Third Link News

Issue 8 : April 2012

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Turning Point

The last six months since our previous newsletter has been a very important time….both in terms of world events affecting financial markets and in terms of the direction of Third Link Growth Fund.

By the last quarter of 2011 there were risks emerging again of another severe shock to the world's financial system (or even a financial Armageddon!) as a result of the European sovereign debt crisis. But lessons arising from the collapse of Lehman Brothers in the US in September 2008 were still fresh in the minds of central bankers, and the European Central Bank stepped in and flooded the market with massive and cheap liquidity in December 2011 and again in February 2012. I believe this represents a significant turning point for investment markets. It does not solve Europe's problems but does show a preparedness to avoid, at all costs, a liquidity crisis in the European (and world) banking system. Liquidity is the life-blood of all economies.

These events, together with the continuing recovery of the US economy (the biggest economy in the world which in turn helps power many others, including China), provides the setting for what I believe will be a favourable environment for share market investors in Australia over the coming years.

Important developments have also taken place for Third Link Growth Fund since our last newsletter. Investors were advised in January this year that we had decided to alter the investment objective of the Fund. From inception of the Fund in May 2008 up until February this year, the objective of the Fund has been to provide a diversified growth oriented investment with a bias at most times to Australian listed shares. This meant it could (and did) invest in Australian shares, international shares (including emerging markets), property, bonds, credit securities and cash. Following considerable feedback from existing investors, together with feedback from prospective investors and wealth advisers, in February this year we decided to alter the objective to make the Fund a dedicated Australian share fund. This means that the Third Link Growth Fund will always be 90%-100% invested in Australian shares, with the balance invested in cash or cash equivalents. The aim of the Fund is now to outperform the S&P/ASX 300 Accumulation Index (which covers the largest 300 shares listed on the Australian market and measures changes in both the value and income of the shares) after fees over rolling 5 year periods.

The key reasons we made the change to the Fund's investment objective were:

- Before the change, the Fund was invested as a *multi-sector fund*, which meant it could be exposed to a variety of different asset sectors. The change turns the Fund into a *single-sector fund*, being just Australian shares, providing greater certainty for investors about where their money is invested.
- Investors are all unique, having their own risk appetite, tax rate, time frame and personal goals. It is therefore difficult to have one multi-sector fund which is capable of satisfying the objectives of many investors. Instead, a single sector fund (in this case exposed to only Australian shares) can better be used as a building block of a tailored overall portfolio.

In addition to the change in investment objective, changes have also been announced about the future charitable giving. From 1 July 2012, Third Link will be embracing an exciting new strategy for its charitable giving, known as the Third Link *Thrive* Program. You can read more about this over the page.

As a result of the changes made, a new Product Disclosure Statement has been produced and the Fund's website (**www.thirdlink.com.au**) has been significantly updated.

Thank you for your continuing investment in Third Link Growth Fund. The fees you pay to us for having your money professionally managed continue to make a difference to others. To date, more than $1,250,000 has been donated to the charitable sector.

Regards

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

Times they are a changing

By Matthew Kidman

Set and forget is a strategy that many stockbrokers and money managers like to promote. It is a stress free way of making money in shares over the long term as compounding returns deliver a financial 'miracle' to the individual.

The argument carries a lot of currency, especially in Australia. According to research by Credit Suisse and the London School of Economics, the Australian share market's performance has eclipsed all other indexes around the globe. In real terms (after inflation), the Australian market has delivered a 7.2 per cent return per annum for the past 112 years. That is a full 1 per cent better than the almighty US stock market. Put another way, $1,000 invested in 1900 would be worth more than $2.4 million before taxes. It also easily outstrips the returns from the less productive assets of cash and fixed interest. Government bonds have delivered a real return of just 1.2 per cent over the 112 years and so it would be dangerous to ignore the share market just because the last decade has bared little fruit.

To set and forget is a strategy that could work well for periods, but those who are alert and can identify change will always walk away with the lion's share of the stock market's spoils. Equity markets are a derivative of human behavior and, like humans, are dynamic and forever changing. In fact, the only truly consistent aspect of the market is change. If there was ever a case to prove the merits of Charles Darwin's theory of 'survival of the fittest,' the stock market is it.

In the long-term equity values will march higher but in the short-term they are inconsistent and volatile in nature. There are protracted periods where the overall market fails to deliver any capital gains for investors, a classic example being the last 8 years in Australia. There are significantly longer periods where individual stock prices hang like a millstone around an investor's neck. Even recognized large, blue chip stocks, can underperform for many years or even decades. For example an investment in Australia's largest company, BHP, at the back end of the mining boom in the 1960s would have taken more than 30 years for the individual to make a real return. Similarly, if you were to buy shares in the then largest domestic bank, NAB, back in 2000 you would still be under water some 12 years later and this does not even take into account the impact of inflation. Given these stark examples it does not pay to set and forget. Stock picking is key and timing is a much maligned and under rated skill for any stock market player. For those investors

> *'Stock picking is key and timing is a much maligned and under rated skill….'*

who delved into the market back in the heady days of 2007 it may take 10 or even 15 years to break even once inflation is taken into account. Investors and professional managers who have the rare skill of timing and vision will, as they have in the past, manage to provide their clients with superior returns. Investors should always back these individuals and they should stay wedded to productive assets in a bid to generate a satisfactory return. And the stock market is the king of productivity.

The overall Australian share market has been on a steady elevator higher over the course of history. It has not been a straight line though with bleak periods in the 1930s, 1970s, the late 1980s and currently. These long-term performance droughts are commonly known as secular bear markets and have the ability to last up to a decade. Critically though, they are the times of greatest change and, more importantly, the greatest opportunity.

The most damaging secular bear market in Australia's history was in the 1970s when a decade long mining boom ended with an orgy of blood letting. At that stage investors needed to realize the economic cycle was turning and the 1980s would be the decade of industrial companies. Unprecedented economic reform kick started Australian productivity levels and the industrial stocks were off to the races.

When the stock market crash of 1987 triggered a 49 per cent decline in just 4 months the world was changing again. Little did we know the 1990s would be a tremendous period of low inflation, steady growth and above average productivity advances? Australian investors needed to identify these changes and get on board the banking sector, which had been recapitalized after the brutal recession of early 1990s. Just as importantly they needed to steer clear of the mining sector, which would suffer from low returns and underinvestment. The materials sector faded to grey and investors stuck hankering for the old days of the 1960s would have destroyed the real value of their capital. The equity managers who sat at the top of the performance tables were those who identified these changes and acted to take advantage.

Jump forward a decade and into a new century the emergence of China propelled the mining sector back into the limelight and slowly put the industrial, property and financial sectors in the doghouse. The materials index delivered investors a 430 per cent capital gain in 7 years from 2001 to 2008. There wasn't an expert in the world, including Jim Rogers, who predicted that kind of return back in 2001.

That brings us to today and, you guessed it, change has re-entered the room. Retailing billionaires Solly Lew and Gerry Harvey are disgruntled about high interest rates while their real concern should be the way the internet is dismantling the traditional retailing model. Meanwhile, the much-loved mining sector has paused. The materials index has floundered for the past 12 months as investors attempt to assess what the impact of a slowing Chinese economy and less fixed asset investment by the middle kingdom mean for the likes of iron ore and coal prices.

To summarise, we are again in a state of flux eagerly awaiting the next trend and applauding the next market leader. It would seem the US market has found comfort in the technology sector again with the likes of Apple and Google changing the way we live and do business. This will be a recipe for productivity increases around the world for many years to come. Australia's turn is not too far away and it is those who stay actively involved that will walk away with the spoils. ■

Matthew Kidman is a former fund manager and the author of the book *'Bulls, Bears and a Croupier'.* The book is a guide for investors on how to have fun and make money from the share market.

Portfolio Update

From February 2012 the objective of the Third Link Growth Fund is to provide an investment in Australian listed shares.

As at the end of March 2012 the portfolio was invested as shown in the table shown at right.

Over the last six months very significant changes have occurred to the Fund portfolio as a result of the change in investment objective that took place in February (and advised to investors in January). From February 2012 the objective of the Third Link Growth Fund, as stated above, has been to provide an investment in Australian listed shares. However, before this time the objective of the Fund was to provide a diversified growth-oriented investment with a bias at most times to Australian listed shares.

To implement the change in investment objective we redeemed our holdings in non Australian equity funds. This included the following funds:

- Magellan Global Fund;
- Aberdeen Emerging Opportunities Fund;
- Colonial First State Global Soft Commodity Share Fund;
- RARE Series Emerging Markets Infrastructure Fund;
- Swita International Asset Allocation Fund;
- Technical Investment Absolute Return Fund;
- Bentham Wholesale Global Income Fund.

To complete the transition, we also sold our direct holding in the following securities:

- Westfield Retail Trust;
- CFS Retail Property Trust;
- Adelaide Managed Funds Asset Backed Yield Trust;
- Multiplex SITES Trust;
- Australand ASSETS Trust;
- ANZ Convertible Preference Shares;
- Australian Infrastructure Fund (part only).

The proceeds from the above realisations were used to add to our existing holdings in Australian equity funds, as well as investing for the first time into the *Aberdeen Classic Series Australian Small Companies Fund* (managed by the Aberdeen Asset Management Group).

A description of each of the fund managers we invest with, including their funds listed in the table at right, 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, 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. ■

AUSTRALIAN EQUITIES			
General:			
JBWere Individually Managed Account	18.8%		
Bennelong Ex-20 Australian Equities Fund	8.2%		
Cooper Investors Australian Equities Fund	11.0%		
Montgomery [Private] Fund	9.1%		
Paradice Mid Cap Fund	11.0%		
Solaris High Alpha Fund	11.0%		
Australian Infrastructure Fund	2.5%	71.6%	
Small Caps:			
Aberdeen Classic Series Australian Small Companies Fund	2.2%		
Eley Griffiths Group Small Companies Fund	2.7%		
Pengana Emerging Companies Fund	12.2%	17.1%	
Other:			
Tasman Market Neutral Fund (managed by Regal Funds Management)	9.4%	9.4%	
			98.1%
CASH & CASH EQUIVALENTS			
Colonial First State Wholesale Premium Cash Enhanced Fund		1.1%	
Custody Account & Other		0.8%	
			1.9%
TOTAL			100.0%

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

Fund Performance

From February 2012 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. However, before this time 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[2] after fees over rolling five year periods.

As at the end of March 2012, the Fund performance relative to the Fund benchmark is shown in the table.

	three months	six months	one year	two years	three years	Since inception (June 2008)[4]
Third Link Growth Fund	+8.2%	+10.4%	−0.5%	+3.6% pa	+14.1% pa	+4.5% pa
Fund performance relative to its benchmark[3]	+1.8%	+1.3%	−1.5%	+1.1% pa	+4.9% pa	+4.5% pa
S&P/ASX 300 Accumulation Index[1]	+8.6%	+10.8%	−6.3%	−1.4% pa	+11.4% pa	−2.4% pa

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

The performance of the S&P/ASX 300 Accumulation Index has been shown for illustrative purposes only. As mentioned above, this index only became the benchmark for the Fund from February 2012.

Over the six month period to the end of March 2012 we have seen most investment markets post credible returns. This has been on the back of easing concerns over the European debt problems during the period following a massive injection of funds by the European Central Bank (around 1 trillion Euro!) into the troubled European banking system. Over the same period we have also seen further signs of economic recovery in the US, albeit slower and more sluggish than many would have expected by now following the large stimulus packages introduced in the previous two years. Tempering these positive developments has been a slowing of growth in China.

The Fund has produced a very satisfactory investment performance during the six month period since our last newsletter, rising in value by 10.4%. Assisting this performance were very strong returns achieved by the smaller companies sector that the Fund has exposure to, and in particular the strong performance achieved by the Eley Griffiths Group Small Companies Fund. Very strong performances were also achieved from various general Australian equities funds we were invested in, in particular the Solaris High Alpha Fund, Paradice Mid Cap Fund and JBWere Individually Managed Account.

It is also noteworthy to see that the compound return from Third Link Growth Fund over the three years to 31 March 2012 is a very healthy 14.1% per annum, which outperformed its benchmark by a credible +4.9% per annum after fees. This period represents exactly three years since the depths of the Global Financial Crisis in March 2009.

Looking forward, the Australian share market appears to have favourable winds that are likely to provide attractive returns, albeit the near term timing is, as always, uncertain. Australian interest rates appear likely to fall (benefiting Australian consumers, the housing market, and likely to result in an easing in the strength of the Australian dollar which will benefit many companies), corporates have strong balance sheets, valuations are not stretched and are below their long term trend (e.g. annualised four year returns from Australian equities are now as low as they have been since the 1970's), dividends are attractive (particularly compared to bond yields), unemployment is relatively low, and our sovereign debt levels are not excessive. But countering this positive setting is the fact that the injection of liquidity in Europe does nothing to solve the huge austerity measures and lack of growth policies which may well come back and cause problems again. There is also the possibility that a further softening in China's growth may put downward pressure on commodity prices (as well as increasing supply) and the Australian resources sector (which comprises a relatively large portion of our stock market). ■

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 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 As mentioned above, the benchmark up until the end of January 2012 was the Morningstar Multi-Sector Growth Market Index and from February 2012 onwards the benchmark was the S&P/ASX 300 Accumulation Index. These calculations are based on the performance of the old benchmark to January 2012 and the performance of the new benchmark from February 2012.

4 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.

Our charitable giving

As many of our investors will be aware, Third Link Growth Fund is a pioneering initiative designed to benefit both investors and the non-profit sector.

It provides investors with the opportunity to invest in a professionally managed fund but where all management fees, net of expenses incurred, are donated to the charitable sector.

From 1 July 2012, Third Link will be embracing an exciting new strategy for its charitable giving, known as the Third Link Thrive Program (*'Thrive'*).

Thrive represents a portfolio approach to the charitable giving of Third Link, forging long-term partnerships with organisations that help Australian children and young people to thrive, not just survive. It's a truism that our children are our future, and in a nation as prosperous as Australia it's not overly ambitious to want great things for our kids – to help them exceed, rather than just meet, educational and wellbeing benchmarks.

When selecting philanthropic partners to join the *Thrive* portfolio, priority will be given to organisations that are:

- national;
- serving children or young people under the age of 25;
- unique and have a demonstrable point of difference;
- at a crucial growth phase in their evolution, where philanthropic funding can result in significant capacity improvements within the organisation; and
- able to demonstrate how Third Link's funding will be leveraged ('the multiplier effect') for maximum social impact.

We have just announced that our charitable partners from 1 July 2012 will be as follows:

- Australian Indigenous Mentoring Experience;
- National Centre for Childhood Grief;
- Outward Bound Australia;
- Foundation for Rural and Regional Renewal;
- The Beacon Foundation.

A description of each of these organisations is listed on the Third Link web site at **www.thirdlink.com.au** (see the section titled 'Our charitable partners'). The list of charitable partners will change from time to time, with such changes reflected on the website. In future editions of this newsletter we will highlight the work of each of these organisations.

Our expectation is that during the next financial year, from 1 July 2012 to 30 June 2013, a minimum of $500,000 will be donated to our charitable partners, demonstrating again what a substantial contribution Third Link Growth Fund is able to make to the non-profit sector through its unique model. As the Fund size increases from its current level of nearly $50 million, so too will the charitable donations. A win win for everyone! ■

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.

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