

Pengana Australian Equities Core Fund

August 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\$1.099	Redemption Price at Month End	A\$1.0936
Style	Fundamental	FUM at Month End	A\$8.2m
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%	6.1%											9.7%

The Fund generated a satisfactory return of 6.1%³ after all fees and costs during August as the Australian All Ordinaries recorded another very strong monthly return of 6.5%. As at 31st of August, the effective cash position of the Fund's NTA stands at 20%. 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 performance were Downer EDI, Mermaid Marine, Sonic Healthcare, REA Group and NAB. The largest detractors were Duet, Telstra, Pacific Brands and Platinum Australia Group.

New holdings added during the month included Customers, NIB Holdings and Credit Corp. The ongoing strong positive fund inflows saw most existing holdings being supplemented with additional purchases. Of these, the larger purchases included Telstra, Ramsay Healthcare, DUET, and Sonic Healthcare. The Fund's holding in Computershare was sold during the month.

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

Net Returns to 31 st August 2009 ³			
	Pengana	Cash Rate	All Ordinaries
1 Month	6.1%	0.3%	6.5%
3 Months	13.9%	0.5%	19.1%
6 Months	30.9%	1.5%	39.5%
12 Months	10.4%	4.0%	-9.5%
14 Months since Inception	12.7%	5.2%	-10.8%

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 Managers' 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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Market Commentary

Market Review

The ASX All Ords Accumulation Index rallied 6.5% over the month of August, lifting the six month market return to just short of 40%. This month it was the turn of the listed property trust sector (+14%) closely followed by Financials (+12%) and Industrials (+11%). The Telecommunications (-7%), Utilities (-4%) and Materials (-1%) sectors delivered negative returns for the month. Globally markets were also comfortably in positive territory with European and US Indices doing a lot better than Asia. China in particular was down 22% amidst concerns regarding the sustainability of the current Chinese economic policies.

Although the medium term outlook for OECD Group countries remains bleak due to consumer deleveraging extending over many years, the consensus view that the worst point in this economic cycle is now behind us is strengthening. This slew of positive economic indicators has been reflected in sharply higher share prices, particularly for the more economically sensitive companies.

Given the near Armageddon base and the scale of the global attempts to re-stimulate, it would be thoroughly disheartening and mathematically unlikely **not** to see some form of recovery. The current cycling of easy comparisons (hard to believe that the Lehmans' bankruptcy and ensuing chaos last September was only a year ago) is an essential driver of positive sentiment. This, together with the weight of cash moving back into equities (particularly as cash rates remain low single digit) and a Funds Management industry eager to use the risk trade to keep up with relative performance targets appears to be the main drivers of the strong equity markets.

However, the fundamental issue remains that an enormous burden of debt has been created. While timely government action (in the various forms of stimuli) may have created an environment that allows large parts of the private sector to recapitalise and rebuild profitability, enormous uncertainty exists around what happens when the authorities (1) stop stimulating, (2) increase interest rates to a more sustainable level and (3) increase taxes to pay down the debt burden.

Domestically the outlook continues to surprise on the upside. 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.

Many market participants seem obsessed by whether the "market" is headed higher or lower. The Pengana Australian Equities Core Fund continues to focus on finding companies whose earnings and cash flows will be substantially higher in the future, irrespective of whether the markets are higher or lower.

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 20%. Diligent research combined with the experience and resources of the Pengana investment professionals continues to uncover valuable investment opportunities.

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