



# Pengana Emerging Companies Fund

## May 2008 Update



### Fund Performance<sup>1</sup>

The fund rose 1.8% (after fees<sup>1</sup>) in May, versus the Small Industrials which fell 1.4%. The resources sector outperformed the industrials by an incredible 14% in the month, leading the Small Ordinaries up 3.9%. While volatility continues, we sense the panic selling witnessed in the March quarter has abated, and a focus on earnings has returned. For lower risk earnings streams, there remain a number of highly prospective investment ideas given the cheap valuations.

Returns to 31 May 2008	Pengana <sup>1</sup>	S&P/ASX Small Industrials	S&P/ASX Small Ords	Relative to Small Industrials
1 Month	1.8%	-1.4%	3.9%	3.3%
3 Months	-4.8%	-4.0%	2.5%	-0.8%
6 Months	-25.8%	-23.9%	-11.1%	-1.9%
1 year	-19.6%	-25.7%	-10.2%	6.1%
2 years p.a.	17.4%	2.0%	14.5%	15.3%
3 years p.a.	25.1%	8.9%	19.8%	16.3%
Since inception p.a. <sup>2</sup>	22.8%	7.7%	16.9%	15.0%

### Key Stock Price Moves

During the month, the key positive contributors were Mineral Resources (up 39%), HFA (31%), Mac Services (15%) and the IT services stocks DWS, Oakton and SMS Management (up between 25-40%). The detractors included Imdex (down 20%), Automotive Holdings (15%), Dexion (18%) and Swick (12%).

### Market Commentary and Outlook

The industrial arena remains volatile, and despite the cheap valuations, the rising earnings risk in some sectors is leading to ongoing investor wariness.

This rising earnings risk is in the front of our minds, and we remain wary of sectors exposed to discretionary consumer and corporate spending, the New Zealand economy, the housing market, media and financial services. Rising input prices (notably steel, labour and fuel) and higher interest rates will also pressure earnings into FY09 in some companies.

On a brighter note, Radio Rentals posted a very strong full year result recently and reminded investors that not all retailers get hurt in a downturn. We remain comfortable with the stock, and in The Reject Shop

which is another retailer with low cyclicality. In that same vein, we are taking a good look at Metcash.

Financial services stocks have underperformed greatly this year due to the pressure on asset values as global markets collapsed. Having reduced our weight in the sector, we are now seeing pockets of promise where quality companies (such as DKN, HFA and Treasury Group) have reached highly attractive valuations and are growing earnings despite the unrest in markets.

A key feature of recent times has been the spectacular implosion of companies who have aggressively acquired to grow, especially when this was debt funded (witness MFS, ABC Learning, Commander Communications). Further significant downside in these types of companies is possible given the increased earnings risk, difficulties in raising debt and/or equity, and higher interest costs. Our portfolio remains clear of such stocks given our inherently conservative process.

Mining and infrastructure services remain a promising sector, with statistics showing further growth in activity into 2009. In a tight labour market, wage pressure will need monitoring, however overall we remain confident having 15-20% of the portfolio exposed.

### Fund Details

Fund size: \$336m

Redemption Price at month end: \$1.78

### Top Ten Positions

CSG Group	MacMillan Shakespeare
Fleetwood	Radio Rentals
HFA Asset Management	The Reject Shop
Mineral Resources	Tox Free Holdings
Mac Services	Treasury Group

### Contact Details

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<sup>1</sup> Total return performance figures are derived from Manager's records and are shown after all fees, and assume reinvestment of income. Investments can go up and down. Past performance is not a reliable indicator of future performance.

<sup>2</sup> November 2004