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Short rush after the ban is lifted

Katherine Jimenez
Hedge funds

HEDGE Funds were likely to "rush out" and restore their short positions on some Australian companies once the short selling ban was lifted next month, according to Russel Pillemer, chief executive of funds management group Pengana Capital.

"I think that you could see some immediate impacts when the short selling ban comes off," he told *The Australian*.

"Fund managers have been waiting to short and as soon as the ban comes off they will start.

"I think you'll probably have some victims in that regard."

The Australian Securities and Investment Commission last week extended the one-month blanket ban on short selling to November 18 for non-financial companies and January for financials.

Pillemer says because many hedge funds have not been able to put on shorts, their books are going more and more long.

However, he does not believe resources will be one of the sectors to come under attack.

"They have been very, very hard hit already," he says.

Pengana is a diversified funds management company that was co-founded by Pillemer in 2003.

The group has about \$1.4 billion in funds under management through nine different funds.

Among its star performers is the Pengana Global Volatility Fund. The Fund trades market volatility using S&P index options and has delivered a sterling 24 per cent net return since its inception in November last year.

The company's short strategy generally revolves around having a long position in one sector and then matching it with a short position in the same sector. For example, it could have a long position on one bank and a short position on another bank.

Of the 10 funds run by Pengana, three use equity shorts as part of their overall strategy.

The Pengana Australian Equities Long Short Fund focuses on stocks in the ASX 300 Index for longs and ASX 200 Index for shorts. The fund holds about 20-30 long and 5-15 short positions.

The Pengana Global Resources Fund provides long and short exposure to global resource securities, including mining, energy, steel, commodities and related services.

We asked Pillemer what the next few months has in store for hedge funds and the broader market.

What is your forecast for the VIX volatility index?

Certainly, until the end of this year, I would



On blocks: Russel Pillemer says there will be victims when the short-selling ban ends but that resources have been hit hard enough already

be surprised if volatility came down to historically low levels. At the moment, it's in the high 70s or even the 80s, whereas historically the average is probably in the 20s.

I think volatility is here to stay. In our view, it will be here for the next 12 months. I think the next six to 12 months it will stay at historically high levels, which might be in the 30s or the 40s.

How is Pengana positioning itself to be among the hedge funds that survive the bear market?

Obviously, we are trying to focus on keeping our performance strong across our funds and trying to avoid the big blow-ups that are out there. Thankfully, we've been able to do that so far. Also, we are focusing on various areas

of the market where you think there is good potential. For instance, we've had some strategies that have done well in these markets, like our Volatility Fund.

Going forward, a dominant number of our strategies are based within the Asia-Pacific region.

Investors are still looking at it (the region) as a growth area and a place where they want to allocate their capital.

My guess is that when regulations come in, it will be much harder for the megafunds to be able to operate with higher regulation.

But for a smaller, nimble player, you still probably will find it easier than those large players to operate and to generate good returns.

What are the bright spots for Pengana?

We have a resources equities fund. Resources have been absolutely hammered over the last few months, but when we look at a situation like that we say: "Has it been overdone?"

We look at the fundamental value of the companies we're investing in versus their trading levels.

And when we look at that today, we say there's absolutely lots of good value to be bought out there.

We are cautiously optimistic from a valuation point of view.

Another area that has been particularly hard hit is listed property. That has been crushed over the last period. That is

something we are also looking at. While there's some interesting investment opportunities there, the property market has probably got a while to play itself out, before we start seeing some upward movement in that part of the market.

What will be the long-term implications of global hedge fund redemptions and how will it play out?

There are redemptions at two levels. One is at the underlying hedge fund level and the other is redemptions at the fund of funds level. I think there will be a lot of redemptions.

Everybody is looking at the end of December as a telling point, because a lot of funds have quarterly lock-ups and you can only redeem it at the end of December.

There will be large redemptions out of both the fund-of-fund industry and directly out of individual hedge funds.

What's also happening, on the fund-of-fund side, there's been a mismatch between liquidity provisions that have been offered to investors and the liquidity provisions from funds.

I think what you will probably find is that the industry will get a fair bit smaller and quite quickly.

The industry will probably become more concentrated and no doubt more regulated. There will be winners out of this.

The other thing I am seeing, in New York, is an extraordinary dependency about the US market in general.

As a result the notion of ploughing more money back into investments into US equities is a pretty hard thing for investors to get their head around.

At the same time, if you look at, for instance, Asia and talk to investors, they still view Asia as being a good place to put their money. It still has any air of optimism about it.

What will regulation mean for the industry?

My guess is regulation is more likely to be a significant issue for the big players in the market, rather than the small players.

If there is heavy disclosure about short-selling positions and you've got big short-selling positions in certain companies, that is going to affect your ability to put on those types of positions.

Short sellers usually try and disguise as much as they can any major short positions they have in any companies. And I think that by being forced to disclose those short positions they will think twice about doing it.

So, if you're a very large hedge fund and you have to put on your shorts in large amounts life could be quite difficult for you in the future.

