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Third Link News

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Democracy under the microscope

"Remember, democracy never lasts long. It soon wastes, exhausts, and murders itself. There never was a democracy yet that did not commit suicide."

John Adams (1735-1826) Second President of the United States.

Since the last newsletter of six months ago we have obviously been through the experience of a change in Prime Minister, a Federal election, a hung parliament and now a minority Government in power. What a challenge this will lead to in governing this country, particularly with the tougher issues around climate change, a possible resources tax, and taxation reform in general.

Hung parliaments may be strange to Australians, but for democracies around the world living with a minority government is more the rule than the exception. Europe, in particular, has a history of patchwork governments.

However it is not only the political landscape that is changing dramatically. So too is the broader environment in which politicians need to govern. Many respected investment commentators believe that most of the developed world is at the end of 35 years of binge-borrowing, of over-consumption, and of under-saving. To add salt to the wound we have an aging population in many countries causing a growing strain on the health and social security system. At the same time the people of most developed worlds want better medical care, better schools, attractive social security arrangements, wide highways, and adequately funded defence … and low taxes of course.

What a dilemma for today's politicians, particularly those political parties always on the knife-edge of popularity!

Writing about the challenges facing politicians and the measures they will need to take, David Brooks wrote in *The New York Times* on May 13, 2010:

"The chances that the world's leaders are going to be able to do these things successfully are between slim and none. It's hard enough to figure out the right mix of spending cuts and tax increases. It's nearly impossible to build a political majority willing to enact them. Sometime over the next decade or so, the world will probably suffer from another series of crushing fiscal crises with significant economic pain and maximum political turmoil."

The process of solving such problems will be unpleasant in the short term, while the benefits will only be seen in the long term – when today's politicians will have left the stage. Unfortunately voting for short-term pain in order to solve long-term problems is a rarity, particularly in these days of 24x7 'populist' media scrutiny.

How lucky we are in Australia that our economic outlook appears fairly positive. From an economic perspective, the developing world is powering ahead with high growth rates and high savings rates and a relentless desire for increased living standards – and Australia has been and continues to be a beneficiary of this growth. This was one of the reasons why Frank Macindoe argued in his article in the September 2009 edition of this newsletter that whilst the Australian market's fortunes have historically been closely linked to the performance of the US markets, the time was approaching for the Dow and ASX to decouple.

But despite the potential for this decoupling to occur over the past year, the reality is that the US and Australian markets still tend to dance to the same tune. This helps explain why the Australian investment market has stalled over the last six months (and over the last year). It would appear there have been continued investor concerns regarding the prospects for sustained improvement in global economic and financial market conditions. Put another way, it seems investment markets (that are usually predictive in nature about future growth) came out of the blocks very quickly from the lows of March 2009 and have since stalled over the last year as people are still assessing whether the pace of recovery will be different this time. Recovery may indeed be at a different pace this time, but Australia's strong growth outlook and the relatively sound balance sheets of its companies should hold us in good stead.

Thank you for your continuing investment in Third Link Growth Fund.

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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

Chris Cuffe, Director
Third Link Investment Managers Pty Limited

Catching the next wave?

By Ashley Owen

While the 'developed world' economies of the US, UK, Europe and Japan stagnate, and their stock markets remain well below their peaks of more than a decade ago, investors are looking for growth in the 'Emerging Markets'.

With the big developed markets burdened down with high levels of government and household debt, slow economic growth rates, aging populations, budget deficits and current account deficits, most 'emerging markets' have low debt levels, export surpluses and relatively strong economies focused on savings and investment instead of consumption and debt.

Investors like to see nice neat straight line growth paths that continue forever – in economic growth rates and in stock prices. Unfortunately things are never that simple. The current batch of so-called 'emerging markets' are not new. All have had active stock markets in previous eras but all have resulted in destruction of wealth for investors due to a variety of causes.

The process of industrialisation started in Britain and Western Europe, and organised stock exchanges sprang up all over Europe, beginning with Amsterdam in 1611. Almost all of these 'old world' European stock markets were closed down at various times during wars and periods of foreign invasion and occupation. From this first wave of 'emerging markets', the only continuously operating stock markets to survive intact for investors were those in London, Dublin and Stockholm.

The next wave of 'emerging markets' were British ex-colonies. Australia and NZ were the two stand-out 'emerging markets' of the 19th century, with growth rates on a par with those of the 'BRIC' countries in the current wave (Brazil, Russia, India & China).

In the decades following World War II the great 'emerging markets' were Japan and Germany in their post-war reconstructions. Both had been thriving industrialised economies from the late 19th century and both had thriving stock markets (Germany from 1685, Japan from 1878) before being destroyed. The re-emerged Japanese stock market provided tremendous returns in the 1950s through to the late 1980s but the boom collapsed in 1990 and the stock market is still 70% below its peak level more than 20 years later. The German economy and stock market enjoyed similar spectacular rates of growth in the early post-war decades but Germany is now left burdened down supporting the rest of Europe which is collapsing under the weight of debt.

The 'emerging markets' in the current wave are not really emerging at all. They are merely 're-emerging' after periods of colonial rule, foreign occupation, wars, revolutions, communism, socialism and military rule.

Latin America – Since gaining independence nearly 200 years ago, most Latin American countries were 'emerging markets' with active stock markets in previous eras. Their stock markets operated during temporary periods of peace and prosperity between wars, revolutions, civil wars, insurrections, military coups and failed socialist and communist experiments, before their recent 're-emergence' once again.

Eastern Europe – A string of countries have re-emerged following the collapse of the communist bloc in the early 1990s. Most of these were 'emerging markets' in previous waves and had thriving stock markets at some point in the 19th century. All were closed during previous wars and again seized under Soviet rule.

Asia – was ruled by a variety of European powers and many countries were also occupied by China and/or Japan at various times. Many were 'emerging markets' with active stock markets in previous eras, but all suffered a variety of closures, seizures in civil wars, communism, military coups and failed dictatorships.

Middle East & Africa – The decolonization period after the end of World War II was marred by bloody independence wars and almost all of the new nations have since suffered a variety of military coups and civil wars. Several countries had stock markets during brief periods of peace, but very few have re-emerged as investable markets so far in the current wave.

The critical question for investors is this: is the recent good performance in the current wave of 'emerging markets' sustainable, or will it turn out to be just another short-lived patch of peace and prosperity that will end in ruin for investors as in previous episodes?

There is certainly evidence to suggest the current wave of re-emerging markets is part of a massive shift in global economic power. And given this took decades to develop, it is unlikely this shift will disappear quickly.

Emerging markets are now not only a major exporter of goods and services to the developed world, but their growth is also being increasingly driven by demand created by rising living standards at home. As the workers in the re-emerging markets are lifted out of poverty and subsistence, they become consumers in their own right.

"These trends are fundamentally changing the shape of global markets."

These trends are fundamentally changing the shape of global markets and the re-emerging markets are at the centre of it all. Some countries will succeed but some will fail. The rapid shift to free market economics is inevitably traumatic, and often results in low returns on investment due to misallocation of capital, and high inflation which can result in civil and political unrest.

We can conclude that the current wave of 'emerging markets' will not continue on their rapid growth paths forever. Some will mature and settle down to a more sustainable but slower pace of growth, while others will get their policy settings wrong and end in collapse, stagnation, hyper-inflation, civil war or revolution. For investors, there are many risks, but the potential rewards can also be high. ■

Mr Owen is a Director of Third Link Investment Managers P/L, as well as Chairman, Portfolio Construction & Asset Allocation Committee of Centric Wealth Ltd

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.

We are now almost two and a half years into managing your Fund with the portfolio positioned as follows:

		30 September 2010	31 March 2010
Growth-oriented investments			
Australian listed shares	– general	42.8%	49.3%
	– smaller companies	12.9%	12.3%
International listed shares	– general	10.5%	8.4%
	– emerging markets	8.6%	8.9%
Property (both domestic and international)		2.3%	0.0%
Alternative assets		3.4%	3.2%
		80.5%	82.1%
Fixed interest securities & cash			
Hybrid securities (Australian listed)		11.2%	9.9%
High yielding global fixed interest securities		2.7%	0.0%
Cash on deposit		5.6%	8.0%
		19.5%	17.9%
		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.

You can see from the above that there has been little change to the asset allocation of the portfolio compared to six months ago. The key changes during this period have been:

- To establish a small exposure (being 2.3% of the portfolio) to Australian listed property trusts via the Perennial Australian Listed Property Securities Trust given we are now satisfied that gearing levels are appropriate and valuations attractive;
- To establish a position (2.8% of the portfolio) in a new fund, the Colonial First State Global Soft Commodity Share Fund to take advantage of the opportunities emerging from the rapid change in the dynamics driving global agribusiness;
- We increased our exposure to listed interest rate securities, referred to as hybrid securities above from 9.9% to 11.2% given the continuing very attractive floating rate yield spreads being offered relative to the risk profile of the securities; and
- We re-established a position (2.7% of the portfolio) in high yielding global fixed interest securities (via the Colonial First State Wholesale Global Credit Income Fund) given the spike up in global credit spreads caused by the adverse reaction to the European sovereign debt concerns during the period (particularly the concern about Greece).

Despite the sluggish long term economic outlook for most developed countries we did not materially change the overall exposure to growth-oriented investments, which now sits at 80.5% of the portfolio. We believe that the economic outlook for Australia (where we continue to have a strong bias, with Australian equities representing 55.7% of the portfolio) remains positive and that equity markets are still within their fair value range (being neither cheap nor expensive). The lingering question though is whether the Australian stock market will perform independently to the US stock market (the so-called 'decoupling' enigma).

The overall size of the Third Link Growth Fund is now $37.4 million.

The key portfolio changes that occurred over the last six months (since our last newsletter) in addition to those already mentioned were as follows:

- The Adelaide Managed Funds Asset Backed Yield Trust, in which the Fund held 750,000 units (purchased in March 2010 for $1.31 per unit) had a capital return of $1.49 per unit, while still trading at around $0.25 per unit post the capital return;
- We took out currency hedges on some of the unhedged international equities exposure when the Australian dollar compared to the US dollar was below 85 cents and subsequently closed these out for a profit when the currency went above $0.90;
- We sold out of a position taken earlier in the year in ConnectEast (one of two listed infrastructure investments directly held) at a loss of 8.4%, a move that subsequently proved incorrect; and
- The Fund paid out $541K of income distributions in July, with $319K reinvested by investors.

The majority of the Fund's assets continue to be 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 ■

A better plan, for a bigger difference

Social Ventures Australia has launched a new Private Ancillary Fund Service, to help Australian philanthropists appreciate not only the simplicity of this kind of giving structure, but also understand how rewarding it can be to provide the non-profit sector with the vital funding it needs. With the support of some well known philanthropists, SVA is determined to increase the profile of philanthropy and grow Australia's giving levels. Find out more at www.socialventures.com.au ■

Fund Performance

We aim to outperform the returns of the Morningstar Multi-Sector Growth Market Index after fees over rolling five year periods.

In order to achieve this objective, we have considerable flexibility in the type of investments and exposure to each that the Fund may hold.

As at the end of September 2010, the Fund performance after fees relative to its index is shown in the adjacent table.

The last six months (being when we wrote the last newsletter) has certainly seen a difficult investment environment for shares, with the Australian share market moving down 3.3%. As shown in the table, your Fund produced a return after fees of –0.5% during this period.

On an annualised compound basis, the Fund's return of +4.0% pa since inception in June 2008 is hardly startling, particularly compared to 'cash in the bank' over the same period. To date, this is a poor reward for the volatility endured during this difficult investment period. Interestingly, the All Ordinaries index (a common barometer used to measure the performance of the Australian share market) is now up 49% to the end of September 2010 from the 6th March 2009 bottom, but is still 32% below the peak level reached on 1 November 2007. Consistent with what we said in the last newsletter, there is still a long way to go yet!

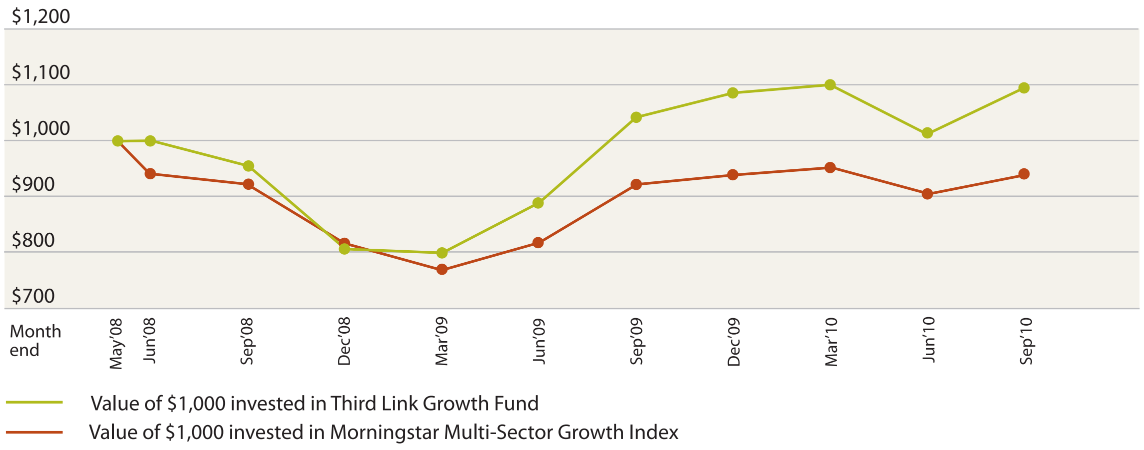
Over the last six month period, there have been a range of factors that contributed and detracted from performance. These are discussed in the Portfolio Update section above.

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 quarterly basis and assuming income distributions were reinvested. This is compared to the value of $1,000 invested in the Morningstar Multi-Sector Growth Market Index over the same period. ■

	Since inception (June'08) (per annum)	2 year (pa)	1 year (pa)	6 mths	3 mths	1 mth
Third Link Growth Fund	+4.0%	+7.2%	+5.1%	–0.5%	+8.3%	+4.5%
Morningstar Multi Sector Growth Market Index	–2.6%	+0.9%	+1.9%	–1.3%	+3.8%	+1.8%
Fund relative performance	+6.6%	+6.3%	+3.2%	+0.8%	+4.5%	+2.7%

Returns are calculated after fees have been deducted and assuming reinvestment of distributions. No allowance is made for tax.

Performance of Third Link Growth Fund vs Morningstar Multi-Sector Growth Index



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.

Returns are calculated after fees have been deducted and assuming reinvestment of distributions. No allowance is made for tax.

Social Ventures Australia Activity Update

The secret to the success of Australian Indigenous Mentoring Experience's (AIME's) program is actually pretty straight forward according to Adam Hansen from AIME.

"AIME isn't simply preaching to kids. It's a program that develops aspirations and gives kids a choice. The message is that to be Indigenous is to be successful and I see kids stepping up to the challenge every day".

The results achieved to date suggest such an approach is working – which is no surprise to Social Ventures Australia (SVA) who recognised the program's significant potential when they began partnering with AIME in early 2009. AIME uses a unique style of structured education mentoring to link university students in one-on-one relationships with high school Indigenous students. AIME's objectives are to increase high school completion rates and university admission rates for those who participate in the program.

Adam Hansen is a Program Manager for AIME and in his role is responsible for co-ordinating the 150 University of Sydney students who are mentoring Indigenous high school students across a number of local high schools, while he also completes his own university studies in Human Movement.

Juggling all these commitments is no easy task – but then again Adam hasn't exactly had an easy life. "I wish AIME had been around when I was at school, it definitely would have helped me out," reflects Adam.

Adam dropped out of school early and was heading down a dangerous path during his teenage years. Fortunately he had the strength of character to turn things around for himself. "As a kid, I didn't have any positive role models with links to education," he explains. "When I was 20 I decided to go back to school. At the time I was really embarrassed, but I knew it was the right thing to do. Looking back I'm very proud of the decision."

'I just share my story with the kids and share my experiences; I get through to them a lot better that way.'

Adam Hansen, AIME

Adam has every right to be proud – he not only got his own life back on track but now helps others to avoid making the mistakes he did.

"Particularly as an Indigenous Australian, to be able to pass on the things I've learnt is hugely rewarding. I see so many young kids who are in a pretty similar situation to what I was – and to be able to give them some guidance, the AIME way, is amazing."

But it is not only the mentees who benefit. The mentors also often reflect on what a privilege it is to be involved. "The mentors get a lot out of it as well, because a lot of them are non-Indigenous and haven't really met Indigenous kids before. It's a good way to bridge the gap," concludes Adam.

Your investment commitment to the Third Link Growth Fund, the management fee of which contributes to SVA's work, enables SVA to support organisations like AIME – and more importantly, help transform lives. SVA thanks you for your support. ■

www.socialventures.com.au