

Pengana Australian Equities Core Fund

December 2008 Update



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Fund Description

The Pengana Australian Equities Core Fund aims to provide investors with an annualised return of 12 to 15%¹ before fees over the medium term via a concentrated core portfolio of equity and interest bearing holdings. The Fund is managed out of Sydney, Australia and uses fundamental research to evaluate investments capable of generating the target return over the medium term.

Fund Features

Style	Fundamental	Management Fees ² (monthly)	1.00% p.a. of NAV
Benchmark	The weighted average of the target Australian Cash Rate used by the RBA	Performance Fees ² (quarterly)	10% of investment surpluses without impacting on cash return, with standard high water mark
Investors	Wholesale Clients only	Minimum Initial Investment	A\$100,000
Inception Date	30 June 2008	AUM at Month End	A\$4.7m
Identification Code(s)	None	Application/Redemption Price at Month End	Application: A\$0.8762 Redemption: A\$0.8718

Fund Commentary

Fund Performance (A\$, net of fees) ³

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008	-	-	-	-	-	-	-1.0%	3.5%	-4.7%	-9.0%	-5.3	3.9%	-12.7%

The Fund generated a pleasing return of 4% during December, extending its outperformance of the general equity market while maintaining a cautious stance with 39% of its NTA in cash as at 31st December 2008.

The Fund took advantage of a volatile market by adding to existing holdings in CSL, Seven Network, Duet, QBE, CBA and IAG at attractive prices. In addition the Fund increased its exposure to good businesses by acquiring new holdings in Woolworths, Resmed and Transfield Services. The latter was acquired via a very deep discount placement due to the strong negative prevailing sentiment.

Following the sharp rally into the year end the Fund was able to maintain a cautious investment stance by disposing of its entire holdings in SEV, Sonic Healthcare, RIO and Worley Parsons, and trimming its exposure to CBA and BHP.

As at 31st December 2008, the Fund's top five holdings were Telstra, Primary Healthcare, CSL, IAG and Computershare. The Fund's top performing holdings for the month were Transfield Services, Primary Healthcare, Computershare and Seven Network, while its exposure to Telstra, Duet and BHP were the major detractors.

Net Returns to 31 December 2008 ³

	Pengana	Cash Rate	All Ordinaries
1 Month	3.9%	0.4%	-0.1%
3 Months	-10.4%	1.3%	-20.2%
Since Inception ⁴	-12.7%	3.0%	-29.7%

Market Commentary

Market Review

The flat monthly performance by the Australian All Ordinaries was the result of weak performances from the Telecommunications (-6%), Financials (-3%) and Utilities (-2%) sectors being offset by robust returns from the Information Technology (19%), Consumer Discretionary (8%), and Industrials (6%) sectors.

¹ This is not intended to be a forecast, but merely an indication of what the Fund aims to achieve over the medium to long term. The Fund may not be successful in meeting this objective. Returns are not guaranteed.

² Plus GST and net of reduced input tax credits. Please refer to the information memorandum for a more detailed explanation.

³ 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.

⁴ Inception date: 30 June 2008

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The RBA cut the cash rate to 4.25% in early December, taking its total easing to 300bps in 3 months. The quantum of the cuts has had three important impacts on the investment environment. Firstly the high risk-free return alternative offered by cash deposits is no longer available, forcing investors to at least look at other asset classes. Secondly, the lower base rate goes a long way towards offsetting the sharply higher margins on debt being charged by banks. Thirdly, the lower interest rate environment reflects the very real risk of widespread deflation rather than the recent concerns of commodity led price inflation.

During the critical Christmas shopping season, the easier monetary policy and its effect on residential mortgage payments combined with lower petrol prices to provide some relief to domestic consumers. Furthermore, the pervasiveness of significant retail discounting and the government cash handouts lifted retail sales at the top line (we may be in for some nasty surprises when we see the negative impact of discounts on profitability). However, the relentless upward pressure on unemployment numbers continues to weigh heavily on confidence levels as the real economy responds to the global credit gridlock hangover.

The major asset classes continue to experience high levels of volatility as investor sentiment ricochets between focussing on the gloomy medium term outlook for the real economy and the anticipation of a "bottom" in the financial markets. Investors are being forced to recognise that a significant addendum to the fiscal and monetary tools is "Time". These high levels of uncertainty and volatility will only subside as time allows the redemptions, deleverage and hidden risks to work their way through the global economy.

Most companies are still grappling with the sudden dissipation of available credit. As capital becomes an increasingly scarce commodity the "kicking boot" has moved from the feet of the corporate customer (which used to be able to set its own terms for credit) to that of the 4 major domestic banks. Credit policies are being ratcheted up (by more than just a few notches) along with fees and margins. The stricter lending environment is also allowing the banks to cajole their customers into improving their balance sheets (by selling assets, cutting dividends and/or capital expenditure and raising equity). Importantly access to substitute markets (especially foreign capital) has all but shut down as foreign banks withdraw from the Australian market to focus on their domestic businesses.

Global economic indicators continue to deteriorate with commodity prices falling sharply as demand weakens. The weaker Australian dollar is providing some price protection for the Australian export sector however the dramatic falls in volumes and prices of hard and soft commodity prices, particularly due to the uncertain outlook for Chinese demand has reduced visibility in forecasting company profits.

Investment Outlook

The fallout from the extended period of low interest rates, easy access to credit and mispricing of risk is currently working its way through phase one. The outcome of this massive and coordinated global government intervention will take time to play out. A significant potential implication is that those companies that do survive the next 12 months will find the cost of finance significantly cheaper.

Value is emerging in a number of industrial and financial companies with the characteristics of good management, dominant market shares, pricing power and balance sheet capacity. The portfolio remains focused on companies with low levels of exposure to the economic cycle (Consumer non-discretionary, Healthcare, Utilities), strong balance sheets and competent management. Several companies have taken their medicine early by coming to the market for additional equity, allowing the Fund exposure to strong balance sheets at a significant discount.

The upcoming reporting season is expected to highlight the substantial polarization between well managed companies with resilient business models and those that have been mere beneficiaries of a robust economic environment.

The Fund remains highly liquid with almost 40% of its NTA in Cash and increasingly vigilant for attractive investment opportunities.

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