

Pengana Australian Equities Core Fund

September 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	A\$1.1411	Redemption Price at Month End	A\$1.1355
Style	Fundamental	FUM at Month End	A\$9.9m
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%
2009/10	3.5%	6.1%	3.8%										13.9%

The Fund generated a strong return of 3.8%³ after all fees and costs during September as the Australian All Ordinaries extended its exceptional rally with a monthly return of 6.0%. As at the 30th of September, the effective cash position of the Fund's NTA stands at 26%. 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 CBA, Graincorp, Customers, DUET and Westpac. The largest detractors were Resmed, TFC and Mermaid Marine.

New holdings added during the month included the RCG Group and TFC while those holdings disposed of included DUET, Boart Longyear, Pacific Brands and Consolidated Media Holdings. The ongoing strong positive fund inflows saw most existing holdings being supplemented with additional purchases. Of these, the larger purchases included Westpac, Telstra, NHF, Customers, NewsCorp and Ramsay Healthcare.

As at 30th September 2009 the top five holdings by value in the Fund were: Telstra, Westpac, CBA, Sonic Healthcare and Ramsay Healthcare.

Net Returns to 30th September 2009³

	Pengana	Cash Rate	All Ordinaries
1 Month	3.8%	0.3%	6.0%
3 Months	13.9%	0.7%	21.5%
6 Months	26.0%	1.5%	36.9%
12 Months	20.3%	3.7%	7.4%
15 Months since Inception	17.4%	5.4%	-5.4%

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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Market Review

The ASX All Ords Accumulation Index rallied 6.0% over the month of September, lifting the six month market return to just short of 37%. Financials (+10%) continued to lead the recovery well supported by the listed property trust sector (+10%) and Consumer Disc Sector (+10%). Telecommunications (0%) and Energy were the lagging sectors. Globally markets also generated healthy positive returns in their local currencies. The Australian Dollar built further on its rally against the US\$ (+5%) and ended the month 40% higher than its 2009 low of 63c.

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.

Investors appear to be pushing cash back into equity markets at an increasing rate creating an interesting conundrum. The stimulus driven economic recovery is being fuelled by exceptionally low interest rates and burgeoning government debt. In addition, the sharply weaker US\$ is forcing investors to seek refuge in hard assets, namely commodities, precious metals and equities. Given the outlook for further US\$ debt issuance and the inflationary risks that come with loose monetary policy one has to wonder why the interest rate curve is not steeper (and long bond prices are not weaker).

Domestically the outlook continues to surprise on the upside. Australia's economic stability has captured the world's attention for several reasons: Our financial institutions have demonstrated their robustness; unemployment continues to defy pessimistic expectations, population growth is expected to drive medium term GDP, our proximity to China coupled with the scale and mix of natural resources is likely to underpin long term economic activity. These factors have allowed the Reserve Bank to begin the process of raising interest rates from the unsustainably low levels. They have also been reflected in the sharply higher A\$.

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 is represented by the Fund's acquisition of a significant holding in RCG Group. The competent and disciplined management team has used its successful track record and strong cash flow from its core business - The Athletes' Foot retail business to procure several new and substantial earnings streams. It is our opinion that the impact on shareholder returns generated by successful retail roll out stories are almost always under estimated.

Another 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, Agricultural and Banking sectors.

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