Pengana Australian Equities Core Fund
May 2009 Update, by Rhett Kessler

Fund Description

The Pengana Australian Equities Core Fund aims to provide investors with an annualised return of 12 to 15% [1] 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

Application Price at Month End	A$0.9959	**Redemption Price at Month End**	A$0.9909
Style	Fundamental	**FUM at Month End**	A$5.7m
Investors	Wholesale Clients only	**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 increase in net asset value subject to the Australian Cash Rate and High Water Mark
Inception Date	30 June 2008	**Minimum Initial Investment**	A$100,000

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%	4.4%	2.2%	-	**-0.7%**

The Fund generated a satisfactory return of 2.2% during May as the Australian All Ordinaries continued higher with a return of 2.2% over the month. As at 31st May 2009, cash made up 28% 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 ~70% level of equity investments.

For the six months ended 31st May 2009, the Fund has generated a positive return of 18.1% against the RBA cash rate of 1.8% and the 6.5% return of the Australian All Ordinaries.

During May the Fund remained an active participant in the deep discount placements as companies took advantage of a buoyant equity market to bolster their balance sheets. These included Platinum Australia, Graincorp, ANZ Bank and Nufarm. The latter two holdings were subsequently sold at healthy premiums. 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 acquired positions in Westfield Holdings, Computershare and MFF while supplementing several of its existing holdings namely; Westpac Bank, CSL, Woolworths and Sonic Healthcare. The Fund disposed of its holdings in NAB, Transfield Services and Century Australia.

Net Returns to 31st May 2009 [3]

	Pengana Core Fund	Cash Rate	All Ordinaries
1 Month	**2.2%**	0.3%	2.2%
3 Months	**15.1%**	0.8%	17.1%
6 Months	**18.1%**	1.8%	6.5%
11 Months Since Inception	**-0.7%**	4.4%	-25.1%

As at 31st May 2009 the top five holdings by value in the Fund were: Telstra, Duet, Metcash, MCG, and IAG. The Fund's top performing holdings for the month were: Primary Healthcare, Sino Gold, Duet, Platinum Australia and Mermaid Marine while its exposures to CSL, Resmed, Telstra and Woolworths were the major detractors.

[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 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 a large diversion in performance from the ASX sectors with Materials (+7%), Energy (+6%) and REITs (+4%) all recording positive healthy returns during May. Interestingly the large negative returns came from the more defensive sectors with Telcos (-9%) Healthcare (-8%) Consumer Staples (-5%) and Utilities (-4%) all recording significant negative performances as investors charged back into the risk trade. It is particularly satisfying to report a return of 2.2% for this month given the fact that the Fund's portfolio is heavily skewed away from the Resources and Energy sectors with the majority of its holdings in companies making up the underperforming sectors.

Global stock markets have now bounced over 30% from their lows in early March. Readers of my April report will find that I have not made material changes to my review comments in this month's report, except perhaps to add that investors have taken on even more risk in anticipation of an unlikely global recovery. This momentum has been encouraged by the massive Chinese stimulus package and its short term impact on commodity demand into the region (while demand remains constrained in the rest of the world).

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.

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. In addition the two Government cash handouts appear to have found their way into discretionary retail spending, providing a robust albeit temporary boost to sales figures. These factors, in combination with the temporarily weak A$ (our economic shock absorber) and the tail end of the high priced commodity contracts resulted in a marginally positive GDP number for the March Quarter. 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 sobering 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).

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 3 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 re-created. In addition to the pricing attraction, the impact of economic Darwinism is also beginning to play out with the strong getting stronger as their weaker competitors fall by the wayside. The Fund has been an active participant in seeking out these opportunities.

The Fund remains conservatively invested with cash levels of 28%. 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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