

Pengana Australian Equities Core Fund

July 2009 Update, by Rhett Kessler



1 of 2

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\$1.0363	Redemption Price at Month End	A\$1.0311
Style	Fundamental	FUM at Month End	A\$7.1m
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%
2009/10	3.5%												3.5%

The Fund generated a satisfactory return of 3.5%³ during July as the Australian All Ordinaries recorded one of its strongest months with a return of 7.7% over the month. As at 31st of July, the effective cash position of the Fund's NTA was 22%, sharply lower than the previous month as significant investment opportunities presented themselves. Importantly the Fund's investment strategy remains focussed on companies with transparent and resilient business models, run by competent management and capable of generating satisfactory returns at the current prices.

The top 5 contributors to the month's performances were Downer EDI, CBA, NAB, Duet and Computershare. Highlighting the rotation out of defensives and into cyclical stocks was the makeup of the 5 largest detractors (which included three healthcare stocks) namely Real Estate.com, Resmed, CSL, Platinum Australia and Sonic Healthcare.

New holdings added during the month included NAB, Pacific Brands, Consolidated Media and Ramsay Healthcare. The combination of strong positive fund flows, the sale of MCG to the Canadian Pension Fund for cash and emerging investment opportunities saw most existing holdings being supplemented with additional purchases. The larger purchases included CBA, Sonic Healthcare, NewsCorp, CSL and Graincorp. The Fund's holding in Woolworths was sold during the month.

As at 31st July 2009 the top five holdings by value in the Fund were: CBA, Telstra, NAB, Duet and CSL.

Net Returns to 31st July 2009³

	Pengana	Cash Rate	All Ordinaries
1 Month	3.5%	0.3%	7.7%
3 Months	9.6%	0.7%	14.3%
6 Months	21.7%	1.5%	25.4%
12 Months	7.7%	4.4%	-11.6%
13 Months since Inception	6.5%	4.9%	-16.2%

Market Commentary

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 distributions. 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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2 of 2

Market Review

The ASX All Ords Accumulation Index rallied 7.7% over the month of July, the strongest monthly performance since March 2000. The surge was led by Industrials (+10%), Materials (+10%) and Consumer Discretionary (+9%) sectors. Healthcare (-3%) and Precious Metals both delivered negative returns for the month while Utilities and Telcos also lagged the overall market. Weakness earlier in the month appeared to trigger buying as hopes of global economic and earnings recovery continued to take hold. Markets elsewhere in the world followed a similar path, the S&P500 index gaining 7.4% to return to levels last seen in early November 2008.

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. In addition many professional investors continue to rotate (in my view belatedly) into companies with higher economic sensitivities in an attempt to capture the robust returns on offer. Furthermore, an important distinction needs to be made between a company's share price and its underlying market capitalisation when assessing the true extent of the retracements in equity values. Because many companies have issued substantial additional shares at significantly lower prices, investors may be surprised to discover that some are already trading at record levels of market capitalization even though their headline share prices erroneously convey a different message.

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 the outlook is more positive. 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.

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 to 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 has taken advantage of the value emerging in these "boring and defensive" sectors to increase equity investments, particularly in the Healthcare and Banking sectors resulting in cash levels reducing to 22%. Diligent research combined with the experience and resources of the Pengana investment professionals continues to provide valuable investment opportunities.

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