

# Pengana Australian Equities Long Short Fund

## October 2008 - Onshore Update



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### Fund Description

The Pengana Australian Equities Long Short Fund is a long / short Australian equities strategy, with a long bias and a bottom-up fundamental approach to stock selection. The Fund targets 20 - 30 longs selected from the largest 300 stocks on the ASX and 10-15 shorts selected from the top 200. The manager has a research-based investment process to evaluate investments capable of generating target returns over the medium term, with a strong focus on cash flow generation and growth at a reasonable price. Macro and technical overlays are used to assist in portfolio construction, exposure sizing and market timing. The average net long position since inception has been 45 to 50%. The Fund aims to provide investors with an absolute return of 12 to 15% per annum over the medium term with relatively low volatility (equity type returns with lower volatility). The manager also adopts procedures to manage risk and preserve the capital of investors. The Fund is managed out of Sydney.

### Fund Features

<b>Style</b>	Fundamental, GARP	<b>Management Fees <sup>1</sup> (monthly)</b>	1.25% per annum
<b>Benchmark</b>	ASX 300 Accum Index	<b>Performance Fees <sup>1</sup> (semi-annually)</b>	20% per annum with a high water mark
<b>Investors</b>	Wholesale Clients only	<b>AUM at Month End</b>	A\$10.1m (A\$12.7m incl. offshore)
<b>Minimum Initial Investment Amount</b>	A\$100,000	<b>Application Price at Month End</b>	Application: A\$0.8870
<b>Inception Date</b>	May 2004	<b>Redemption Price at Month End</b>	Redemption: A\$0.8844

### Fund Commentary

Fund Performance (A\$, net of fees)													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008	-4.2%	-3.2%	-3.8%	7.0%	-0.4%	-8.7%	0.3%	5.1%	-4.8%	-13.5%			<b>-24.5%</b>
2007	1.3%	0.9%	1.2%	1.9%	3.2%	0.7%	0.4%	0.8%	2.7%	1.7%	-0.8%	-0.2%	<b>13.7%</b>
2006	2.1%	1.2%	4.3%	0.9%	-1.1%	2.6%	0.5%	0.1%	0.7%	3.6%	0.9%	2.1%	<b>17.7%</b>
2005	2.6%	-1.3%	0.2%	-0.6%	-0.8%	3.3%	0.7%	4.2%	2.6%	-0.9%	3.0%	1.8%	<b>15.0%</b>
2004					0.8%	1.1%	5.3%	-0.2%	2.7%	5.9%	2.9%	0.7%	<b>19.3%</b>

The fund commenced the month of October 54% net long, ending the month 62% net long. After sundry income and all costs and fees, the net return for October 2008 was a NAV decrease of 13.5% to \$0.8857 per unit.

Global equities markets have suffered their weakest two months of performance in 40 years. The ASX 300 Accumulation Index declined 12.9% over October, on the back of rapidly slowing global growth and a continued sharp decline in commodity prices (Reuters Jefferies CRB Index was down 24%, its worst month on record). All ASX sectors declined in October. Highlighting the performance skew towards large cap stocks, the 20 Leaders Index declined by only 7% while the Small Ords Index declined by 25%. The mid-cap 50 Index, to which the Fund has always been heavily exposed, fell 21.4%. Best performing sub-indices were Health Care (-3%) and Telcos (-3%). Worst performing sectors were property (-25%) energy (-19%) and materials (-18%).

#### Key Contributors / Detractors

Best performers in the long portfolio were Sonic Healthcare and Telstra. Mt. Gibson Iron, Boart Longyear, WorleyParsons and other mid-and small caps were significant detractors. Residual short positions in consumer stocks contributed positively. Given the way the month panned out, the inability to add shorts proved problematic.

### Market Commentary

In October several key steps were taken by global governments and central banks to stimulate the economy through aggressive fiscal and monetary policy and to address liquidity issues directly. However, with limited appetite for risk, investors have been selling equities and bonds and allocating to cash at a rapid rate. While the worst of the deterioration in credit markets and cost of debt may have passed, many companies are now facing substantial revenue and margin pressure as global growth slows sharply. Furthermore, the expectation of a growth slowdown extending into 2010 in China (the key sentiment driver for global materials demand) is gaining traction. Earnings downgrades have begun in earnest but have further downside risk. Large cap resources

<sup>1</sup> All percentages are plus GST net of reduced input tax credits. Please refer to the Information Memorandum for a more detailed explanation.

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stocks remain the key driver of earnings growth for the Australian market over the next two years, according to the research that we follow, while commodity forecasts are still being pulled back continuously in reaction to continued negative news flow.

Given that economic conditions will not change rapidly once such a negative dynamic sets in, the quality of company balance sheet and cash-flows remain paramount factors for selecting stocks in this environment. However, shattered investor confidence, equity fund redemptions and forced selling into low liquidity, have thrown up some stocks that satisfy our criteria, where valuations have become forgiving, at least in the short term. Some names have already rallied 40 - 50% off their October lows.

The gradual unlocking of global credit markets, recapitalisation of the global financial system, lower commodity prices, lower interest rates and fiscal stimuli have the potential to set the stage for a recovery in global growth. However, we recognise that the resumption of significant earnings growth after a period of such financial impairment and de-leveraging will take a long time.

We continue to run a relatively small gross exposure. Our temporary inability to short has adversely affected performance for a second month. However, from 19<sup>th</sup> November the ban on covered short selling will be partially lifted and as long as the ban is temporary there will be no change to our investment process or modus operandi. Stock selection focus is on the long side, using extreme volatility to advantage. Your managers are retaining a medium term long bias towards building a portfolio of beneficiaries of lower short term interest rates (sustainable yield), selected industrials and a smaller exposure to global growth.

The Fund's net long exposure at the time of writing is around 61%, with a net overweighting in "defensive" industrials, "oversold" mid-caps and infrastructure stocks. We are neutral / underweight financials, property and consumer-discretionary stocks.

### Further Fund Information

Net Returns to 31 October 2008					
	PAELSF Net Return <sup>2</sup>	PAELSF Gross Return <sup>3</sup>	Cash	ASX 300 Accumulation Index	PAELSF Average Net Exposure <sup>4</sup>
1 Month	-13.5%	-13.3%	0.5%	-12.9%	58.0%
3 Months	-13.4%	-13.1%	1.6%	-18.4%	58.3%
6 Months	-21.0%	-20.4%	3.4%	-26.9%	54.7%
1 year	-25.3%	-24.4%	7.0%	-38.3%	50.8%
2 years	-10.9%	-4.8%	13.7%	-19.5%	48.9%
Since inception <sup>5</sup>	43.9%	77.5%	30.0%	42.2%	49.3%
Annualised Volatility	11.6%	12.4%	0.2%	14.4%	

Risk Characteristics	
Annual Volatility	11.6%
Sharpe Ratio	0.21
Downside Deviation	5.8%
Sortino Ratio	0.42
Risk Free Rate Assumed	6.0%

Portfolio Structure	
Long Positions	28
Short Positions	4
Equity Long Exposure	64.9%
Equity Short Exposure	3.04%
Net Long Exposure	61.9%

Performance Contributors	
Equity Longs	-12.0%
Equity Shorts	0.9%
Derivatives	0.0%
Fixed Interest	-2.1%

Top 5 Positions (in alphabetical order): 18.7%	
Diversified Utility & Energy Trusts	
Insurance Australia Group	
Origin Energy	
Sonic Healthcare	
Spark Infrastructure	

<sup>2</sup> Net Performance, after all fees and charges.

<sup>3</sup> Gross Performance excludes both management and performance fees.

<sup>4</sup> Exposure is delta adjusted for derivatives and preference shares.

<sup>5</sup> Inception date: May 2004

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