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Aussie Fund Eyes Global Volatility as Asset Class
By Martin de Sa'Pinto, Senior Financial Correspondent | Friday, August 31, 2007

SYDNEY, Australia (HedgeWorld.com)—Traditional and alternative asset manager Pengana Capital has launched a fund that will aim to exploit market volatility through equity index investments. The new offering, Pengana Global Volatility Fund, is the first of its kind in Australia, and already has a \$150 million commitment from a large Australian institution.

Chief Investment Officer Nick Griffiths said in a press statement that the new fund was "an ideal investment tool for sophisticated wholesale investors who are concerned about the size of their exposures to the major asset classes and the attendant risks." Earlier this week, the fund received the "Innovative Product of the Year" award at the annual Standard & Poor's Fund Awards in Australia.

The Global Volatility Fund will look to profit from equities market volatility through short-, medium- and long-dated investments in futures, options and warrants. Al Wilkinson, a former director of the Chicago Board Options Exchange, designed and will manage the fund. Mr. Wilkinson knows a thing or two about volatility: He led the development of the CBOE Volatility Index—commonly known as the VIX—a measure of the implied 30-day volatility of S&P 500 index options. He also served as the first chairman of the Chicago Futures Exchange, a wholly owned subsidiary of the CBOE. He joined Pengana, which manages a total of \$1.8 billion, in March of this year.

"We'll be targeting the S&P 500 initially, but intend to expand to other liquid indexes such as the FTSE and the DAX," Mr. Wilkinson said in an interview. He said there are no capacity issues, since the strategy can deploy around \$750 million using S&P-based products alone. "This is the first in a family of volatility products that we aim to develop over the next five years," he said. "These may eventually include products based on oil, precious metals, currencies, agricultural products and debt."

Mr. Wilkinson also confirmed that the fund's initial \$150 million seeding would be run in a managed account, and that the fund had a further \$150 million in commitments over the next two to three months. "We're looking to manage about \$350 million by year-end, and \$500 million by the end of the first quarter of 2008, when the fund is likely to soft close," he said. The fund will be ramping up capacity over the next few months, "hiring new employees and organizing logistics. It currently has four or five dedicated staff, with a similar number of support staff.

The fund will have a one-year lock-up and after that redemptions will be every three months, added Mr. Wilkinson. Although the strategy is highly liquid, he explained that the lock-up and the long redemption lead time is "because we will be using futures, options and warrants of varied expiration: The difference in the behavior of the volatility of short-, medium- and long-dated securities gives us a very unique profit and loss stream," he said.

"The front six months of options react more violently to volatile periods, for us it's a sensitivity issue," he explained, "... but we will try and accommodate the unique needs that some of our clients may have."

Mr. Wilkinson also said that, regardless of the "volatility environment," the fund should do well in a catastrophic movement—which he defined as a 15% movement in a relatively short period of time—whatever the cause of the movement. "But the uniqueness of this as a volatility strategy is that it is designed to perform pretty well in a variety of environments," he said.

He said the strategy had been used on behalf of a client in a trading account for the last five years, with documented returns that have been independently verified for the last 30 months. In this period, he said, the strategy had returned an annualized 65% with volatility of 18%. The worst drawdown of 9.5% occurred in May 2006.

But wait: May 2006 saw a sharp correction across the world's major markets. Wasn't this precisely the sort of environment in which Pengana Global Volatility should perform extremely well? "We ran into some pricing anomalies at the time, and paid heavily to get into some unique opportunities," explained Mr. Wilkinson. "We took a mark-to-market loss in May, but over the following three months, the strategy generated a total of 45% to 50%."

Target returns are somewhat more modest. "We're aiming for an annualized 24% to 25% over a rolling three-year period," said Mr. Wilkinson, though another contact at the fund said they would be "disappointed" if returns did not exceed this level. "We should do better if there are violent movements on the downside, but if there is a continuous bull that returns 25% with no sharp movements in either direction, the fund's returns will lag those of the index," Mr. Wilkinson added.

Pengana Global Volatility has a master-feeder structure, with a Cayman-based master fund and an Australian feeder. The fund's directors are also examining the possibility of listing a closed-end fund on the Australian and New Zealand exchanges, though no decision has yet been made.

The minimum investment for institutions and qualified investment professionals is \$250,000 Australian dollars. Investors who want to set up managed accounts will have to fork over something more, with a minimum requirement of \$100 million. The fund offers a dual fee structure—there is either a 2% annual management fee and a 20% performance fee, or the management charge is waived with a 30% performance fee. In both cases there is a high water mark.

Citco will act as the fund's accountant and administrator, while the auditor is PricewaterhouseCoopers, Cayman Islands. The custodian and prime broker is Chicago-based Goldman Sachs Execution and Clearing LP, with Walkers of the Cayman Islands acting as legal adviser.