Pengana Emerging Companies Fund
March 2009 Quarterly Review

Money Management | LONSEC FUND MANAGER OF THE YEAR 2008 WINNER Australian Equities – Small Cap

FUND AWARDS 2007 AUSTRALIA WINNER STANDARD & POOR'S

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PENGANA CAPITAL

Australian Equities - Small Caps

Fund Performance

Net performance for periods ending 31 March 2009 [1]

	3 months	6 months	1 year	2 years p.a.	3 years p.a.	Since inception p.a.[2]
Pengana Emerging Companies Fund	-0.2%	-29.8%	-36.4%	-26.0%	-5.4%	+5.7%
S&P/ASX Small Industrials Acc Index [3]	-7.3%	-32.9%	-44.3%	-33.4%	-18.1%	-7.2%
Outperformance	**+7.1%**	**+3.1%**	**+7.9%**	**+7.4%**	**+12.6%**	**+12.9%**
S&P/ASX Small Ordinaries Acc Index	-2.0%	-30.6%	-45.8%	-29.2%	-13.8%	-2.8%
Outperformance	**+1.7%**	**+0.8%**	**+9.3%**	**+3.2%**	**+8.4%**	**+8.5%**

Fund Commentary

Whilst global equity markets remained volatile over the quarter, March exhibited renewed life with the All Ords rallying 8.1%, the largest one month rise since December 1993. Interestingly the Small Ordinaries index outperformed the broader market rising 10.2% in March, and this outperformance has continued into April. It is too early to be totally confident that markets are set for a sustained recovery, however there are certainly reasons to be more confident than in the past year. If market continue to recover, history shows that smallcaps are likely to outperform large caps as investors re-embrace riskier assets.

Over the quarter our fund fell by 0.2% versus falls of 7.3% and 2.0% in the Small Industrials and Small Ordinaries indices, respectively.

From its low point on March 10th the smallcap sector rallied 18% by the end of March, with further gains into April. While this recovery is spectacular we caution that many of the best performing stocks are firmly in the lower quality bracket. Many stocks with serious balance sheet issues and/or unpredictable earnings streams have bounced very hard following 90%+ falls. So while our fund has certainly enjoyed some of the recent strength, our aversion to speculative stocks has seen us miss some of this "junk rally". Chasing low quality stocks which can bounce spectacularly from lows is a dangerous game. Investors should remember that ABC Learning rose by over 90% in three days in June 2008, only to go broke less than 2 months later.

The global and economic picture is certainly not showing firm signs of recovery, however there are some signs that the rate of decline is slowing. From here the key factors will be the effectiveness of government responses at cushioning the downside, the extent to which China is able to reignite, and the stability of the banking system. History shows that equity markets are likely to move well ahead of a recovery in the economy, hence waiting for firm evidence of a recovery is often too late. Defensive stocks are likely to lag a recovery, hence in recent months we have been selectively buying some cyclical stocks with solid balance sheets and proven management that we believe had been over sold.

In the meantime the opportunities for stockpickers in the smallcap market are highly prospective. The bear market has seen many investors abandon the sector leaving a relatively uncrowded market, which is ideal for those prepared to do the work. Valuations appear universally cheap and we are not short of high quality growth stocks which can navigate rougher economic times. Our disciplined approach has now led to strong outperformance in both rising and now falling markets.

Portfolio activity

As we have commented on many occasions previously we remain very wary of cyclical companies exposed to the dramatic slowdown of the Australian economy. These stocks have been amongst the worst performers of the past 12 months. More recently we have been selectively buying some of these heavily sold down stocks where we found after stress testing our models under the most negative recessionary conditions we could still arrive at a valuation materially above the prevailing share price. This led to the purchase of mining service companies **Campbell Brothers, NRW** and **Bradken**, retailers **Billabong, David Jones** and **Premier Investments** (owner of Just Jeans), media companies **APN** and **Mitchell Communications** and financial services stock

[1] All performance figures are calculated net of fees and assume reinvestment of income distributions. Past performance is not a reliable indicator of future performance.

[2] Since November 2004

[3] The fund does not invest in resource stocks.

Australian Wealth Management. NRW was sold 3 weeks after purchase in March after the share price rose 50% and thus breaching our valuation. Strong share price performances from defensive stocks **Austbrokers, Navitas, Dominos, Metcash** and **Ramsey Healthcare** led us to trim our weightings in these stocks.

The sudden rise in equity markets over the last month reminds us of the dangers of attempting to time markets. Philosophically we will always attempt to keep cash balances in the fund to a minimum, ideally around the 5% level.

Market Commentary

Market backdrop

Whilst the economic backdrop remains weak, globally economic data has generally been better than expected over recent weeks. This has seen a change in the risk appetite of investors towards the higher risk, generally more economically sensitive companies. Conversely companies that run more defensive businesses have seen their share prices lag as money has been switched into higher risk shares. Higher commodity prices over the quarter have assisted the performance of mining companies with the Small Resources Index rising 12.4% versus the Small Industrials Index's fall of 7.3%.

Key stock moves during the quarter

Key successes in the portfolio during the period included **McMillian Shakespeare** (up 54%), **Tox Free Holdings** (34%), **Mineral Resources** (30%), **Webjet** (27%) and **Transfield Services** (15%). Key detractors were **Sonic Healthcare** (down 23%), **DKN** (28%).

Strong gains in **McMillian Shakespeare** and **Webjet** were enjoyed after both companies delivered profit results that were above market expectation. The resilience of these companies' earnings is testament to the quality of their businesses. **Tox free** rallied on the back of winning a waste treatment contract with Woodside and is in a good competitive position to win recently tendered contracts with Rio Tinto and others following competitor Transpacific's woes. **Mineral Resources** and **Transfield Services** were positively rerated over the period following encouraging profit results and after being oversold.

Pathology operator **Sonic Healthcare** suffered a sharp fall in its share price as investors switched from defensive healthcare stocks to fund their purchases of more economically sensitive stocks as their risk appetite improved over the later part of the quarter and over concerns surrounding the potential for the Federal government to cut pathology payments to the industry. On this later point we are not overly concerned with a pathology funding cut in Australia as the industry is likely to use any cut as an excuse to impose co-payments to medicare reimbursed pathology tests.

Outlook

Overall comment

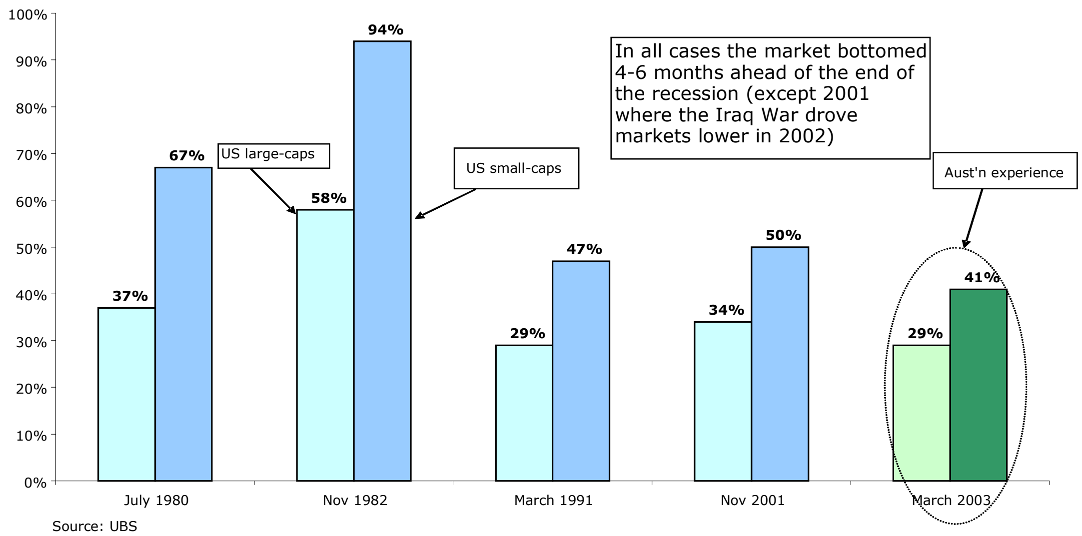
There is no doubt that the global economy has experienced one of its largest jolts in history yet as with every other economic meltdown, recovery will inevitably follow. The only real uncertainty is the speed and shape of the recovery, a question that we don't believe can be accurately answered right now. Accordingly we remind investors to remain disciplined with their long term investment principals and not be spooked by the shorter term volatility.

The recent spectacular rally in global equities is due to emerging confidence that the US banking sector has seen its worst, a dramatic drop in volatility, and comments by the US Fed that an economic recovery can be expected in late 2009. This sounds promising, but the events of the past year mean that uncertainty will not go away quickly, and that there is just as likely to be false starts in this recovery. We do not take a firm view either way, but are highly aware of the risks and have invested accordingly.

Importantly if the market does continue to strengthen based on a slightly improved economic outlook, smallcap stocks might reasonably be expected to outperform the broader market based on historical data. In previous US recessions Small Caps have historically had greater falls than the broader market leading into recessions, but have outperformed the broader market during the recovery phase.

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 Bounces[1]



Source: UBS

Key observations include:

1) in all cases small caps strongly outperformed large caps in the recovery following a recession [4],

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) [4], 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 Caps [4].

Obviously the current economic situation is worse than during the recessions referred to above, but markets have also fallen further to reflect this. **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.

How are we positioned?

While our portfolio remains conservatively positioned, we have certainly added some cyclical stocks at the margin in recent months. We remain totally averse to companies with serious balance sheet issues, however, have found many heavily sold down stocks where the current share price is implying apocalyptic earnings outcomes, and that such stocks are potentially worth 2-3 times the current price if a "mid-case" earnings outcome eventuates. In other words, share prices in such oversold stocks can still perform very well even if earnings fall.

The majority of our portfolio remains in high quality growth stocks which have a low reliance on the overall economy and very healthy balance sheets. In recent weeks some of our "favourites" such as MacMillan Shakespeare, Slater and Gordon, Probiotec, Toxfree Holdings, and CSG Group, have finally attracted investor attention after showing strong earnings growth. Many of these stocks are overlooked in volatile markets but recent trading suggests that our patience is paying off.

The companies we own provide a strong flow of dividends to our unit holders. Currently the dividend yield of the companies we own is around 6.0%, mostly fully franked.

Our diversified fundamental stock selection approach is suited to all markets

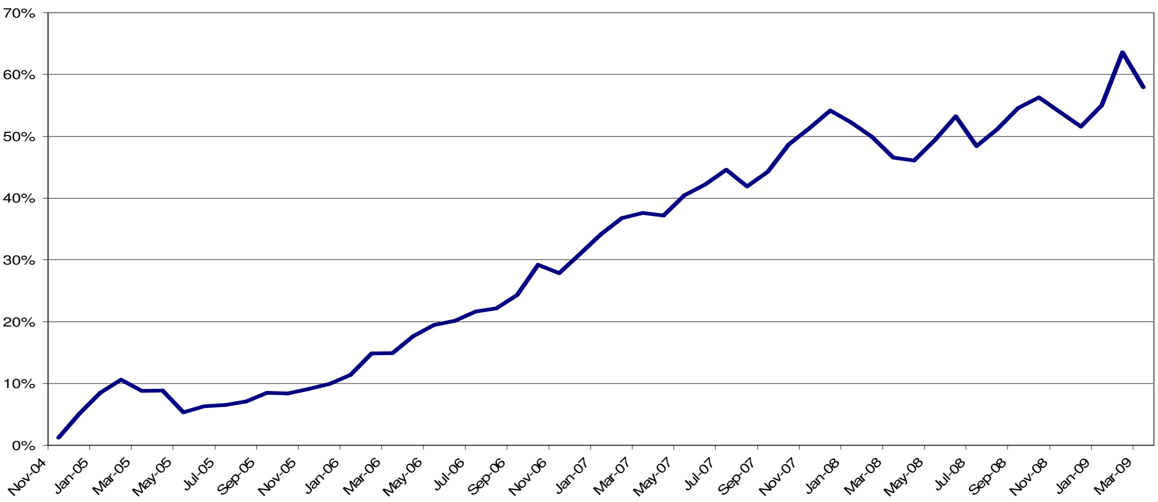
Our conservative approach has so far delivered excess returns in good and bad markets, as shown in the chart below. Given the spectacular bounce in some stocks of late it would be easy to be seduced by seemingly cheap stocks by ignoring risks. This is a very dangerous game. A disciplined approach is critical.

[4] Past performance is not a reliable indicator of future performance.

We believe investors with a medium term view will be rewarded by our process and risk controls which are based on the following:

1. Management contact is critical – we visit roughly 7 companies per week,
2. Cash is king – we value companies on their cashflow rather than profits which can be distorted,
3. We don't invest in resource companies – valuations are too susceptible to small changes in commodity prices,
4. No loss making companies – without an earnings track record, meaningful valuations are impossible to derive,
5. Avoid highly geared stocks – equity holders carry all the risk,
6. Sell mistakes quickly – no room for emotion when investing,
7. Our fund size is limited – this is critical to remain nimble and an active stock picker,
8. Diversification - by stock and sector alleviates specific risk factors.

Cumulative Excess Return vs Small Industrials Index



Source: Pengana

Company Visits

Our central belief is that contact with management is the key to unlocking value within the smallcap sector, hence during the quarter we made **face-to-face contact with 65 companies** and unlisted competitors of listed stocks. The table below shows the listed companies with which we had direct contact during the period.

Amcom	Cardno	Greencap	Primary Healthcare	Snowball
APA Goup	Challenger Infrast	Healthscope	Probiotec	Sonic Healhcare
ASG Group	Coca-Cola	IINet	Program Maintenance	The Mac Services
Austar	Cochlear	Iress	Ramsey Healthcare	The Reject Shop
Austereo	Colorpak	Jetset	Reckon	Thinksmart
Australand Property	Coventry	MacMillian Shakespeare	Redflex	Toxfree
Australian Infrastructure	Crane Group	Macquarie Communicati	Ridley	Transfield Services
Australian Wealth Mgt	CSG	Macquarie Leisure	Saferoads	Transfield Services Infra
AV Jennings	DKN	Mineral Resources	SAI	Treasury Group
Babcock and Brown Wind	Domino	Mitchell Communications	Salmat	Webjet
Blackmores	Duet	Navitas	Seek	Wellcome
Boral	Emeco	Peet & Co	Sky TV NZ	WHK Group
Bradken	Fletcher Building	Premier Investments	Slater & Gordon	Wotif

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Fund Description

The Pengana Emerging Companies Fund seeks to combine the skills of highly experienced small company investors (30 years experience between the two fund managers) 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** [5]	1.3325%
Benchmark	S&P/ASX Small Ordinaries Accumulation Index	**Performance Fees** [5]	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**	$178m
Inception Date	1 November 2004	**Application Price at Month End**	A$ 1.0711
Identification Code(s)	APIR PER0270AU ARSN 111 894 510	**Redemption Price at Month End**	A$ 1.0647

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[5] All percentages are on a GST inclusive basis less applicable reduced input tax credits. Please refer to the Product Disclosure Statement for a more detailed explanation.