

Pengana Australian Equities Core Fund

March 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\$5.0m |
| Identification Code(s) | None | Application/Redemption Price at Month End | Application :A\$0.9337 Redemption:A\$0.9291 |

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% | -1.4% | 7.9% | - | - | - | -6.9% |

The Fund generated a very satisfactory return of 7.9% during March as the Australian All Ordinaries bounced back 8.1% from its lows. As at 31st March 2009, cash made up 32% of the Fund's NTA which, while lower than the 44% at the end of February still reflects a cautious approach to the volatile market. This month's performance by the Fund is particularly pleasing given the sub-70% level of equity investments.

For the three Months ended 31st March 2009, the Fund has generated a positive return of 6.6% against the RBA cash rate of 0.9% and a negative return of -1.7% by the Australian All Ordinaries.

The Fund continued to benefit from deep discount placements, participating in the AXA and ESG raisings. Both of these were subsequently sold at healthy premiums. After benefiting from selling its defensive holdings at or near their highs in January and February, the Fund was very active in re-establishing its exposure to quality defensive companies at attractive levels following their sharp sell off. Consequently the Fund re-established significant holdings in Resmed and Sonic Healthcare and added to existing holdings in Telstra, Woolworths and Transfield Services. New holdings were established in ANZ Bank, Century Australia and Lihir Gold. The Fund disposed of its holdings in CBA and BHP while reducing its exposure to Computershare.

As at 31st March 2009 the top five holdings by value in the Fund were: Telstra, Resmed, Macquarie Communications, CSL and Metcash. The Fund's top performing holdings for the month were: Macquarie Communications, Computershare, NAB, Westpac, and CBA while its exposures to Telstra, CSL and IAG were the major detractors.

Net Returns to 31st March 2009 ³

| | Pengana | Cash Rate | All Ordinaries |
|-------------------------------------|---------|-----------|----------------|
| 1 Month | 7.9% | 0.3% | 8.1% |
| 3 Months | 6.6% | 0.9% | -1.7% |
| 6 Months | -4.6% | 2.2% | -21.5% |
| Since Inception ⁴ | -6.9% | 3.9% | -30.9% |

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 expenses, 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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Market Commentary

Market Review

The very strong rebound in equity markets was led by the more cyclical sectors including the Information Technology (+21%), Industrials (+15%), Financials (+14%) and Consumer Discretionary (+14%) sectors. The rotation from the more defensive sectors as investors hunted aggressively for companies leveraged to a rebound saw weakness in Healthcare (-7%), Telecommunications (-5%) and Consumer Staples (-1%).

Although global stock markets have bounced by over 20% off their lows, it is my view that nothing material has changed with regard to the outlook on the real economy. While financial markets traditionally anticipate a recovery by 6-12 months two significant hurdles exist for the Australian market. Firstly the domestic economic cycle is following the US cycle with a lag of approximately a year, indicating that even if investors are correct about a bottom in the US it is premature to apply this to Australia for at least another 9 months. Furthermore, the current global stimulus while necessary comes at a price. If successful, both interest rates and tax rates will need to be lifted, the former to counter the massive increase in money supply while the latter is to attempt to pay for the largesse of the stimulus programs.

The recent RBA cuts to its official cash rate of 425bps in 7 months have provided significant relief to the holders of residential mortgages. The combination of government handouts, lower petrol prices and significant retail discounting have led to improve household disposable income. However, the increasing uncertainty surrounding job security and falling asset prices continues to weigh heavily on consumer sentiment resulting in drastic changes to consumer behaviour. In short, the average consumer is limiting spending to mainly non-discretionary items.

At the corporate level, the interest rate cuts have provided relief from the ever widening credit spreads (the additional impost over and above the RBA cash rate that banks charge their customers for the privilege of borrowing money). However, caught between the lack of availability of credit and declining revenues, company management are being forced into wholesale dividend cuts and equity raisings. Cuts to capital expenditure plans and payrolls have become common management agenda topics.

The extent of deleveraging occurring at both the consumer and corporate levels (and its negative impact on the velocity of money), is forcing monetary authorities (both domestically and internationally) to announce ever increasing "stimulus packages" in the hope of improving confidence levels and counterbalancing the sharp decline in spending from the private sector. However, both political and logistical obstacles are likely to delay the impact of these programs, creating a period where the effects of deleveraging will have serious consequences for companies and individuals with low margins of safety.

Unemployment levels continue to rise sharply in the US and other economies. Domestic indications for job losses are getting significantly worse. Furthermore, the relentless bad news ("trumpeted by every daily newspaper") 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.

In reality, 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. Fighting fire with fire has become a relevant truism as the excesses of cheap money and reckless leverage is being addressed by additional government leverage. The short period of relative stability has triggered a surprisingly sharp rally in financial markets. However I remain convinced that Investors will be 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. In short, new business has much better margins for the Banks but may not make up for the legacy business written during more optimistic times.

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

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significantly 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. How quickly things have changed. While only last month I cautioned on the "defensives" as they had become "crowded trades", the rapid rotation into higher "beta" stocks saw the selected pricing fall back significantly and creating attractive opportunities. The Fund has been active participant in buying back its holdings in these stocks at very attractive levels.

The Fund remains conservatively invested with cash levels of 30%. However, we remain increasingly vigilant for attractive investment opportunities as the investors oscillate between the fear of capital losses and the fear of missing out.

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