

Pengana Comment on Short Selling Ban

15 October 2008



Background

The Australian Securities & Investments Commission (ASIC) announced on Sunday 21 September 2008 that:

- covered short sales, in addition to naked short sales, for all listed stocks would not be permitted (subject to a limited authorised market-maker exception)
- ASIC will reassess and advise the market in 30 days, whether or not it will at that time, or at a later date, reopen covered short sales for non-financial stocks
- For financial stocks, the review will be in line with the time limits imposed by other international regulators such as the US and UK.

The reason proffered for this action was that "the recent market global conditions, coupled with extensive short selling of stocks, particularly financial stocks, may be causing unwarranted price fluctuations. These fluctuations if unchecked, threaten the operation of fair and orderly stock markets."

Most market participants recognize covered short selling as a useful mechanism in price discovery. ASIC has subsequently emphasised that it sees a legitimate place for short selling in the market and that the ban on short selling is a temporary measure.

Short Selling Employed by Pengana

Of the ten funds run by Pengana, three employ equity shorts as a component of their overall strategy. They are:

Pengana Australian Equities Long Short Fund (PAELSF)

- Focus on stocks in the ASX 300 Index for longs and ASX 200 Index for shorts
- Typically holds 20 - 30 long and 5 -15 short positions

Pengana Global Resources Fund (PGRF)

- Provides long and short exposure to global resource securities including mining, energy, steel, commodities and related services
- Employs pairs trading in liquid, large capitalisation stocks and directional long and short positions in mid and small capitalisation stocks

Pengana Asia Special Events Master Fund and Pengana Asia Special Events (Offshore) Fund (PASEF)

- Invests in securities that are primarily subject to corporate events and listed on Asian (including Japan) and Australian stock markets
- Short selling used to hedge exposure in M&A scrip deals

Implications

The short selling ban has created distortions in the market that had a limited negative impact for some of the funds. For example, spreads on some Australian M&A transactions widened causing an estimated loss of 30bps for the PASEF.

On an ongoing basis, the ability to short individual stocks has been reduced although it is still possible to short equity indexes and short stocks in other markets (where permitted). In addition, the short selling ban coincides with a period of reduced corporate activity and dramatic falls in the market that lead most of our funds to be selectively increasing their long exposure rather than their shorts.

We do not anticipate that the current blanket ban on short selling in Australia will remain in place for a significant length of time. Overall we welcome a system that promotes transparency and responsibility with respect to short selling and are working with AIMA to represent our views to regulators.