

# Pengana Australian Equities Core Fund

## April 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%<sup>1</sup> 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

<b>Style</b>	Fundamental	<b>Management Fees<sup>2</sup> (monthly)</b>	1.00% p.a. of NAV
<b>Benchmark</b>	The weighted average of the target Australian Cash Rate used by the RBA	<b>Performance Fees<sup>2</sup> (quarterly)</b>	10% of increase in net asset value subject to the Australian Cash Rate and High Water Mark
<b>Investors</b>	Wholesale Clients only	<b>Minimum Initial Investment</b>	A\$100,000
<b>Inception Date</b>	30 June 2008	<b>AUM at Month End</b>	A\$5.4m
<b>Identification Code(s)</b>	None	<b>Application/Redemption Price at Month End</b>	Application: A\$0.9748 Redemption: A\$0.9700

### Fund Commentary

#### Fund Performance (A\$, net of fees)<sup>3</sup>

	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%	4.4%	-	-	<b>-2.8%</b>

The Fund generated a satisfactory return of 4.4% during April as the Australian All Ordinaries extended its sharp rally with a return of 6.1% over the month. As at 30 April 2009, cash made up 37% of the Fund's NTA, highlighting a cautious approach to a volatile market. This month's performance by the Fund is particularly pleasing given the sub-70% level of equity investments.

**For the six Months ended 30 April 2009, the Fund has generated a positive return of 9.6% against the RBA cash rate of 1.9% and the -3.3 of the Australian All Ordinaries.**

The Fund continued to benefit from deep discount placements, participating in the DUET, Seek and Onesteel raisings. Onesteel was subsequently sold at a very healthy premium. The Fund also continued the strategy of actively re-establishing its exposure to quality defensive companies at attractive levels following their sharp sell off. Consequently the Fund added to many of its existing holdings namely; Mermaid Marine, Telstra, Lihir Gold, Primary Healthcare, Metcash, Woolworths, IAG and Sino Gold. The Fund disposed of its holdings in ANZ, Tabcorp and Computershare while substantially reducing its holdings in Transfield Services.

The Fund has benefited from a currency hedge put in place to protect its investments in Resmed, CSL and Computershare – all companies that have substantial US\$ earnings. The hedge was put in place at the A\$/US\$ exchange rate of 63.11 during March due to concerns about an oversold A\$. It has been closed out at 76.82 in the middle of May realising a substantial gain (ironically in addition to strong performances by the A\$ share prices of RMD and Computershare).

#### Net Returns to 30 April 2009<sup>3</sup>

	Pengana	Cash Rate	All Ordinaries
<b>1 Month</b>	4.4%	0.3%	6.1%
<b>3 Months</b>	11.1%	0.8%	9.7%
<b>6 Months</b>	9.6%	1.9%	-3.3%
<b>Since Inception</b>	-2.8%	4.2%	-26.7%

As at 30 April 2009 the top five holdings by value in the Fund were: Telstra, Metcash, Resmed, Duet and IAG. The Fund's top performing holdings for the month were: Mitchell Communications, Transfield Services, Mermaid Marine, Downer Group and Telstra while its exposures to MCG, Lihir Gold, Primary Healthcare and CSL were the only negative detractors.

<sup>1</sup> 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.

<sup>2</sup> Plus GST and net of reduced input tax credits. Please refer to the information memorandum for a more detailed explanation.

<sup>3</sup> Total return performance figures are derived from Mangers' 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. Inception date: 30 June 2008.

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### Market Commentary

#### Market Review

The extended rally in equity markets saw all the ASX sectors recording healthy positive returns for April. The leaders included the Consumer Discretionary (+12%), Consumer Staples (+12%), Industrials (+8%) and Utilities (+7%) sectors. The Banks began the month with further strong gains, however the disclosure of a sharp deterioration in loan books by the Majors provided a sobering dose of reality. In spite of this the Financials Ex-Property sector closed up 4% for the month.

Global stock markets have now bounced almost 30% off their lows. Investors are interpreting improvements in the second derivative of bad news (the economy is still deteriorating BUT at slower rate) as "green shoots" and therefore good news. It remains my view that the outlook for global economies remains bleak. Importantly, given the near Armageddon base and the scale of the global fiscal and monetary attempts to revive, it would be thoroughly disheartening and mathematically unlikely to not see some form of recovery. Furthermore, it appears counterintuitive that merely transferring debt from the private to the public sector represents a sustainable solution to the financial crisis.

While financial markets traditionally anticipate a recovery in the real economy by 9-15 months, two significant hurdles exist for the Australian market. Firstly the domestic economic cycle has lagged the US by approximately a year, indicating that even if investors are correct about predicting the US recovery, it seems premature to apply this to Australia for at least another 9 months. Secondly, 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 required in the stimulus programs. This indicates a high probability of a W shaped recession.

Domestically, the substantially lower interest rate environment, lower petrol prices and the widespread use of discounting at the retail level has provided a significant counterbalance to the bleak outlook for the average consumer. Furthermore the two Government cash handouts appear to have found their way into discretionary retail spending, providing a robust albeit temporary boost to sales figures. However, the increasing uncertainty surrounding job security and falling asset prices continues to weigh heavily on consumer sentiment. All four major bank management teams made sober references to the retail bad debt cycle having only just begun.

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 deep discount capital raisings. The latter has accelerated as many companies have been waiting for a firmer price environment to execute the balance sheet reparations. (As an aside this is a major positive for the banks).

In reality, the "green shoot" indicators being reported globally have triggered a revival in investor risk appetite. "High beta" stocks with leverage to an economic recovery are back in demand, even though global governments have yet to provide a sustainable solution to the global financial crisis. Valuations both at a stock level and sector level have moved up sharply as investors rush to apply their large cash balances into equities. Unfortunately unemployment levels continue to rise both domestically and globally as the real economy grinds lower. As worst case scenarios recede, it appears the fear of missing out (FOMO) is once again triumphing over the fear of capital loss.

#### Investment Outlook

The fallout from the extended period of low interest rates, easy access to credit and mispricing of risk continues to work its way through the different phases. The sharp fall in almost every asset class attracted the coordinated global government response at the fiscal and monetary levels. The massive liquidity provided has allowed many companies to successfully recapitalise their balance sheets (and dilute existing shareholders). Value emerged across a range of sectors but the recent rerating of global markets by almost 30% from their lows has shifted the risk/reward equation away from fundamental investors in many instances

Ironically value is re-emerging in a number of defensive companies as investors desert those companies with; good management, dominant market shares, pricing power and balance sheet capacity for the more leveraged plays. The Fund remains focused on companies with low levels of exposure to the economic cycle (Consumer staples, Healthcare, Utilities), strong balance sheets and competent management. How quickly things have changed! While only 2 months ago I cautioned on the "defensives" as they had become "crowded trades", the rapid rotation into higher "beta" stocks has seen attractive opportunities being created. The Fund has been an active participant in buying back its holdings in these stocks at very attractive levels.

**The Fund remains conservatively invested with cash levels of 33%. However, we remain increasingly vigilant for attractive investment opportunities as investors oscillate between the fear of capital losses and the fear of missing out.**

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