

Pengana Australian Equities Core Fund

January 2009 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\$0.8776 Redemption:A\$0.8732

Fund Commentary

Fund Performance (A\$, net of fees) ³

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
2008/9	-1.0%	3.5%	-4.7%	-9.0%	-5.3	3.9%	0.2%	-	-	-	-	-	-12.5%

The Fund generated a small positive return of 0.2% during January in contrast with a very weak Australian All Ordinaries (-5.0%). As at 31st January 2009, cash made up 39% of the Fund's NTA, maintaining a cautious stance

The Fund took advantage of a volatile market by adding to existing holdings in: Metcash; Woolworths; NAB; Westpac and QBE. In addition the Fund took advantage of a deeply discounted placement to acquire a new holding in the gaming company, Tabcorp.

Following the sharp rerating of defensive stocks during the month, the Fund was able to trim its exposure to CSL, Duet and QBE while also disposing of its entire holding in Resmed.

As at 31st January 2009, the Fund's top five holdings were: Telstra; Primary Healthcare; IAG; NAB and Metcash. The Fund's top performing holdings for the month were: Duet; CSL; Resmed; Transfield Services and MCG, while its exposure to NAB, CPU, and Westpac Bank were the major detractors.

Net Returns to 31 January 2009 ³

	Pengana	Cash Rate	All Ordinaries
1 Month	0.2%	0.4%	-4.9%
3 Months	-1.4%	1.2%	-11.9%
6 Months	-11.5%	2.8%	-29.5%
Since Inception ⁴	-12.5%	3.4%	-33.2%

Market Commentary

Market Review

Another battle in the ongoing war between growth and defensive equity selection by investors was decided in favour of defensives. The weak start to the 2009 calendar year by the Australian All Ordinaries during January was due to; Industrials (-11%), Financials (-9%) and Consumer Discretionary (-9%) sectors giving way as global economic data releases revealed more

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 shown after all fees and charges, 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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bad news. Consequently the better performing sectors comprised; Healthcare (6%) Telecommunications (0%) and Consumer Staples (-1%), which continue to dominate the Fund's equity investments.

At the risk of sounding repetitious, the RBA cut the cash rate again in early February by yet another 100 basis points. This takes its total easing to 400bps in 5 months. This drastic reduction in the base reference rate for the Australian economy has been mirrored around the globe as Reserve Banks seek to re-inflate their economies en masse. However, given the massive scale of the deleveraging occurring at both the consumer and corporate levels (and its negative impact on the velocity of money), the monetary authorities may soon run out of ammunition as global interest rates head down to low single digits.

These cuts are having three important implications for the investment environment. Firstly the previously 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 corporate debt being charged by banks. Thirdly, the rhetoric accompanying these cuts indicate that monetary authorities are extremely focussed (almost to the exclusion of other issues) on avoiding widespread deflation.

While unemployment continues to rise sharply in the US and UK economies, domestic job losses remain subdued. Furthermore, the sharply lower interest rates, new home owners grants and the December Federal stimulus package have provided some early respite to some consumers and corporates. However, the relentless bad news from Australia's trading partners, global financial companies and wholesale funding sources continues to weigh heavily on confidence levels as the real economy responds to the global credit gridlock.

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. The major fiscal and monetary authorities have yet to provide a realistic solution to the global financial crisis in spite of the substantial stimulus packages being rammed through their legislative bodies. Investors are being forced to recognise that the 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.

At a more micro level, 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.

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. Interestingly phase two started aggressively as many of the top 20 (by market cap) Australian companies raised equity through deeply discounted placements. Investors were able to access quality companies with much improved balance sheets at significant discounted share prices by stumping up over \$34 billion during the last 6 months. The Fund was an active participant of these placements.

Value is emerging in a number of industrial and financial companies with; 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.

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 39% of its NTA in Cash and increasingly vigilant for attractive investment opportunities.

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