

Pengana Emerging Companies Fund

Small Cap Stocks in a Market Recovery



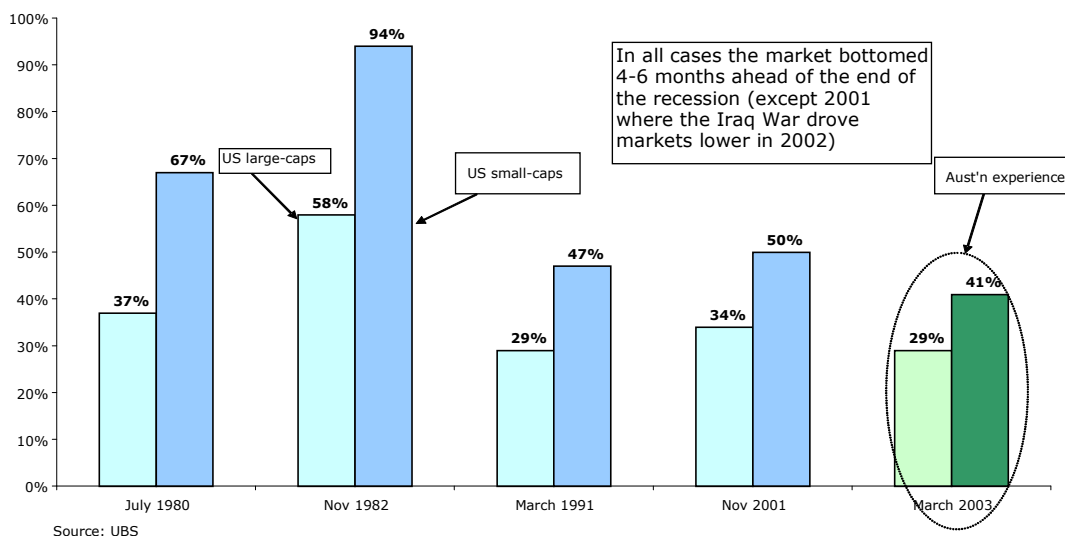
1 of 2

Small Cap Stocks in a Market Recovery

While it is premature to call the bottom in markets, a key consideration for investors is how do Small Cap stocks perform into a recovery. Many simply assume that Small Caps would recover after the broader market as investors regain confidence, however history shows the opposite to be true. **On the available data, while Small Caps have historically had greater falls than the broader market leading into recessions, they have also outperformed the broader market during the recovery phase**¹. This is because riskier assets tend to be sold down further in a down market, and recover faster than more defensive assets once investors look through the malaise into a potential economic recovery.

The chart below shows the performance of the US stock market in the last four recessions, plus the performance of the Australian market following the market lows reached in early 2003 during the Iraq war. In each case for the US market, the chart represents the 12 month performance from the market low, with large caps measured by the S&P 500, and Small Caps measured by the Russell 2000 index.

Chart One – Bear Market Bounces¹



Key observations include:

- 1) in all cases small caps strongly outperformed large caps in the recovery following a recession¹,
- 2) in all cases bar one in the US, the market bottomed 4-6 months before the recession ended (excluding the 2001 recession where markets were driven down further by geopolitical uncertainty and the impending Iraq War)¹, and
- 3) although the historical market data for Australia is not available as far back, the performance from the most recent bear market low made in March 2003 (Iraq War), shows a similar level of outperformance by Small Caps¹.

Obviously the current economic situation is worse than during the recessions referred to above, but markets have also fallen further to reflect this. Given the uncertainty surrounding the US banking industry, credit markets, and the depth of the recession, predicting the market low is more difficult than ever. **But the key message is that the market low is likely to be made during the recession, not after it.** In our view, unemployment is a lagging indicator of the health of the economy, and is the one measure which receives the most media attention. In other words, the markets are likely to bottom and begin recovering even though the headlines show the economy (i.e. unemployment) is getting worse. While this may seem counter-intuitive, it is because markets are forward looking and rallies are driven by the confidence of an economic improvement in the future.

¹ Past performance is not a reliable indicator of future performance.

Pengana Emerging Companies Fund

Small Cap Stocks in a Market Recovery



2 of 2

Fund Description

The Pengana Emerging Companies Fund combines the skills of highly experienced small company investors (collectively 30 years experience) and a limited fund size with an objective of providing 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 ².

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\$ 174m
Inception Date	1 November 2004	Application Price at Month End	A\$ 1.035
Identification Code(s)	APIR PER0270AU ARSN 111 894 510	Redemption Price at Month End	A\$ 1.029

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

Advisors & Retail Clients: Justin Brooks, +61 3 8663 7906, justin.brooks@pengana.com

² Past performance is not a reliable indicator of future performance.

Pengana Capital Ltd (ABN 30 103 800 568, Australian financial services license number 226566) is the issuer of units in the Pengana Emerging Companies Fund (the "Fund"). A product disclosure statement for the Fund is available and can be obtained from our distribution team. A person should obtain a copy of the product disclosure statement and should consider the product disclosure statement carefully before deciding whether to acquire, or to continue to hold, or making any other decision in respect of, the units in the Fund. This report was prepared by Pengana Capital Ltd and does not contain any investment recommendation or investment advice. This report has been prepared without taking account of any person's objectives, financial situation or needs. Therefore, before acting on any information contained within this report a person should consider the appropriateness of the information, having regard to their objectives, financial situation and needs. Neither Pengana Capital Ltd nor its related entities, directors or officers guarantees the performance of, or the repayment of capital or income invested in, the Fund. An investment in the fund is subject to investment risk including possible delays in repayment and loss of income and principal invested. Past performance is not a reliable indicator of future performance.