thirdlink

Third Link News

Issue 3 : September 2009

Could this be 'V' for victory?

From the lows of March 2009 (just before the time of our last newsletter) to the end of September 2009 the strength of the recovery in stock markets has been the big talking point in investment circles.

However, the strong recovery over the past six months is not unusual. There have been several similar patterns historically whereby following a downturn, the market enjoyed a strong recovery over a six month period – in fact some seven separate occasions since 1930 where during such a period the market rose more than +25%.

From its lows in March 2009 the Australian stock market rose +44% in the six months following, representing the strongest recovery following a collapse. However, this has not been the strongest six month period ever. That record belongs to the period July 1979 to Jan 1980 when the market rose +48% while on its way to reaching the peak in November 1980.

Cycles and patterns are often only easy to see in hindsight. We can now look back on the past six months and see it as just another bounce off the bottom like several other similar cycles in the past. As usual, human fear drove investors to exaggerate the 'bad news' and sell off shares far too much. When they realised the error, the market quickly reversed as it has done in past cycles.

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All bear and bull markets behave similarly, with bear markets averaging approximately 15 months in duration and falling 33% and bull markets lasting on average three times as long and rising around 100%. But of course, so far we have not recovered anywhere near the pre collapse highs of November 2007. The basic maths is that if a market falls 50% then it needs to recover by 100% to get back to the starting point!

So where to from here? The answer no doubt lies in the extent and speed of recovery of most world economies from recession (or at least markedly slow growth, as has been the case in Australia). After the short sharp contractions in almost all world economies, contractions have now slowed or stopped in virtually all cases, and the leading economic indicators are almost universally showing signs of recovery already. However, I am not sure it will be a typical 'V shaped recovery' (that many economists talk about) in many parts of the world. One worry is whether the recent indicators of the economic recovery will be vindicated by stronger growth next year or whether the 'green shoots' will fade away as the benefits of the fiscal stimulus wear off. Interest rates are a second area of concern, with worries that central banks may move too quickly to raise short-term interest rates, or that market forces could lead to sharp increases in interest rates charged on loans for housing or business and also in yields on government bonds. And let's not forget that consumer demand out of the US/UK/Europe is being weighed down by a huge over-hang of household debt and public debt, exacerbated by the massive stimulus debt burdens which may well slow global growth for many years.

However, despite the question marks that exist over the pace of recovery in many parts of the world, I believe Australia is very well placed to enjoy a return to stronger growth, primarily as a result of:

- the strength of its banking system;
- relative lack of problems in its housing market;
- relatively 'manageable' government debt, post the stimulus packages; and
- its 'slip-streaming' off China's extraordinary and continuing high growth.

Accordingly, I feel very comfortable with the positioning of the Third Link Growth Fund and its bias to investing in the Australian share market.

Thank you for your continuing investment in the Third Link Growth Fund. All the net management fees of the Fund continue to go to support the non-profit sector through the inspirational work of Social Ventures Australia. It is a valuable contribution, which is making a difference to the lives of some of Australia's most disadvantaged people.

Regards

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Decoupling and Australia's positive outlook

By Frank Macindoe, Director, Private Wealth Management, Goldman Sachs JBWere

Two years ago, when the first rumblings of the US sub-prime problems began to be discussed, the buzz word was 'decoupling'. The theory was that the problems of excessive consumption and gearing in the US and Europe did not apply to the growth markets of Asia, most notably China. It was hoped that Asia with its high savings rates, conservative financial systems and strong population growth would escape the coming downturn, as would Australia.

That was before the fall of Lehman Brothers caused a full-blown global banking crisis and a disastrous fall-off in global trade. We were all reminded that the only thing that goes up in a crisis is correlation, with the Australian market falling and rising again in lock-step with US markets. In fact, the ASX 200 fell 54% from high to low, exactly the same percentage as the Dow and as at the time of writing had recovered 50% against the Dow's 52%.

As the crisis has receded, however, the outlook for the Australian economy has improved much more than for the US. In an article in September, Bill Gross[1], a very influential commentator, described some key features of what he called the 'new normal' for the US including a recovery in savings rates, growth being driven by public rather than private expenditure and lower home-ownership rates. He also said that 'Asia and Asian-connected economies (Australia, Brazil) will dominate future global growth'. Sounds very much like the 'decoupling' thesis.

Australian consumption at record lows

Though the US is not perhaps as important to world economic growth as it has been, it is still extremely influential as a source of ideas. Perhaps the US is the source of one of the most common misconceptions about Australia – that consumers here have been on a debt-fuelled consumption binge which is only now in the early stages of unravelling.

Goldman Sachs JBWere (GSJBW) Chief Economist Tim Toohey believes the data does not support this view, with Australian consumption recently being at a record low as a share of gross domestic product ('GDP') at just 54.3%. This stands in sharp contrast to the countries that we are most often compared with. Consumption as a share of GDP in the US is at a record 70.5%. Even looking at the UK, which has experienced a decline in consumption share since mid-2002, the GSJBW Economics team believes the decline pales into comparison to the decline in Australia's consumption share.

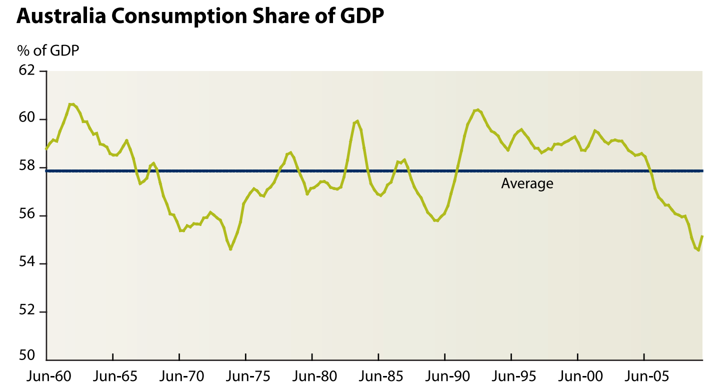
On a per capita basis, consumption has fallen to a pace consistent with the depths of the early 1980s recession – easily the worst recession in Australia in the post-War period – and is well below that of all other recessions except for the early 1990s. This again means Australia has a lot more in common with the high savings countries of Asia than the big spenders in the US and the UK.[2]

It is therefore much easier to imagine a steady and durable recovery in Australian consumption relative to most Western economies. With consumption at record lows as a proportion of the economy, savings back at levels not seen since the early 1990s, record fiscal stimulus, dramatic easing in home loan rates, a profitable banking sector capable (if not yet willing) of lending to business and consumers, the outlook for the Australian consumer is much stronger than is commonly thought.

This should support many domestically oriented companies, while those that are exporters will generally do well from the strength of Asian economies.

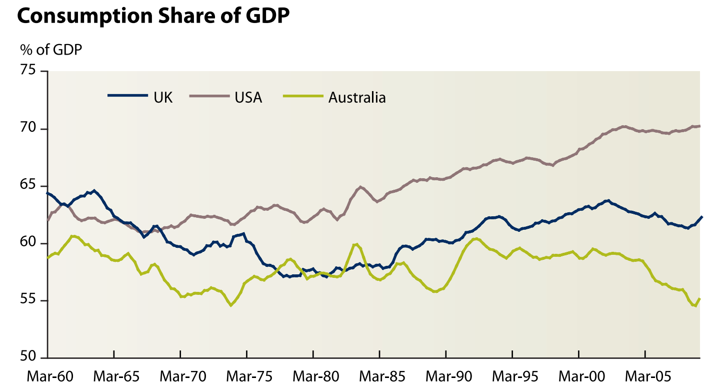
Perhaps the biggest reason for caution, apart from another Lehman-like crisis, despite the rosy outlook, is that we are now so closely linked to China and the rest of Asia as our major export markets, that if that region were to endure a hiccough in its growth, it would be a major event for Australia's terms of trade and confidence.

Australia Consumption Share of GDP



Source: GSJBW Research Estimates, Datastream

Consumption Share of GDP



Source: GSJBW Research Estimates, Datastream

Mr Macindoe is an adviser to Chris Cuffe in relation to the Third Link Growth Fund. The opinions expressed in this article are his personal opinions and may not represent the view of Goldman Sachs JBWere or Treasury Group Investment Services.

To the extent that this document discusses general market activity, industry or sector trends, or other broad based economic or political conditions, it should not be construed as research or investment advice.

[1] Managing Director of PIMCO, see www.pimco.com

[2] This and the preceding two paragraphs have been sourced from a GSJBW research report *A Record Low For Consumption Is A Great Place To Start* by Tim Toohey and the GSJBW Economics Team.

Portfolio Update

The objective of the Third Link Growth Fund is to provide a diversified growth-oriented investment with a bias at most times to Australian listed shares.

Although we aim to outperform the returns of the All Ordinaries Accumulation Index over time, we have considerable flexibility in the type of investments the Fund may hold outside of Australian listed shares.

We are now some 16 months into managing your Fund with the portfolio positioned as follows:

	30 Sept 2009	31 March 2009
Growth-oriented investments		
Australian listed shares	65.1%	45.1%
International listed shares	12.7%	11.3%
Property (both domestic and international)	0%	0%
Alternative assets	6.2%	3.0%
	84.1%	59.4%
Fixed interest securities & cash		
Hybrid securities	3.3%	21.2%
High yielding global fixed interest securities	5.6%	11.9%
Cash on deposit	7.1%	7.6%
	15.9%	40.6%
	100.0%	100.0%

The majority of the Fund's assets are invested in other managed funds run by third party investment managers. The above figures do not 'look through' each underlying fund, but are based on the overall classification of each fund.

The key adjustment to the portfolio over the last six months has been to very significantly increase the exposure to growth-oriented investments, from 59.4% at the end of March 2009 to 84.1% at the end of September 2009. This change was a result of our growing confidence in two key areas: the continued recovery in global credit markets albeit slower than we had expected; and the relentless stimulus being provided to economies around the world by their governments who were keen to facilitate economic growth and recovery from recessions. This increased exposure to growth-oriented investments has proved to be correct so far, with stock markets around the world rebounding strongly over the last six months.

The increased exposure to growth-oriented investments was achieved by directing increased funds inflow and the reduction in hybrid securities which we sold having enjoyed good gains from the recovery in credit markets. We also took the opportunity to reduce the exposure to high yielding global fixed interest securities given the material tightening in credit spreads which had provided good returns over the period.

As can be seen from the table, we continue to deviate significantly from only holding Australian shares. Our rationale is as follows:

- Although there are many positive signs that economic growth is likely to be recovering we were caught somewhat by surprise at the speed of the rise in stock markets over the last six months. Rather than 'chase a rally' we have decided to hold our position with our existing fixed interest securities (with their attractive yields) while we adopt a 'wait and see' position.
- We believe exposure to international shares is still warranted at present, despite the positive outlook for Australia compared to other countries, given:
  - diversification benefits; and
  - some international markets, particularly emerging markets, appear to have good long term growth prospects compared to Australia.
- We believe that credit markets have priced in unrealistic default rates and will continue to recover further and thereby provide attractive gains.

The key portfolio changes that occurred over the last six months (since our last newsletter) were as follows:

- A takeover occurred for one of the Fund's three direct equity investments, Macquarie Communications Infrastructure Group, which yielded a healthy 20% profit.
- We allocated money to a new 'alternative assets' manager, Technical Investing, that specialises in using a combination of fundamental information and technical analysis to capitalise on major themes and trends.

As stated above, the majority of the Fund's assets are invested in other managed funds run by third party investment managers. A description of each of these managers/funds can be found on our website at www.thirdlink.com.au. In summary, the managers being used are as follows:

Australian equities
- Cooper Investors
- Solaris Investment Management
- Platypus Asset Management
- Orion Asset Management
- Paradice Investment Management
- Eley Griffiths Group (smaller companies)
- Goldman Sachs JBWere/ Frank Macindoe
- Pengana Capital (smaller companies)

International equities
- Intrinsic Value Investments
- Taube Hodson Stonex Partners
- Magellan Financial Group
- Arkx Investment Management (global carbon reduction)
- Schroders Group (emerging markets)

Property
- Perennial Investment Partners

Alternative assets
- Select Asset Management
- Technical Investing
- Ellerston Capital

Fixed interest & cash
- Colonial First State Investments

Fund Performance

We aim to outperform after fees the returns of the All Ordinaries Accumulation Index over rolling five year periods. The Fund performance is calculated by comparing unit prices over the relevant measurement period and also taking into account income distributions made during the period.

	Since inception (June'08) (per annum)	1 year	6 months	3 months
Third Link Growth Fund	+3.2%	+9.2%	+30.9%	+17.4%
All Ordinaries Accumulation Index	– 9.4%	+7.4%	+36.9%	+21.5%
Fund relative performance	+12.6%	+1.8%	– 6.0%	– 4.1%

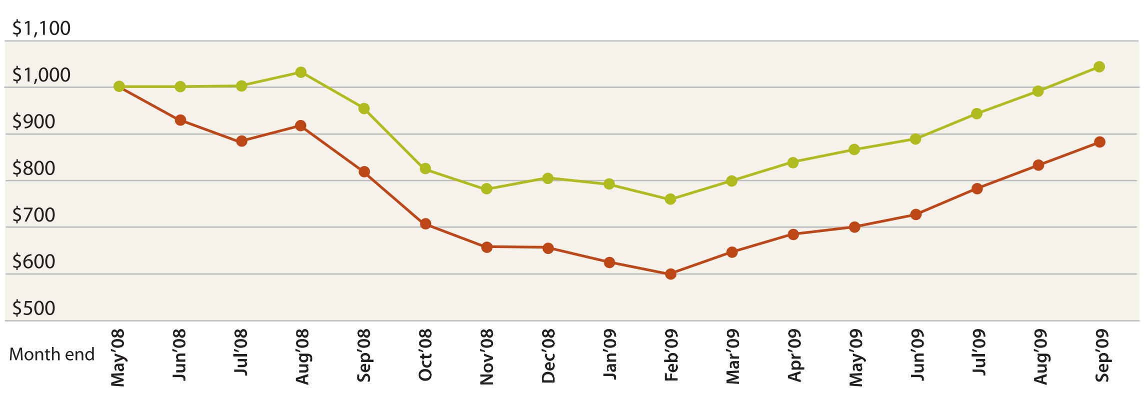
As at the end of September 2009, the Fund performance after fees relative to the All Ordinaries Accumulation Index[1] was as shown in the table above.

The pleasing aspect is that since inception the Fund performance is now positive, a satisfying achievement after enduring one of the most tumultuous periods in the history of financial markets. However, the Fund performance has slipped behind the All Ordinaries Accumulation Index over the last one, three and six month periods as we were not fully exposed to growth-oriented investments during the period, instead maintaining some holdings in fixed income securities. The sharp recovery in markets since the lows of March 2009 has taken us somewhat by surprise.

The key contributors to the Fund underperformance relative to the index over the last six months (being when we wrote the last newsletter) were: not being fully invested in growth-oriented investments given such markets rose strongly; and the exposure to unhedged international equities during a period when the A$ appreciated significantly against the $US. However, the Fund performance was served well by: a healthy exposure to smaller companies; a small exposure to emerging markets which rallied strongly from a low base; the rally in high yielding global credit securities; and the takeover of one of the Fund's direct investments, Macquarie Communications, which yielded a 20% profit.

The graph below shows the value of $1,000 invested in the Third Link Growth Fund since the start of June 2008, tracked on a month by month basis and assuming income distributions were reinvested. This is compared to the value of $1,000 invested in the All Ordinaries Accumulation Index over the same period.

Performance of Third Link Growth Fund vs All Ordinaries Accumulation Index[1]



Value of $1,000 invested in Third Link Growth Fund

Value of $1,000 invested in All Ordinaries Accumulation Index[1]

[1] The All Ordinaries Accumulation Index is Australia's premier market indicator and represents the 500 largest companies listed on the Australian Securities Exchange measured by market capitalisation and with dividends reinvested. 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.

Social Ventures Australia
Activity Update

At just 21, Hazel was given shocking news that would change her life forever. She was diagnosed with Multiple Sclerosis, a debilitating neurological disease that over time, has left her in permanent need of round-the-clock care.

As a single Mum caring for her young son and with her care needs increasing, Hazel began to research her future options and in the process made a startling discovery. She realised, 'I may have to go into an aged care home because there is nothing out there. It made me feel like I had no other choice, that I had nowhere else to go. It made me feel down and depressed with the thought that this is reality - and I didn't want to go there.

'I needed something else where I didn't lose my individuality and I could be my own person. That's where Youngcare came in'.

At that time, Youngcare had just completed the first ever Youngcare Apartments in Brisbane, offering everything a young person requiring round the clock care needs to live a young life filled with hope, possibility and dignified care.

Thankfully now, Hazel is a resident with her very own state of the art, purpose built Youngcare Apartment and benefiting from a unique model of 24/7 care. Now, Hazel is living the kind of life that every young person deserves: 'It's changed my world. It's made it more positive for me'.

But there are still many others that are not as fortunate. Over 6 500 young people are living in aged care around the country, with an estimated further 720 000 in desperate need of assistance. Aged care offers the type of care that is designed for the end of someone's life, where the average age is 83 and life expectancy is only two years. How could this possibly be appropriate for a young person like Hazel?

'It's changed my world. It's made it more positive for me.'

Hazel, Youngcare Apartments resident

There are many young Australians just like Hazel that urgently need help and Youngcare has vowed to provide hope, possibilities and dignified care for every young person who needs it. But it's a big job and Youngcare is only made possible through the combined support of the community, business, government and of course Social Ventures Australia (SVA).

SVA provides multi-year funding and tailored support to a carefully selected portfolio of non-profit ventures led by outstanding social entrepreneurs. Youngcare is just one example of the worthwhile organisations that SVA are working with, each seeking to drive an important area of social change.

Your investment commitment to the Third Link Growth Fund, the management fee of which contributes to SVA's work, has been an important component of SVA's growing funding base. And through growing its funding base, SVA can continue to support organisations like Youngcare – and more importantly, help transform the lives of young Australians like Hazel. SVA thanks you for your support.

www.socialventures.com.au