 'Fund'). Applications can only be made on the form in the current Product Disclosure Statement dated dated 20 February 2012, which includes references to additional information which forms part of this PDS. A Product Disclosure Statement can be obtained by contacting Third Link or on **www.thirdlink.com.au**. Potential investors should consider the Product Disclosure Statement before deciding whether to invest, or continue to invest, in the Fund.