

Pengana Australian Equities Core Fund

June 2009 Update, by Rhett Kessler



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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 (Cum Distrib)	A\$1.0322	Redemption Price at Month End (Cum Distrib)	A\$1.0272
Style	Fundamental	FUM at Month End	A\$6.9m
Benchmark	The weighted average of the target Australian Cash Rate used by the RBA	Management Fees² (monthly)	1.00% p.a. of NAV
Investors	Wholesale Clients only	Performance Fees² (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%	3.7%	3.0%

The Fund generated a satisfactory return of 3.7% during June as the Australian All Ordinaries extended its rally with a return of 3.9% over the month. As at 30th June, the effective cash position of the Fund's NTA was 42%, highlighting the cautious approach to a volatile market. This month's performance by the Fund is pleasing given the ~60% level of equity investments.

In addition the Fund passed a significant milestone celebrating its One Year Anniversary with a positive return of 3.0%. This return, while below the RBA cash rate for the year of 4.8% is particularly gratifying given the extremely difficult environment highlighted by the negative 22.1% return for the Australian All Ordinaries.

During June the Fund's strategy of building its holdings in quality defensive companies that had been deserted by investors searching for recovering cyclical paid off handsomely. The top 5 contributors to the month's performances were MCG, Downer EDI, Telstra and the two healthcare stocks - Resmed and CSL.

Several new holdings were added during the month including CBA, REA Group and a small position in NewsCorp. Significant additions to existing holdings included Graincorp, Duet and Westpac Banking Corporation. These purchases were funded by the sales of the Fund's holdings in ANZ Bank, Westfield, IAG, Seek and Mount Gibson Iron. Importantly the Fund also accepted a cash bid of \$3.00 per share from the Canadian Pension Fund for its large position in MCG.

As at 30th June 2009 the top five holdings by value in the Fund were: Telstra, Duet, Westpac, Metcash and CBA.

Net Returns to 30 June 2009³

	Pengana	Cash Rate	All Ordinaries
1 Month	3.7%	0.2%	3.9%
3 Months	10.6%	0.7%	12.6%
6 Months	17.8%	1.6%	10.7%
1 Year since inception	3.0%	4.7%	-22.1%

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 ongoing strength in equity markets was led by the Telco (+9%), Healthcare (+8%) and Banks (+7%) sectors with Utilities (-4%) and Materials (-0%) as the only detractors. Interestingly, over the 12 month period the defensive sectors - Information Technology (-2%), Healthcare (-3%) and Consumer Staples (-8%) - have significantly outperformed the more economically sensitive sectors - REITS (-49%), Materials (-35%) and Energy (-26%). It is particularly satisfying to report the positive return of 3%¹ over the 12 months given the negative returns generated by every sector in the Australian All Ordinaries over this period.

Global stock markets have continued their sharp recovery - now up over 35% from their lows in early March. Readers of my April and May reports will begin to find my commentary repetitive as I continue to caution on the levels of risk being assumed by investors in anticipation of an unlikely global recovery. Investor momentum is being encouraged by the massive Chinese stimulus package and its short term impact on commodity demand within the South East Asian region (while demand remains constrained in the rest of the world).

It remains my view that the outlook for global economies remains bleak with consumer deleveraging extending over many years particularly in the US and the UK. 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. The mountain of debt created by these packages will create significant competition for capital and may have a "crowding out" effect on the recovering private sector.

Domestically, lower interest rates, government fiscal stimulus and the impact of the Chinese stimulus efforts (which dwarfs that of many other countries both in size and centralised economy induced speed to market) have combined to underpin the key economic indicators of employment and retail sales. 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). Critically the domestic banking system continues to provide the much needed liquidity albeit at "very healthy all-in margins" for the Australian economy, generating an enviable resilience as measured against many other economies. Many listed companies have taken advantage of firmer equity prices to repair their balance sheets (while simultaneously diluting existing shareholders). As an aside this is a major positive for the banks.

Investment Outlook

While the direction of the overall market is difficult to predict, I am increasingly confident that the environment for absolute return focussed stock picking continues to improve. The impact of the recent volatility and negative returns has created a less crowded market, priced at more realistic levels. Even if the market remains flat for 2-3 years, this opens up significant opportunities for the Pengana Australian Equities Core Fund.

Two years ago (it seems like 20!), many segments of the market were running hard, attracting many new entrants including cash rich hedge funds, fully staffed principal trading desks at the investment banks, highly geared momentum players and overactive retail punters. It was an environment of few and narrow windows of opportunity for acquiring attractively priced equities.

The current outlook stands in direct contrast. The much publicised margin loan fiascos (and other schemes) have removed enormous amounts of leverage from the market. Financial services industry staffing levels are down sharply - ironically at a time when experience, industry knowledge and diligent research are most likely generate positive returns for investors.

One example of this trend can be found in several defensive companies with competent management, dominant market shares, pricing power and robust balance sheets. Investors appear to be deserting these companies for the more leveraged plays at a time when the impact of economic Darwinism is just beginning to play out.

The Fund remains conservatively invested with cash levels of 42%. However diligent research combined with the experience and resources of the Pengana investment professionals continue to provide valuable investment opportunities.

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