

Pengana Australian Equities Long Short Fund

December 2008 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

Style	Fundamental, GARP	Management Fees ¹ (monthly)	1.25% per annum
Benchmark	ASX 300 Accum Index	Performance Fees ¹ (semi-annually)	20% per annum with a high water mark
Investors	Wholesale Clients only	AUM at Month End	A\$8.4m
Minimum Initial Investment Amount	A\$100,000	Application Price at Month End	Application: A\$0.7895
Inception Date	May 2004	Redemption Price at Month End	Redemption: A\$0.7871

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%	-10.1%	-1.0%	-32.8%
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%	14.5%
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%	19.0%
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%	15.8%
2004					0.8%	1.1%	5.3%	-0.2%	2.7%	5.9%	2.9%	0.7%	20.8%

The fund commenced the month of December 61% net long, ending the month 48% net long. After sundry income and all costs and fees, the net return for December 2008 was a NAV decrease of 0.98% to \$0.7883 per unit.

The ASX 300 Accumulation Index declined 0.14% over the month of December and 38% over the 2008 calendar year. Despite a further rush of capital raisings, the market ended the month on a stronger note, mainly in cyclical names. Best performing sectors (essentially a reversal of November) were Consumer Discretionary (+8%), Small Resources (+7%) and Industrials (+6%). Worst performing sectors were Telcos (-6%), Financials (-3%) and Small Industrials.

Key Contributors / Detractors

Best performers in the long portfolio were Lihir Gold and QBE Insurance Group, Toll Holdings and Insurance Australia Group. Hybrid securities, Transfield Services, DUET and Telstra were detractors. Short positions contributed positively when taking the performance of long pairs into account.

The Fund's residual exposure to two hybrid securities representing 14% of the fund at month end continues to cause us pain on a mark-to-market basis, detracting over 3% from December performance. However, we have noted stabilisation and recovery in these names since late December, continuing into mid-January in a market less ruled by fear. Notwithstanding risks (illiquidity in particular), hybrids now represent extraordinary medium term value in our view. We have been able to partially hedge one of the hybrid names by taking a short position in the underlying equity. It remains our intention to steadily reduce absolute exposure to hybrids into a strong recovery.

¹ 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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Market Commentary

Calendar 2008, particularly in H2 was characterised by considerable risk aversion as the equity market was gripped by fear. Sentiment trumped fundamental metrics. Since late December we have witnessed a technical 'risk appetite bounce' as investors added some cyclical risk to portfolios.

Unprecedented fiscal stimulus packages are combining with aggressive interest rate cuts as governments and central banks attempted to flood the global economy with additional liquidity in order to stave of a full blown global debt deflation cycle. The key issues facing investors heading into 2009 remain the trade-off between ongoing poor macro news flow (economic and earnings) versus increasingly attractive risk-adjusted valuations for equities. Despite macro challenges we believe that calendar 2009 will be an up year for equities but will be characterised by meaningful rallies and pullbacks. There is some risk that the market will retest its Nov 2008 lows as earnings reality dawns through the reporting season. However, valuations are sufficiently attractive and sentiment sufficiently negative to warrant judicious exposure to cyclicals, reflecting a shift back into risk assets in an extremely low interest rate environment. There has already been a meaningful rally in high grade corporate credit. We expect that an upward drift in the unemployment rate will be the key factor driving further falls in Australian official interest rates in H1 2009.

At the stock level it is likely that the equity market will continue to be fixated with corporate financial flexibility and solvency, at least through H1 2009. The quality of company balance sheets and cash-flows remain paramount factors for selecting stocks in this environment. Only stocks with these characteristics will change hands on normal PE multiples and dividend yields. In contrast, stocks which are perceived to be financially vulnerable in a debt-constrained environment will continue to trade on very low forward multiples as shareholders risk significant equity dilution and dividend cuts. We recognise that the resumption of meaningful earnings growth after a period of such financial impairment and de-leveraging is unlikely until well into financial 2010.

We have set a mid 60% gross equity market exposure and have reduced our net exposure to 52% ahead of the company reporting season. Your managers are retaining a medium term long bias towards building a portfolio of beneficiaries of lower short term interest rates (sustainable yield), selected strongly funded industrials with a smaller exposure to financials, domestic cyclicals and global growth. We are underweight resources and property and net short selected overvalued industrials. We have included several short pair trades against long positions.

Further Fund Information

Net Returns to 31 December 2008					
	PAELSF Net Return ²	PAELSF Gross Return ³	Cash	ASX 300 Accumulation Index	PAELSF Average Net Exposure ⁴
1 Month	-1.0%	-0.9%	0.3%	-0.1%	65.0%
3 Months	-23.0%	-22.7%	1.3%	-18.5%	61.7%
6 Months	-22.7%	-22.1%	3.0%	-27.2%	59.5%
1 year	-32.8%	-31.9%	6.6%	-38.9%	54.8%
2 years p.a.	-23.1%	-18.4%	13.5%	-29.0%	49.4%
Since inception ⁵	28.1%	58.4%	31.0%	33.0%	49.8%
Annualised Volatility	12.4%	13.2%	0.2%	14.5%	

Risk Characteristics	
Annual Volatility	12.4%
Sharpe Ratio	0.11
Downside Deviation	5.5%
Sortino Ratio	0.26
Risk Free Rate Assumed	4.25%

Portfolio Structure	
Long Positions	20
Short Positions	7
Equity Long Exposure	57.0%
Equity Short Exposure	9.0%
Net Long Exposure	48.0%

² Net Performance, after all fees and charges.

³ Gross Performance excludes both management and performance fees.

⁴ Exposure is delta adjusted for derivatives and preference shares.

⁵ Inception date: May 2004

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Performance Contributors	
Equity Longs	2.4%
Equity Shorts	-0.1%
Derivatives	0.0%
Fixed Interest	-3.2%

Top 5 Positions (in alphabetical order): 22.6%
CSL Limited
Insurance Australia Group
Spark Infrastructure
Transfield Services
Westpac Banking Corporation

Contact Details

Pengana Capital Limited • Level 29, 20 Bond Street, Sydney, NSW 2000, Australia • T +61 2 8524 9900 • F +61 2 8524 9901
ABN 30 103 800 568, AFSL 226566

For further information, please visit our website at www.pengana.com or contact:

Institutional Clients: Denis Carroll, +61 2 8524 9974, denis.carroll@pengana.com
Private Clients: Juliet Dunworth, +61 2 8524 9984, juliet.dunworth@pengana.com
Retail Clients: Justin Brooks, +61 3 8663 7906, justin.brooks@pengana.com