

Pengana Emerging Companies Fund January 2009 Update



Australian Equities - Small Caps

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Fund Performance

Net performance for periods ending 31 January 2009 ¹							
	1 month	3 months	6 months	1 year	2 years p.a.	3 years p.a.	Since inception p.a. ²
Pengana Emerging Companies Fund	-1.9%	-14.2%	-31.3%	-44.8%	-24.2%	-2.3%	+5.5%
S&P/ASX Small Industrials Acc Index ³	-5.3%	-13.0%	-36.0%	-46.7%	-31.6%	-15.2%	-7.1%
Outperformance	+3.4%	-1.2%	+4.7%	+1.9%	+7.4%	+12.9%	+12.7%
S&P/ASX Small Ordinaries Acc Index	-4.7%	-10.2%	-41.5%	-47.9%	-28.4%	-12.2%	-3.6%
Outperformance	+2.8%	-3.9%	+10.2%	+3.1%	+4.2%	+10.0%	+9.2%

Fund Commentary

Volatility remains high on global equity markets as we enter a very important interim reporting season. The key issue facing investors remains the trade-off between the ongoing poor macro news flow and increasingly attractive equity valuations. **History shows that the best time to invest is when markets and expectations are at their most bearish.**

The market fell around 5% in January which we outperformed by 3%. Whilst it continues to be disappointing to report negative absolute performance numbers we are encouraged that our early defensive action taken last year has sheltered unit holders from some of the market's pain over the last 6 months. **\$10,000 invested in the fund at inception, and assuming reinvest of distributions, would now be worth \$12,630 (up 26%). This compares with a \$10,000 investment in the Small Industrials Accumulation Index now being worth \$7,360 (down 26%).**

Key stock price moves

Key successes included Duet Group up 23%, Webjet up 10%, Transfield Services up 7%, and Slater & Gordon up 6%. Key detractors were ASG Group down 23%, WHK Group down 8% and Navitas down 8%.

Market Commentary and Outlook

Our portfolio remains defensively positioned given the earnings pressure and risks surrounding highly geared stocks. The near term outlook remains murky despite tentative improvement in global credit markets since November offset by a deterioration in global macro economic news flow through January. Yet through all the gloom continually spoken and written about with such emotion on TV and in the newspapers there are many strong positives for patient investors prepared to look beyond the latest daily headlines:

- industrial company share prices are trading on valuations that are cheap on almost any measure;
- some cost pressures are beginning to ease for business – including energy, steel, wages and interest rates.
- interest rates have been cut aggressively with the government policy stance now very accommodative; and
- the emergence of global policy responses in the form of numerous stimulus packages to kick start economies;

We await the approaching reporting season with much anticipation as it could lead to the final step down in earnings expectations for 2009 and 2010 as analysts extrapolate current poor trading into 2010 forecasts.

Through the reporting season we expect:

- reasonable results for the six months to 31 December but sobering commentary on the slow end to 2008 and sluggish beginning to 2009;
- commentary from companies on their strategies to manage the lower \$A. Remembering the average level of the \$A over the six months to 31 December was still high at US\$0.83 compared with US\$0.65 currently;

¹ Net performance figures are derived from Manager's records and are shown after all fees, and assume reinvestment of income. Past performance is not a reliable indicator of future performance.

² Since November 2004

³ The fund does not invest in resource stocks.

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- the degree to which falling official interest rates are offset by higher margins demanded by lenders;
- dividend payout ratios to be pared back as a precautionary measure in uncertain times;
- asset write downs as auditors require companies to reassess the carrying value of impaired assets; and
- companies having to recapitalise their balance sheets through either asset sales, or more likely, deeply discounted equity raisings.

As we have seen from companies which have announced results in the last two weeks the market is proving very unforgiving of poor results even where poor results were expected (Boral was down 16% on the day and Incitec Pivot down 30%). Accordingly we are very wary of investing in companies that are likely to be experiencing rapidly falling earnings until we see some clarity in the underlying earnings picture for these companies.

In terms of the composition of our portfolio we remain defensively positioned for the time being as we are cautious in the near term on stocks exposed to the Australian economy with plenty of uncertainty still surrounding the timing and degree of improvement in activity and the eventual flow through to earnings. For now the companies we own generally have little debt, excellent management that have proven their abilities through both good economic times and bad and offer compelling valuation upside.

Experienced investors are now selectively buying shares in companies with valuations which have been excessively discounted as there is no doubt that the market will find its feet at some stage. The difficulty, and thus the opportunity as a stock picker, is to identify those companies that will flourish when economic conditions improve (i.e. cyclical influences) from those with inferior businesses and/or excessive debt that will require recapitalisation and/or turnaround (i.e. structural influences).

Top 10 Positions (in alphabetical order)				
Austar	CSG Group	Metcash	Sonic Healthcare	Tox Free Solutions
Austbrokers Holdings	McMillan Shakespeare	Resmed	The Reject Shop	Transfield

Fund Description

The Pengana Emerging Companies Fund combines the skills of highly experienced small company investors (collectively 30 years experience) with a limited fund size to provide above market returns over the medium term. Our benchmark is the S&P/ASX Small Ordinaries Accumulation Index. The fund managers Steve Black and Ed Prendergast are part owners of the business and investors in the fund, providing a strong incentive to perform. The Fund has strong research ratings from all major research houses and over the period since its inception has delivered returns well above benchmark.

Fund Features

Style	Bottom up stock picker	Management Fees	1.3325%
Benchmark	S&P/ASX Small Ordinaries Accumulation Index	Performance Fees	20.5% of the performance above the Benchmark
Investors	Open	Fund Raising	Maximum of 0.5% of the Benchmark capitalisation
Minimum Initial Investment Amount	A\$25,000 (direct)	FUM at Month End	A\$ 186m
Inception Date	1 November 2004	Application Price at Month End	A\$ 1.053
Identification Code(s)	APIR PER0270AU ARSN 111 894 510	Redemption Price at Month End	A\$ 1.047

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