

# Pengana Emerging Companies Fund

## October 2008 Update



1 of 2

Australian Equities - Small Caps

### Fund Performance

Net performance for periods ending 31 October 2008 <sup>1</sup>							
	1 month	3 months	6 months	1 year	2 years p.a.	3 years p.a.	Since inception p.a. <sup>2</sup>
<b>Pengana Emerging Companies Fund</b>	-19.6%	-20.0%	-28.5%	-48.4%	-11.7%	+5.3%	<b>+10.0%</b>
<b>S&amp;P/ASX Small Industrials Acc Index <sup>3</sup></b>	-21.3%	-26.5%	-36.2%	-52.5%	-22.7%	-10.0%	<b>-4.1%</b>
<b>Outperformance</b>	<b>+1.7%</b>	<b>+6.5%</b>	<b>+7.7%</b>	<b>+4.1%</b>	<b>+11.1%</b>	<b>+15.2%</b>	<b>+14.1%</b>
<b>S&amp;P/ASX Small Ordinaries Acc Index</b>	-24.8%	-34.9%	-43.3%	-53.3%	-20.6%	-6.5%	<b>-1.1%</b>
<b>Outperformance</b>	<b>+5.2%</b>	<b>+14.9%</b>	<b>+14.7%</b>	<b>+4.9%</b>	<b>+8.9%</b>	<b>+11.8%</b>	<b>+11.1%</b>

### Fund Commentary

Global equity markets collapsed in October as the credit crisis worsened, and leveraged hedge funds unwound positions aggressively. For equity investors there was nowhere to hide. The Small Ordinaries fell -24.8% and the Small Industrials fell -21.3% with our fund down -19.6%. Whilst we are never pleased posting negative absolute performance it is encouraging to see the fund outperform its benchmark in both up and now down markets. Since the fund was inceptioned four years ago, and not withstanding recent weakness, it has generated a return of +10.0% p.a., a strong 11.1% p.a. above the Small Ordinaries Index and 14.1% p.a. above the Small Industrials Index.

#### Key stock price moves

Key successes in the portfolio during the period included Sonic Healthcare, Metcash, Austbrokers, McMillan Shakespeare and Tox Free Solutions. Key detractors were Ausenco, Transfield Services and Mineral Resources. The two key themes reflecting on performance for the month were the strong performances from the defensive stocks we own and the underperformance from some of our small industrial stocks that service the mining industry. Over recent months we have been reducing our exposure to mining service companies as our growth expectations have been tempered following commodity price weakness. Currently around 10% of the fund is invested in mining service companies, mostly in businesses with low risk contracts.

### Market Commentary and Outlook

Equity markets posted their worst monthly fall since October 1987 as fears surrounding the increased likelihood and implications of a global recession spread. Earnings risk has certainly increased, but we believe current valuations are implying far worse outcomes than is probable. With equity markets down 40-50% in the past year, now is the time to pick through the mess and identify the lowest risk value.

There are clear signs that we should be past the worse of this debt market induced crisis with global interest rates now falling and Libor rates (the interest rates that global banks transact with each other) reducing. The freeing up of global credit markets and global government stimulus packages will eventually return confidence to equity markets.

We are certainly not brave enough to pick the absolute bottom of the market, however, taking a medium term view we firmly believe equity investors will be handsomely rewarded from current levels. Interest rates look likely to fall to 4% domestically (and much lower overseas). At this level, the post-tax return from holding cash is likely to fall below inflation. Six months ago investors were rewarded by avoiding volatile equities and investing in term deposits at over 8%.

<sup>1</sup> Net performance figures are derived from Manager's records and are shown after both management fees and performance fees, and assume reinvestment of income. Past performance is not a reliable indicator of future performance.

<sup>2</sup> Since November 2004

<sup>3</sup> The fund does not invest in resource stocks.

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2 of 2

Since then the All Ords has fallen a further 30%, and interest rates are heading towards 4%. Clearly the asset allocation equation has changed.

In the smallcap sector we are finding many high quality stocks, with earnings not heavily reliant on the economy, and conservative balance sheets, trading at record low valuations. As a reminder the current forward PE of the fund is around 9 times and the underlying dividend yield of the companies we own above 6% (mostly fully franked). We have taken advantage of indiscriminate selling of stocks to add many quality companies to the fund. In this category are stocks like Sonic Healthcare, Slater and Gordon, Probiotec, Austbrokers, and Metcash – all operating proven franchises with little sensitivity to a slowing economy. Overall we believe we are well positioned to ride out the economic uncertainty given that the fund is relatively defensively positioned in companies with strong franchises and proven management.

Top 10 Positions (in alphabetical order)	
Austbrokers Holdings	Mac Services
ARB Corporation	Metcash
CSG Group	Sonic Healthcare
Fleetwood	The Reject Shop
McMillan Shakespeare	Tox Free Solutions

### Fund Description

The Pengana Emerging Companies Fund seeks to combine the skills of highly experienced small company investors (collectively 30 years experience) with a limited fund size to provide above market returns over the medium term. Our benchmark is the S&P/ASX Small Ordinaries Accumulation Index. The fund managers Steve Black and Ed Prendergast are part owners of the business and investors in the fund, providing a strong incentive to perform. The Fund has strong research ratings from all major research houses and over the period since its inception has delivered returns well above benchmark.

### Fund Features

<b>Style</b>	Bottom up stock picker	<b>Management Fees</b>	1.3325%
<b>Benchmark</b>	S&P/ASX Small Ordinaries Accumulation Index	<b>Performance Fees</b>	20.5% of the performance above the Benchmark
<b>Investors</b>	Open	<b>Fund Raising</b>	Maximum of 0.5% of the Benchmark capitalisation
<b>Minimum Initial Investment Amount</b>	A\$25,000 (direct)	<b>FUM at Month End</b>	A\$ 226m
<b>Inception Date</b>	1 November 2004	<b>Application Price at Month End</b>	A\$ 1.2612
<b>Identification Code(s)</b>	APIR PER0270AU ARSN 111 894 510	<b>Redemption Price at Month End</b>	A\$ 1.2536

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