Zenith Investment Partners Pty Ltd

Highly Recommended
Recommended
Approved
Not Approved
Redeem

Tyndall Australian Share Wholesale Portfolio

31 Jan 2011

The Tyndall Australian Share Wholesale Portfolio (the Fund) offers investors a value-biased, long-only Australian equities portfolio. The Fund leverages off the proven Tyndall Comparative Value Analysis (CVA) process that has been employed to successfully manage Tyndall's other Australian equity products since 1989. Zenith believes this process, in combination with the experienced investment team, should enable the Fund to deliver on its return objectives.

The most important developments since our last review have been the new corporate ownership of Tyndall as well as the departure of one of the partners.

In March 2011Tyndall was acquired from Suncorp-Metway Limited by Nikko Asset Management (Nikko AM), one of the largest asset managers in Japan. Importantly there was no change to the ownership structure of the Tyndall Australian equities business, which remained a 50/50 joint venture between Tyndall Investment Management Limited (TIML) and the majority of staff in the Australian Equities team. Following the departure of Roger Collison (Head of Research) in late 2010 the Tyndall Australian equities team consists of 10 investment professionals and is headed by Bob Van Munster. The Fund is managed under a co-portfolio management structure by Van Munster and Brad Potter. Zenith rates both managers highly based on their level of industry experience and performance track record to date. The investment team is well resourced, experienced, well incentivised through equity participation and for the most part have worked together for many years.

The objective of the Fund is to outperform the S&P/ASX 200 Accumulation Index by more than 2.5% p.a. over rolling five-year periods. The manager believes markets are inefficient and aims to exploit these occurrences through the application of its proven proprietary CVA framework. The investment process incorporates a comprehensive assessment of company financials (P&L, Cashflow and Balance Sheet), coupled with a rigorous visitation program (company management, suppliers, competitors and customers). The research process culminates into a 3-year internal rate of return (IRR) for all investable stocks.

The co-portfolio managers construct the portfolio from a short list of stock opportunities that are ranked according to their respective level of IRR. The Manager aims to construct a well diversified portfolio of high expected return stocks, in accordance with the fund's risk constraints. In addition, the Manager applies a portfolio optimiser periodically to evaluate the portfolio's efficiency and exposure to risk. The highly concentrated portfolio will typically consist of between 20 to 35 securities with a cash allocation of up to 20% (although the Manager aims to be fully invested).The portfolio is managed to an ex-ante tracking error range of between 3% - 5% (up to 8% in exceptional circumstances) with an average annual portfolio turnover of between 35% - 55% p.a.

Investors should be aware that the Fund is concentrated in nature. While this may potentially provide superior long-term excess returns it may also generate a higher level of volatility than its comparable long-only peers.

Fees include a management fee of 0.80% with no performance fee. The fee structure is highly competitive in comparison to the Fund's value style peers.

Given the Fund's concentrated approach, the Fund is most appropriate for investors who can withstand periods of higher volatility in return for the potential of higher growth. From a portfolio perspective Zenith recommends the Fund be blended with a complementary investment style (i.e. Growth) to generate a style neutral outcome.

Zenith rates the Tyndall Australian Share Portfolio RECOMMENDED.

Key Features	*Description*
APIR Code	TYN0028AU
Asset Class	Australian Shares
Sub-Asset Class	Large Companies
Investment Style	Value
Zenith Assigned Benchmark	S&P / ASX 300 (Accum)
Tracking error (% p.a.)	3 to 8 (% p.a.)
Recommended Investment Timeframe	5 + years
Investment Team Size	10

Cumulative and Monthly Net Performance

Performance Analysis

Performance Statistics		5 Yrs	3 Yrs	1 Yr
Performance (% p.a.)	Fund	3.95	-1.32	3.48
	Benchmark	3.67	-1.25	8.72
	Median	3.74	-0.88	7.17

The objective of the Fund is to outperform the S&P/ASX200 Accumulation Index by more than 2.5% p.a. (pre-fees) over rolling five-year periods.

Although the current co-portfolio management structure commenced in July 2007 the Fund has a long track record (strategy commenced in 1990). Based on the medium to long term return track record (as illustrated above), it has been unable to achieve its return objective. While disappointing Zenith maintains confidence in the CVA process and investment team's ability to achieve the Fund's return objective over the prescribed timeframe.

The Fund isn't income focused but has a semi-annual distribution frequency. The income/growth returns over the last few financials years (01/07 - 30/06) are as follows:

2009-2010: Growth 10.52%; Income 2.96%; Total Return 13.48%

2008-2009: Growth -21.42%; Income 4.02%; Total Return -17.40%

2007-2008: Growth -17.21%; Income 5.10%; Total Return -12.11%

Consistency Analysis

Consistency Statistics		5 Yrs	3 Yrs	1 Yr
Excess Rtn - All Mkts (% of Mths)	Fund	50.00	52.78	41.67
	Median	46.67	47.22	41.67
Excess Rtn - Rising Mkts (% of Mths)	Fund	50.00	57.89	42.86
	Median	44.44	47.37	42.86
Excess Rtn - Falling Mkts (% of Mths)	Fund	50.00	47.06	40.00
	Median	50.00	47.06	40.00

Zenith endeavours to identify Managers that can generate a consistent level of outperformance above benchmark through all market conditions over the long-term. The consistency statistics illustrate the Manager has been able to generate excess returns in all market conditions approximately 50% of the time over the medium to long-term (3-5 years).

The Fund's value style bias would indicate a tendency to outperform in falling market conditions. However, this hasn't been clearly evident in the consistency statistics over the medium to long term.

Risk / Return Analysis

Risk / Return Statistics		5 Yrs	3 Yrs	1 Yr
Information Ratio	Fund	0.06	-0.02	-1.66
	Median	0.03	0.07	-0.94
Sharpe Ratio	Fund	-0.11	-0.34	-0.10
	Median	-0.13	-0.34	0.18
Standard Deviation (% p.a.)	Fund	16.33	18.90	13.27
	Median	15.96	17.84	12.89
Tracking Error (% p.a.)	Fund	4.28	4.64	3.22
	Median	3.67	4.10	2.43

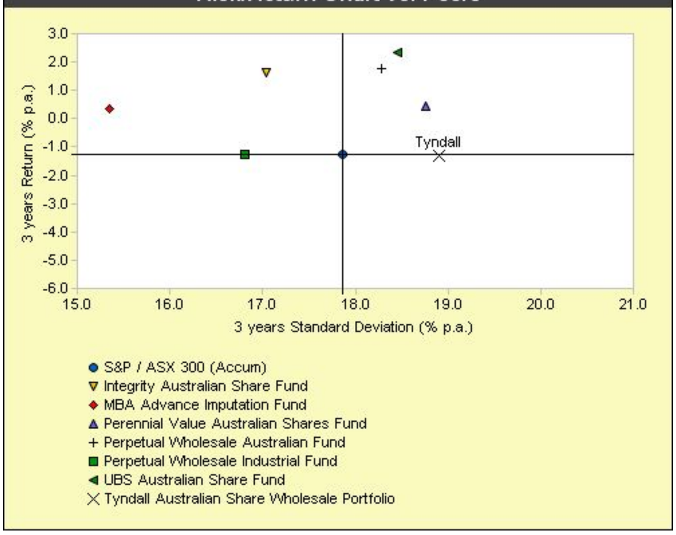
The Fund's expected ex ante tracking error target range is between 3% - 5% p.a.

The Fund's tracking error has ranged within the target bands consistently through all time periods. The level of risk (Standard Deviation) is an outcome of the bottom-up stock selection process; however volatility has been marginally above the median manager, as expected given the Fund's concentrated nature.

From a risk-adjusted perspective the Fund's Information and Sharpe ratios have been unimpressive over the medium to long term in an absolute sense but comparable to the median manager. Although Zenith prefers these measures to be strongly positive, indicating a superior risk/reward proposition, we remain confident that the Manager can generate a consistent level of outperformance.

The risk/return chart below illustrates the performance of the Fund in comparison to some of its key competitors.

Risk/Return Chart vs. Peers



Investment Personnel

Name	Title	Tenure
Bob Van Munster	Head of Australian Equities	11 Yr(s)
Warwick Cumming	Deputy Head of Equities / PM	11 Yr(s)
Malcolm Whitten	Portfolio Manager	17 Yr(s)
Jason Kim	Quantitative Research Analyst / PM	10 Yr(s)
Tim Johnston	Senior Research Analyst / PM	13 Yr(s)
Brad Potter	Senior Research Analyst / PM	9 Yr(s)
Craig Young	Senior Research Analyst / PM	15 Yr(s)
Michael Maughan	Senior Research Analyst	3 Yr(s)
James Eginton	Assistant Analyst	1 Yr(s)
David Thoms	Dealer	1 Yr(s)

Organisation

The Tyndall Australian Share Wholesale Portfolio is managed by Tyndall Investment Management Limited (Tyndall). The Australian equities business is a 50/50 joint venture between Tyndall Investment Management Limited (TIML) and the majority of staff in the Australian Equities team. Formerly a subsidiary of Suncorp-Metway Limited (Suncorp) TIML is now fully owned by Nikko Asset Management (Nikko AM) following its acquisition in March 2011. Nikko AM is one of the largest asset managers in Japan with offices in London, New York, Singapore and Hong Kong. Importantly, there were no changes to the ownership structure of the equities business.

Zenith considers the sale of Tyndall to Nikko AM as a positive. The sale is in accordance with Suncorp's plan to simplify their business operations in order to focus on its life insurance business. Overall, we consider Nikko AM's global network to be an advantage for Tyndall in which to gain additional regional and global insights to complement their existing capabilities.

The joint venture between TIML and Tyndall Equities was formed in October 2004 to provide equity ownership and therefore a retention incentive to key staff. In fact, 8 of the 10 investment personnel retain equity ownership with only two equity holders having departed since inception. As at 30 November 2010 the joint venture was managing AUD$4.0 billion in Australian equities under various strategies. The Fund was established in 1995 and has grown to approximately $1.6 billion under management.

Investment Team

The Tyndall Australian equities team consists of 10 investment professionals and is headed by Bob Van Munster. Van Munster was recruited to manage the team in 1999 and has extensive industry experience having previously worked at County NatWest as head of Industrial Equities, at BZW as Australian Equity Strategist and at Legal and General as Director of Domestic Equities. While Van Munster heads the team, the Fund operates under a co-management structure whereby Van Munster manages 80% of the portfolio and Brad Potter manages 20% of the portfolio. Both Van Munster and Potter contribute a wealth of experience with collectively over 50 years of investment experience. Potter joined Tyndall in 2002 providing coverage of the Mining and Financials Sectors. Potter worked previously at Westpac as Director - Corporate Finance and at Ord Minnett as a Senior Resource Analyst.

All funds in the equities business operate under this co-portfolio management structure, having transitioned to this model in July 2007. This was to mitigate key person risk such that the loss of any single individual wouldn't result in a significant skills loss.

These individuals are further supported by a very experienced team of portfolio managers and senior investment analysts. This includes Warwick Cumming, Deputy Head of Equities, who has over 30 years of investment experience. The team also boasts a dedicated quantitative resource with Jason Kim as the Quantitative Analyst / Portfolio Manager. Jason's responsibilities include quantitative risk control for the portfolios; portfolio construction and creating quantitative tools that add value to the Tyndall CVA process. He's also the lead portfolio manager for the Institutional Income mandates.

The team structure and work process is both well organised and clearly defined with stock and sector responsibilities allocated across analysts (approximately 15-20 stocks per analyst) to ensure solid peer review of companies and a ready basis for comparison with other stocks in other sectors. This structure also ensures there is a succession plan in place should someone leave the group. In addition, each analyst has a back up analyst to cover stocks when people are unavailable. The team also attempts to ensure that at least two people attend company visits and meetings with company management to ensure a cross-check of views and assessment.

The team meets 5 times a week which incorporates 3 research meetings, one portfolio review meeting and one portfolio construction meeting. At the research meetings the team discusses company news items, broader market conditions and dynamics as well as review analyst stock recommendation updates/changes. Analysts present a standardised template that contains the historical and projected company income and balance sheet with all assumptions. This peer review of stock recommendations is considered an integral aspect of Tyndall's investment process, ensuring the responsible analyst has considered all perspectives in arriving at their recommendation. This process also ensures that all members of the team are up to date with company recommendations.

While analyst recommendations are the predominant driver of stock selection, individual portfolio managers have final discretion on portfolio construction. The Portfolio Construction Committee (PCC) exists to provide further peer review of all portfolio decisions and to ensure all portfolio managers are aware of any pertinent information. Although the portfolio managers have final discretion they must present to the committee prior to executing any changes. The PCC consists of all portfolio managers and the dealer and meets on a weekly basis.

Team stability has been reasonable; the most significant departure in recent years has been Roger Collison, Head of Reseach, in late 2010. While disappointing, this loss represented the only senior departure in recent history. There has also been two less senior departures in the last three years; Adam Ritter (Dealer) in late 2009 and Alex Wright (Trainee analyst) in late 2008. However, these individuals were replaced with the appointments of David Thoms (Dealer) and James Eginton (Assistant Analyst). Interestingly, Tyndall has not replaced Collison or re-assigned the Head of Research role, with all team members reporting to Van Munster. Collison's portfolio management responsibilities were delegated to Brad Potter. The Manager has stated there's a possibility of further expansion in the future at the junior level. Overall, Zenith considers the investment team to be adequately resourced.

Team stability at the more senior level is most likely a testament to the equity participation by most of the team which provides a strong incentive and aligns the team's interests with that of the business. Apart from equity participation, which can form a large component of remuneration, team members are paid a base salary as well as a bonus based on meeting certain performance targets.

In summary, the Tyndall Australian Equities team is well resourced and Zenith rates highly the portfolio management of Van Munster and Potter. The team is very experienced, well incentivised through equity participation and for the most part have worked together for many years. The peer review process ensures that a collegiate environment is fostered and is one of the core strengths of the CVA process.

Investment Process

The objective of the Fund is to outperform the S&P/ASX200 Accumulation Index by more than 2.5% p.a. over rolling five-year periods. The Manager believes markets are inefficient and aims to exploit these occurrences through the application of its proven proprietary Comparative Value Analysis (CVA) process.

To achieve its objective Tyndall applies a rigorous bottom-up fundamental process to determine a stock's 3-year IRR valuation. Tyndall believes that this intrinsic value is best evaluated by examining the assets and current or normalised earnings power of a company while assigning value to the potential growth only in exceptional cases. By buying when the market value of a company is significantly lower than its intrinsic value and using sound risk management techniques Tyndall believes it can enhance the risk/return trade-off of traditional value investing.

Security Selection

The Manager applies the proprietary process called Comparative Value Analysis (CVA) that is used across the Australian equity funds offered by Tyndall. The process seeks to identify companies with sustainable medium term earnings that are trading at a significant discount.

The starting universe for the process is all stocks listed in the S&P/ASX 200 Index. A liquidity screen employing a very conservative approach is initially used to filter the universe. The filter considers the median daily turnover of each stock over a 90 day period and to be eligible the Manager must be able to enter and exit a position within this period based on a notional 1% weighting in the portfolio and not using more than 25% of the daily turnover. This results in a reduced universe of approximately 175 stocks. These stocks are then subjected to an additional proprietary, multi-factor stock screen which ranks stocks by value, quality and combined scores. The screen uses valuation metrics including one year forward consensus price to earnings, grossed up dividend yield, enterprise value multiple and two qualitative metrics to filter the universe.

After the initial screens for liquidity, value and quality, Tyndall relies predominantly on internal proprietary research, preferring not to rely on stockbroker or other external research to direct their investment decisions. However, external sources are used for a variety of purposes including information flow, company and competitor contacts, earnings revisions, forecast earnings dispersions and to contribute to the understanding of industry structures and competitive advantages. Those stocks that pass through the initial filter are subjected to rigorous fundamental analysis. This includes projections of a company's Balance Sheet, Profit & Loss and Cash Flow Statements as well as key financial ratios in an integrated model. The focus is on the ability of the balance sheet and cash flow to finance potential growth and returns to shareholders and estimate future normalised returns for a company given the industry dynamics, strategic positioning and capabilities of management.

From this fundamental research the Manager attempts to derive an intrinsic valuation for the company based on conservative inputs. For example, in its discounted cash flow valuation (DCF) process analysts incorporate a 'Franchise period' when forecasting earnings and cash flows. The franchise period is defined as the length of time a company can achieve abnormal growth or return on capital employed and is generally 4 to 8 years. To ensure the validity of all valuations analysts compare valuations across techniques including capitalisation of normalised earnings, discounted cash flows and, when appropriate, break-up valuations of companies.

A standard set of macro assumptions are employed in all the models to ensure consistency throughout the process. These assumptions include currency, commodity and interest rate outlooks. Rather than attempt to develop independent forecasts the team takes a view on consensus built from inputs from brokers and other forecasters and uses these figures in their models. If the team hasn't determined an outlook on any of these inputs the model defaults to the consensus views or the most trusted. Company models are updated and / or initiated when either there is new information that is likely to change estimated returns on stocks or new stocks appear attractive on the manager's value / quality screens.

Company contact, including visits to suppliers, customers and competitors, forms an important component of the research process. The objective is to gain a better understanding of the operations of the company and the industry in which it operates which should lead to better investment analysis and valuations. Company visits are undertaken to validate inputs into the company models, to determine the strategic value of the assets and assess management's ability

To ensure the consistency of assumptions, errors, omissions and validity of forecasts the other analysts and team members extensively review all research before the valuation, expected return, balance sheet and dividend-related forecasts are accepted into the Tyndall stock selection process.

In Zenith's view, the investment process is well structured and consistently applied across the full range of Tyndall Australian equity funds.

Portfolio Construction

The output of the Tyndall CVA research process is the production of a 3-year IRR calculation for each stock. A matrix, which is automated and live, generates the IRR to be discussed by the PCC. The portfolio managers will generally select stocks with a high IRR whilst selling stocks that have low IRRs.

Portfolio construction is the responsibility of the two portfolio managers, Van Munster and Potter, who construct individual portfolios that are then combined to form the Tyndall Australian Share Wholesale Portfolio. However, while final discretion remains with the two Portfolio Managers they must present their portfolios to the PCC consisting of all the Portfolio Managers for the Australian equity products and the dealer. It should be noted that by this stage all stocks that are eligible for portfolio inclusion have already been through the intensive peer review process conducted by the team. The purpose of the PCC is to ensure that all information and ideas are shared across the team, to provide peer review as well as provide the dealer with execution instructions.

The IRR calculations are recalculated as expected outperformance which is then used for a BARRA optimisation to generate a model portfolio of stocks and stock weights to assess the portfolio's efficiency and exposure to risk. While this optimisation process provides an excellent guide for portfolio construction, the objective of the portfolio managers is to create a reasonably diversified portfolio of high expected return stocks, in accordance with the Fund's risk constraints. The portfolio is constructed based on this objective with their assessment of the various risk return tradeoffs of each stock. Volatility, stock concentration, sector and style risks are all considered.

The portfolio is then monitored on a daily basis and there are a number of events that may trigger the review of a portfolio position. These include:

- Changes to the IRR due to stock price changes
- Anomalous stock movements
- A stock weighting deviates more than 30% from the model portfolio target
- A stock approaches its assessed fair value
- A new stock enters the top 20 stocks ranked by IRR
- Poor price or earnings performance of a stock
- New material information becomes available
- An analyst signalling a change in forecasts or valuation
- Capital raising, IPOs, merger and acquisition activity

Tyndall's buy and sell decisions are only undertaken if the manager believes that a switch will deliver a more than sufficient margin to improve portfolio returns after transaction costs.

The portfolio will generally consist of between 20 - 35 stocks. Stock exposure is limited to a maximum active position (to benchmark) of +/- 6% and a minimum weighting of 1%. The maximum / minimum weighting to any one sector is +/- 8%. The portfolio is managed to an ex-ante tracking error range of between 3% and 5% (up to 8% in exceptional circumstances) with an average annual portfolio turnover of between 35% - 55% p.a. In July 2007 portfolio managers were granted discretion to invest up to 7.5% of the portfolio in the stocks that didn't meet the strict criteria of the process. This allows the managers to select stocks that may have high expected returns but those returns may not fit well into Tyndall's three year time horizon. While the managers have discretion they must explain their logic to the PCC for peer review. The Fund will typically be fully invested with low cash levels but has the ability to retain a maximum of 20% in cash.

Overall, Zenith views the underlying CVA process well and is encouraged by the strong connection between the stock research performed by the analysts and the portfolio construction.

Risk Management

Portfolio Constraints	*Description*
Cash (%)	0% to 20%
Portfolio Turnover (% p.a.)	35% p.a. to 55% p.a.
Weight - GICS Rel. Index (%)	-8% to 8%
Security Numbers	20 to 35
Tracking error (% p.a.)	3% p.a. to 8% p.a.
Weight - Security Rel. Index (%)	-6% to 6%

Risk management is firmly ingrained into the culture of Tyndall as readily evidenced in the underlying CVA process which employs multiple valuation methodologies to confirm valuations as well as very conservative inputs to valuations. The peer review process ensures that biases are mitigated and all positions examined thoroughly. Formal portfolio constraints are also in place to ensure the portfolio is constructed within certain risk limits.

Within the formal constraints the portfolio managers use a number of tools to help them achieve an appropriate ex-ante risk/return trade-off. Although judgement and analyst input are the primary determinants of portfolio construction. BARRA analysis (commercial risk software) is employed throughout the process to help optimise the portfolio. This ensures that the portfolio managers remain mindful of all the risks that are inherent in the portfolio. These include volatility, leverage, industry, price and earnings momentum, value and size. If these exposures are deemed imprudent then the portfolio may be adjusted to improve the risk exposure.

Tyndall also periodically runs scenario analysis on the portfolio by reference to recent past episodes that have been problematic for the market and for Tyndall in particular. If this process leads to an assessment that the downside risk is too large then the portfolio is again assessed and may be adjusted with additional sector, factor or stock constraints. Overall, Zenith is comfortable with the risk management process employed.

Risks of the Fund

As is the case with all Australian equities based products, the biggest risk to this Fund is a sustained downturn in the Australian equity market, which could lead to negative performance. This risk can be significantly reduced by investors adopting a medium to long-term (3 - 5 years) investment time frame when investing in this Fund.

The Fund's value style will generally lead the Manager to lag their growth style peers in a prolonged bull market environment. In contrast, we expect the Fund to outperform the benchmark in flatter markets and bear market conditions.

Managing high levels of funds under management (FUM) can constrain a manager's ability to add value; however Tyndall has indicated a capacity limit of between 0.75% - 1.0% of the S&P / ASX 200 Accum. Index. Liquidity issues may arise when establishing and liquidating portfolio positions in small and mid cap securities, while managing a high level of FUM. Overall, Zenith Investment Partners Pty Ltd

Zenith believes Tyndall, based on its current level of FUM, remain below levels were capacity issues may arise.

Key person risk has been largely mitigated by the dual portfolio manager structure but the loss of either Van Munster or Potter would be considered significant. In addition, both members maintain equity ownership in the business, which further reduces the risk of departure by either Portfolio Manager.

Applications of the Fund

3 years Excess Correlation Table	
Fund Name	**Excess Correlation**
Ausbil - Australian Active Equity Fund	0.06
BT Wholesale Core Australian Share Fund	-0.01
Fidelity Australian Equities Fund	-0.16
Schroder Wholesale Australian Equity Fund	0.67

In general, compared to most other asset classes equities offer investors the opportunity for higher capital growth over the longer term with some income. However, this higher growth is also often associated with higher volatility. Therefore, it's recommended that investors adopt a longer time frame when investing. Investors should also be cognisant of the fact that the Australian equity market is fairly concentrated, with a couple of sectors dominating the market (i.e. Resources and Financials) and that in total it only represents approximately 1% of global equity markets (in terms of market capitalisation). Therefore, to mitigate this concentration risk it is highly recommended that investors diversify their investments across asset classes and internationally.

The Fund's annual portfolio turnover is expected to be between 35% - 55% p.a. (in normal market conditions) potentially providing a tax effective outcome, with a low level of capital gains realised annually. From a tax-awareness perspective Tyndall seeks to maximise the after tax return for investors by monitoring stock franking credits (45 - day rule) and managing transactions around the 12-month holding period to ensure unit holder benefits are maximised where possible.

The Fund provides investors with a high quality Australian equity offering managed in a high conviction manner. The Manager's value style bias may provide strong relative returns in bear market conditions rather than bull market conditions; therefore Zenith recommends the Fund be blended with a growth orientated Australian equities products to achieve a more diversified exposure to the sector. The blending of both styles should deliver a more consistent return over the medium to long term and remove some of the volatility which would be experienced if a significant style bias was present.

Fees

The management fee for the fund is 0.80% with no performance fee. The Fund's fee structure is highly competitive in comparison to its Large Cap value peers.

Author: Steven Tang
Investment Analyst
Email: steven.tang@zenithpartners.com.au
Ph: (03)9642 3320
Fax: (03)9642 3319