Pengana Emerging Companies Fund
April 2009 Update

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

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Australian Equities - Small Caps

Best Smaller Companies Fund Money Magazine Winner 2009 Best of the Best 2009

PENGANA CAPITAL

Fund Performance

Net performance for periods ending 30 April 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	9.1%	11.0%	-4.8%	-31.9%	-24.1%	-3.4%	+7.7%
S&P/ASX Small Industrials Acc Index [3]	13.7%	11.3%	-3.1%	-38.2%	-30.4%	-14.4%	-4.3%
Outperformance	**-4.6%**	**-0.4%**	**-1.7%**	**+6.3%**	**+6.3%**	**+11.0%**	**+12.0%**
S&P/ASX Small Ordinaries Acc Index	13.5%	16.7%	4.8%	-40.5%	-26.4%	-10.4%	0.1%
Outperformance	**-4.4%**	**-5.7%**	**-9.5%**	**+8.6%**	**+2.3%**	**+7.0%**	**+7.6%**

Fund Commentary

The fund returned 9.1% in April as markets showed a strong rebound globally. Following the extremely bearish start to 2009, recent data show that the rate of economic collapse may be abating. There is no doubt there will be a global downturn, but investors are now slightly more confident that an end is in sight, and that the depth of the downturn may not be as bad as first feared.

It is too early to form a strong view on whether this is a bear market rally, or the start of a meaningful recovery given the uncertainty surrounding the depth of economic damage. History shows however, that share markets can rise strongly during periods where economic growth remains negative and earnings forecasts continue to fall.

Smallcaps have typically outperformed larger stocks into a recovery, which has certainly been the case of late. The All Ords has bounced 21% from the lows in early March, with the Small Ordinaries rising by 34%. Within the smallcap sector, the best performance came from the highest risk and in many cases lowest quality stocks. We remain highly disciplined in managing risk, hence while our fund has enjoyed the recent bounce in markets, our reluctance to buy speculative stocks has seen us miss some of the more spectacular short term performance.

Our fund currently has a healthy mix of high quality growth stocks which are not heavily reliant on the state of the economy, and some stocks which are more sensitive to the economy. Our valuation work suggests that the latter are currently priced for apocalyptic earnings outcomes and hence show major upside if the outcome is "less bad" than expected.

Following last years' disasters many investors have exited the smallcap market resulting in a less crowded environment for stock pickers such as us. Therefore, even if markets do not fully recover in the short term, the rewards for disciplined stocks pickers could prove handsome given the lack of focus the sector is currently attracting.

Key stock price moves

Key successes during the month included Bradken (up 93%), Thinksmart (50%), CSV Group (35%), Mineral Resources (24%), Billabong (24%), and Transfield Services (22%). Key detractors were Ramsay Healthcare (down 6%), Healthscope (6%), MacMillan Shakespeare (5%) and Webjet (4%).

[1] Net performance figures are derived from Manager's records and are shown after all fees and expenses, and assume reinvestment of income. Past performance is not a reliable indicator of future performance. The value of investments can go up and down.

[2] Since November 2004

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

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Market Commentary and Outlook

The speed and extent of the recent market bounce has taken most by surprise, given just how bearish the world felt in early March. With markets up 20%+ from those lows, and the world economy still facing major challenges, it would be easy to dismiss this rally as a classic bear market rally, only to be followed by further weakness as the economic challenges come to fruition. However if the recent signs of an abatement in the rate of decline in the economic outlook prove correct, markets will continue to gain confidence that the worst is behind us, and potentially rally much further.

The outlook hinges squarely on the condition of the banking system and the timing and extent of economic recovery, especially in the US and China. It is too early to have a firm view on these large imponderables, hence building an investment strategy about a definitive conclusion right now is too risky.

First we should summarise the reasons the markets have taken some comfort that the worst may be behind us:

- Ben Bernanke's comments on March 15th regarding "green shoots" emerging of an economic recovery,
- volatility has subsided with the VIX index falling from over 80 to below 40,
- leading indicators such as the ISM index (which measures non-manufacturing activity in the US) showing a potential recovery,
- signs that the US banking sector is profitable, and potentially not in need of further rescue capital,
- a major correction in credit spreads, showing renewed confidence in the lending system,
- Govt stimulus measures (esp. US) increased dramatically, and resembling a "kitchen sink" approach, and
- indications that Chinese stimulus is having a direct impact on demand, driving commodity prices higher.

On balance we believe it would be risky to simply dismiss these factors as a false start. Valuations in many cases are still suggesting that anything other than the worst possible economic outcome leaves room for share prices to move much higher notwithstanding the impending earnings pressure. In many instances recently, stock prices have not fallen dramatically despite earnings downgrades, because the expectation of such an outcome was already priced in.

In the Australian smallcap sector, some of the best performers of late have been highly risky, almost speculative situations. Some stocks which looked like a 90% chance of going broke in March, are now a 70% chance of going broke, with the perceived change resulting in a 2-3 fold increase in share price. This might look exciting, but is way too risky for our fund. Remember Babcock and Brown rose from 68c to $3.00 in six trading days in September 2008, only to be delisted worthless three months later.

As we mentioned in our March quarterly update, we recognised the potential for oversold stocks with reasonable balance sheets which were priced for shocking earnings declines to bounce hard if the economic picture stabilised somewhat. Such stocks have served us well of late, and in some cases well exceeded our expectations (for example Bradken which rose 93% in April). We remain invested in a range of stocks with these characteristics, however they form a relatively small part of our portfolio.

Standing back from the larger economic issues, we firmly believe the environment for disciplined stock pickers with a medium term focus has never been better. The collapse in prices has scarred many investors who have sworn off the sector for some time. This leaves a relatively uncrowded space for those remaining, hence our ability to find mis-priced stocks where others aren't looking is heightened.

Top 10 Positions (in alphabetical order)	
Austbrokers Holdings	Sonic Healthcare
Austar	Slater & Gordon
CSG Group	Tox Free Solutions
McMillan Shakespeare	Transfield Services
Resmed	WHK Group

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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$25,000 (direct)	**FUM at Month End**	A$ 196m
Inception Date	1 November 2004	**Application Price at Month End**	A$ 1.169
Identification Code(s)	APIR PER0270AU ARSN 111 894 510	**Redemption Price at Month End**	A$ 1.162

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