



Analysts: Simone Arblaster; Andrew Yap

Product Facts

Manager	Pengana Capital Limited	Fund type	Wholesale	Boutique	Yes
APIR code	PCL0001AU	Specialisation	Multi-manager	Multimanager	Yes
Fund status	Open	Peer group	International Equities - Small Cap	Inception date	Oct. 31, 2005
Min. investment (A\$)	25000			ICR (%pa)	2.56

Standard & Poor's View

S&P rates this fund three stars, reflecting our conviction that the manager will consistently generate risk-adjusted returns in-line with both its relevant investment objectives and its peers.

Pengana offers investors a unique opportunity to gain exposure to three regional small-cap managers that are not usually available to the retail investor. The portfolio is equally weighted to three regions, the U.S., Europe, and Asia (currently only Japan), and regional managers with a strong local presence have been selected. S&P views Pengana's qualitative assessment of managers as sensible. The assessment focuses on the investment process and expertise in this segment of the market, as well as structural factors such as incentives, stability, the manager's remaining capacity, and any information advantage the manager may enjoy over competitors.

S&P recognises the merits of selecting managers with a local presence and believes a wider use of regional managers in the Asian segment of the portfolio would be beneficial. At the time of writing the report, an additional manager had been selected and Pengana was in the final stages of negotiating terms with them.

S&P considers the investment team to be of a reasonable size compared to other multi-managers (it is the only multi-manager in the small-caps peer group). There is also good experience within the team, which S&P views positively.

The performance of the underlying managers has been varied and a large cash holding in June 2009 was a significant detractor. Cortina Asset Management, the U.S. manager, has been the biggest contributor over the past year, while performance in the European portion, managed by Munros Capital Management, suffered due to some micro-cap holdings.

The management fee has been reduced to 0.75% per year and, similar to other Pengana products, the fund has a performance fee. S&P is comfortable with the 10% performance fee over the benchmark, given the reduced management fee.

Product Features

The Pengana Global Small Companies Solution uses a multi-manager approach to constructing its portfolio, with equal weighting given to three regions: North America, Europe (including the U.K.), and Asia (currently only Japan). The product has a composite benchmark of one-third Russell 2000 Index, one-third HSBC Smaller Europe (ex 50% U.K.) Index, and one-third MSCI Japan Small Cap Index. It currently invests in one specialist small-cap fund manager in each region. The underlying managers have all been chosen by Pengana for their characteristics such as their structure, alignment, and obviously for their stock selection capabilities.

The underlying managers have varying levels of conviction in their portfolios: Cortina, the U.S. manager, is the most diversified with around 70 stocks; Sparx Asset Management, the Japanese manager, and Munros, the European manager, are more concentrated with around 50 stocks. The European manager is likely to have a portion of the fund in micro-caps, which reduces liquidity in the portfolio.

Since inception of the fund there has been one change in manager, with Kempen & Co. replaced by Munros, following the departure of key investment staff to Munros. The fund was successfully transitioned through an in-specie transfer.

Other managers may be added to the mix; the manager is assessing Asia ex Japan managers to broaden the Asia coverage in the aggregate portfolio, using funds currently with the Japanese manager. Pengana may also look to exposure in other emerging markets, such as Eastern Europe and Latin America, which would give the investor further exposure to areas not easily accessible to the Australian retail investor.

The fund seeks to outperform the customised benchmark (after fees) over the medium term (three to five years), and has a targeted absolute return of 10% to 15% over the long term (after fees). Pengana does not take tactical macroeconomic positions, and uses cash flow to manage the product to the strategic benchmark. From July 2007, the product became fully hedged back to the Australian dollar.

The fund has a 10% per year performance fee, levied on the fund's return in excess of the return on the composite benchmark, and payable quarterly. If no fee is payable in any quarter, the accrued performance fee, whether positive or negative, will be carried forward to the next quarter. The performance fee is unusual for the peer group but is consistent with other Pengana funds. The management fee is 0.75%, which has been reduced from 1%. S&P considers the lower management fee relative to peers is appropriate when a performance fee is introduced. The buy/sell spread is 0.4%.

Fund Objectives

Benchmark	Index Not Applicable
Target return (% p.a.)	B'mark + 2%-3% pa, plus Absolute Return of 10%pa
Target tracking error	N/A

Investment Style

The fund adopts an active investment style with portfolios that are high conviction in their region. Pengana invests in managers to diversify the aggregate portfolio, which is easily achieved if the regions have a relatively low correlation. The underlying managers use bottom-up, fundamental research to identify investment opportunities. The fund aims to provide investors with an exposure to the long-term risk premium in



small companies and the alpha that may be generated within this relatively inefficient asset class. The manager believes that, over the longer term, higher returns can be expected from small cap companies than from large cap companies. In part, this is due to the lack of research by investment brokers into companies at the smaller end of the market, resulting in pricing inefficiencies. Investors looking to capture this small-cap risk premium will need to accept the possibility of more volatile returns in the short term.

The manager believes the regional multi-manager approach is better because smaller companies are typically more affected by country and inter-regional factors than industry factors. Therefore, Pengana has selected local managers with an understanding of the markets in which they invest which the manager considers is an advantage in identifying attractive stocks. Local managers also make it easier to visit companies, meet senior management, and monitor developments, which S&P also views positively. Another important attribute of the underlying managers is their low level of assets under management and their culture of performance, rather than asset-gathering. This typically leads to investments in boutique companies because ownership and alignment are very important to Pengana. Within the underlying funds, there is no distinct style bias. The underlying funds are all small-cap portfolios, although Munros has the ability to invest 20%-30% in micro-cap stocks.

Passive					Active
Value					Growth
Small Cap					Large Cap

Investment Team

Nick Griffiths is the product's portfolio manager. Joining Pengana in 2003, he brought 14 years of asset-allocation and manager-selection experience to the firm, gained primarily with Aon Consulting. Mr. Griffiths is also the chief investment officer for the Pengana group, dividing his time fairly equally between the two roles. Mr. Griffiths is supported by a risk analyst, Alex Harris, and an investment analyst, Tom Threlfall. Since S&P's last review, investment analyst, Jessica Theng, has left the firm. Ms. Theng held a relatively junior position, joining in March 2007 and leaving in January 2009 to pursue another opportunity. Her main role was assisting with the fund-manager research and risk-management function, a role which Mr. Harris and Mr. Threlfall have now assumed. Mr. Harris joined the group in mid 2008 and Mr. Threlfall moved across from the Pengana property group.

In October 2009, Pengana appointed Greg Clarke to join the team. He has 18 years' experience in the industry, most recently as Director of Implementation Solutions at QIC. Mr. Clarke also has direct experience managing a global small companies fund and will play an important role in the management of the fund and development of the multi-manager business.

Mr. Griffiths also takes advice from industry contacts, third-party consultants (CPG Research & Advisory), and internal marketers to arrive at a recommended "long list" of suitable managers. The consultants also assists with on-site due diligence. Pengana has outsourced custody and fund administration functions to third-party provider BNP Paribas. Trading is completed by Pengana Capital.

S&P considers the team to be adequately resourced and is pleased with the ongoing focus on looking for new managers in new regions and those already covered. Remuneration aligns the members of the team with performance and also ensures there is

an emphasis on performance rather than asset growth, which S&P views favourably.

New					Experienced
Small					Large
Unstable					Stable

Investment Process

Pengana's goal in the manager-search process is to find regional specialist small-cap managers that understand their markets, have low assets under management, have a high degree of ownership of their funds-management business, have no distinct investment style bias, and have demonstrated strong performance. Pengana also looks for managers that have a disciplined fundamental-research process, focused on stock selection in growing and strong markets.

A disciplined approach to screening and monitoring managers is adopted. The team will screen managers in conjunction with external investment consultants, Bloomberg fund search, and other industry contacts, to arrive at a "long list" of regional small-cap managers. The team will then conduct returns-based analysis on these funds using Pertrac, an off-the-shelf, hedge fund-of-funds tool. Pengana assesses managers on the consistency of the fund's performance over the full market cycle, on both an absolute and relative basis. It also monitors the manager's allocation of risk. Pengana short-lists the strongest managers and then undertakes a due-diligence exercise, including a visit to the fund manager's premises. The underlying managers will be visited at least once a year and Mr. Griffiths may be accompanied by external consultants, who will also provide their assessment of the manager's capabilities. Aside from the annual visit, Pengana receives monthly surveillance information from the manager and has a quarterly strategy review. Monthly information is also received from back-up managers and managers that the team is monitoring, which S&P views positively.

A 10-factor ratings matrix is completed following the onsite visit, covering corporate structure, the level of enthusiasm shown by the manager, the valuation methodology, the manager's level of assets under management, and its willingness to reserve future capacity for Pengana. These criteria focus Pengana on "boutique" managers. S&P notes that boutique managers may reach capacity relatively quickly if the manager is skilful at generating alpha.

Pengana currently invests in Cortina to gain U.S. small companies exposure. Cortina invests in companies with a market capitalisation of between US\$300 million and US\$2 billion, focusing on companies with strong business models, cash-flow growth, and franchise characteristics. Sparx is employed to give the fund exposure to small to mid-sized, Japanese companies. Sparx determines intrinsic value by assessing earnings quality, management, and business potential. It identifies significant gaps between intrinsic value and share price and then seeks a catalyst to reduce the gap. Exposure to European (including U.K.) smaller companies is gained through Munros Capital Management. This Edinburgh-based manager is style neutral, focusing on companies that exhibit strong cash-flow growth and have solid assets. Munros tends to concentrate its research efforts on industries in which it feels it has the greatest competence. In appointing these managers, Pengana has not constrained the manager's investment approach, apart from upper limits on country, sector, and stock holdings to ensure diversification. Investments in Munros and Cortina are by way of segregated investment contracts, whereas the investment with Sparx is through its Dublin-listed pooled fund, which restricts



any changes to the mandate. All three have daily unit-pricing, which is preferred by the manager and investors with cash flow requirements.

The portfolio mandate states that the fund is constructed with equal allocations to the U.S., Europe, and Asia. However, the actual allocation to the Asian region is currently only in the Japanese market. Pengana almost invested with an Asia ex Japan manager in mid 2009 but decided against it following a key departure. An alternate manager has now been selected for this mandate and, at the time of writing this report, Pengana was in the final stages of negotiating terms with them. S&P considers that a more diversified portfolio, with the inclusion of an Asia ex Japan mandate, would be beneficial to the end investor as it would provide a broader regional exposure and hopefully reduce volatility within the portfolio. A manager will be terminated for poor performance, if key people leave the manager, or if the business is under threat, for some reason. The manager has had the experience of transitioning a mandate in the European allocation which was successfully completed through an in-specie transfer.

Pengana will manage the portfolio within 5% either side of the strategic asset allocation. It rebalances monthly, which is executed passively, where possible, using net cash flows. The ranges provide some leeway in managing asset allocations but not enough to detract from the performance of underlying managers, which S&P views favourably. The manager does not take tactical asset-allocation positions in the fund. Cash holdings are limited to 5% for each of the underlying managers. Cash reached a peak of more than 15% in 2009 as the manager prepared itself for investment in a new underlying manager. A cash drag was the result, which has had a negative impact on the fund's performance (see under "Performance").

Currency Management

In July 2007, Pengana changed the investment mandate to allow the portfolio to be fully hedged back to the Australian dollar. This change has removed the effects of foreign-currency movements on the portfolio's total return.

Performance

Over the 12 months to June 30, 2009, the manager produced a gross return of negative 31.1%, against its composite benchmark return of negative 22.7%, therefore underperforming by 8.5%. Over the same period, the MSCI World ex Australia Small Cap Index (local currency) returned negative 24.2%.

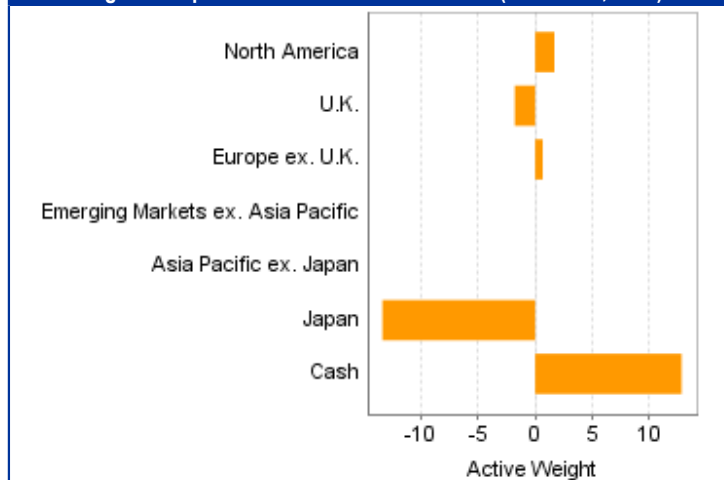
Of the three managers, Munros was the biggest performance detractor because of its exposure to micro-cap stocks. In the 2008 calendar year, Munros underperformed its benchmark by 6.7% and it has struggled since, underperforming the benchmark by 13.4% for the six months to the end of June 2009. Munros typically has 20%-30% in micro-cap stocks, which was reduced to 10% by June 30, 2009. Munros also prefers quality stocks that haven't performed well over the past year in a largely speculative European small-caps market. Pengana will continue to monitor the performance of the Europe manager and looks to see improvements in the coming year. Cortina, the US manager, outperformed over the past year and was the biggest contributor to fund performance. This underlying manager is more thematic than the other two and was quick to reposition its portfolio in 2008 to escape the worst of the decline. It managed to outperform the benchmark after the significant sell-off of small caps in October 2008 and has remained above the benchmark to July 2009. Sparx

underperformed its benchmark in 2008 by 4.7% following a good year in 2007. In 2009, it has generally managed to keep pace with the benchmark.

In June 2009, Pengana had a cash holding of 15.4% (2.6% of which was cash held by the underlying managers) in preparation for its investment in an Asia ex Japan manager. The investment didn't proceed but the cash allocation remains high in expectation that another Asia ex Japan manager will be selected. This is inconsistent with the mandate of holding a maximum of 10% in cash, including operational cash held by the underlying managers. Unfortunately, as the market rallied, the manager gave up performance because of the cash drag, which has detracted 6.6% over the 12 months to June 30, 2009.

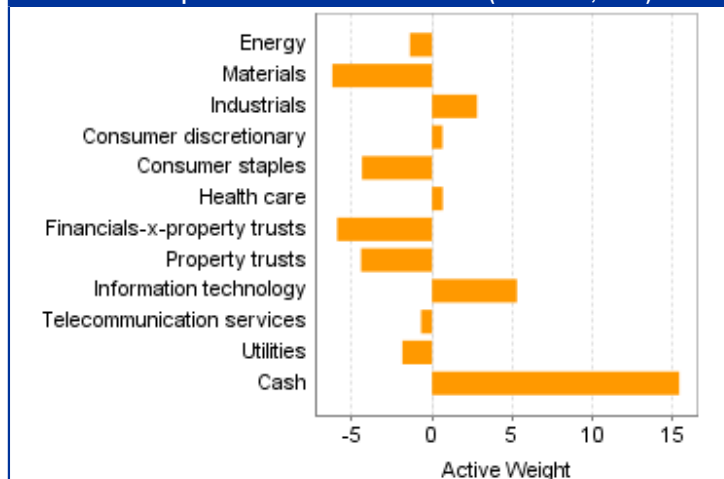
Performance Measures	
Average portfolio turnover (%)	80
Typical number of stocks in portfolio	150-200
Source: Pengana Capital Limited	

Regional Exposure Versus Fund Benchmark (at June 30, 2009)



Source: Pengana Capital Limited

Sector Exposure Versus Fund Benchmark (at June 30, 2009)



Source: Pengana Capital Limited

Risk Management

Pengana monitors risk through monthly telephone calls with each of the underlying managers, who report to Pengana on performance, risk, and any significant changes to people, process, or portfolios. At a minimum, Pengana visits its incumbent managers each year, and also catches up with those on its back-up

list. A monthly reconciliation of the records kept by the custodian, the broker, and Pengana, is also conducted to ensure accounts and holdings data are accurately and consistently recorded.

The investment-management agreements with Cortina and Munros are by way of segregated contracts, and priced daily by an independent custodian. The investment with Sparx is through a pooled fund domiciled in Dublin to allow daily unit pricing. There have been no issues with the pooled fund; however, Pengana is subject to the pooled fund's investment mandate constraints, such as risk and return objectives. However, as Pengana was the initial investor in this fund, it was involved in the mandate design. Pooled fund mandate guidelines form a part of the due diligence process and Pengana would not invest in a fund which was inconsistent with its objectives.

Each manager is required to notify Pengana immediately if a breach of mandate has occurred. Pengana has set country, sector, and stock limits for each manager to ensure diversification. S&P considers the monitoring of the managers and risk management within Pengana as appropriate.

Management Group Profile

Pengana Capital Ltd. is a boutique organisation offering investment capabilities in real estate, fixed income, alternative assets, Australian equities, and global small companies funds. Founded in 2003, Pengana is majority owned by directors and staff. Headquartered in Sydney, it has offices in Melbourne, London, and Chicago. Its parent, Pengana Holdings Pty Ltd., provides back-office and support services to its various business units.

Pengana was established to attract investment teams and individuals from established fund-management groups, setting up segregated business entities under a single holding company. This business structure gives investment teams more time to focus on investment issues, while the parent and third-party providers handle compliance, reporting, legal, and accounting functions.

In May 2008, nabInvest, National Australia Bank's direct investment management business, took a significant minority stake in Pengana. If a liquidity event occurred (for example, if the business is listed or sold to a third party), the nabInvest ownership would be diluted to one third. Pengana continues to have three key equity holders; however, further rounds of equity may be offered to employees with Pengana from time to time. As part of the nabInvest suite of investments, there are some marketing benefits through the distribution team and easier access onto platforms but Pengana is responsible for the core distribution.

Market Share

Pengana has been in existence since 2003, initially providing a listed-property capability. It has since expanded its range of offerings to 10 strategies and this is likely to be the limit. At June 30, 2009, the 10 investment strategies had assets under management of A\$900 million, of which the Pengana Global Small Companies Solution had A\$25 million. The small-cap client base consists of two institutional mandates as well as a small portion of retail money (A\$2.4 million). The product is currently available on two retail platforms.

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Release authorised by: Leanne Milton.

S&P Fund Rating Reference Information



Fund Rating Peer Groups by Sector			
<p>Australian Equities</p> <ul style="list-style-type: none"> Large Cap Diversified Large Cap Income Large Cap Indexed Large Cap Industrials Long Short Small Cap Specialist <p>Australian Fixed Interest</p> <ul style="list-style-type: none"> Cash Cash Enhanced Fixed Interest Fixed Interest Income Mortgages Mortgages High Yield Mortgages Conventional Mortgages High Yield Hybrid Mortgages Hybrid <p>Australian Property</p> <ul style="list-style-type: none"> Direct Commercial Direct Development Direct Diversified Direct Direct Industrial Direct Residential Direct Retail Direct Rural Direct Specialised Diversified Fixed Interest Listed 	<p>International Equities</p> <ul style="list-style-type: none"> Diversified Equities Emerging Markets Emerging Markets Asia ex Japan Emerging Markets China Emerging Markets India Large Cap Diversified Large Cap Income Large Cap Indexed Large Cap Industrials Long Short Long Short Specialist Long Short Regional Regional Japan Regional UK/Europe Regional US Regional Asia Small Cap Specialist Healthcare Specialist Information Technology Specialist Resources 	<p>International Fixed Interest</p> <ul style="list-style-type: none"> Diversified Fixed Interest Diversified Fixed Interest Income Fixed Interest Fixed Interest High Yield Fixed Interest Income Mortgages Mortgages High Yield Mortgages High Yield Hybrid Mortgages Conventional Mortgages Hybrid <p>International Property</p> <ul style="list-style-type: none"> Direct Commercial Direct Development Direct Diversified Direct Direct Industrial Direct Residential Direct Retail Direct Rural Direct Specialised Diversified Property Listed 	<p>Alternative Assets</p> <ul style="list-style-type: none"> Commodities Multi-sector Private Equity Listed Private Equity Unlisted Infrastructure Listed Infrastructure Unlisted <p>Alternative Strategies</p> <ul style="list-style-type: none"> Single Strategy Funds Multimanager Single Strategy Funds Single Manager Multi-Strategy Funds Multimanager Multi-Strategy Funds Single Manager <p>Multi Sector</p> <ul style="list-style-type: none"> Capital Guaranteed 20 40 60 80 100 Equity Other

Fund Rating Philosophy
A star rating is a forward looking assessment of a manager's ability to consistently generate risk-adjusted returns (net of fees) in excess of both its relevant investment objectives and its peers.

Fund Rating Process
In assigning a star rating to a fund, Standard & Poor's evaluates: the size, skill, and stability of the manager's investment team; the clarity, implementation, and risk management of the investment process; the fund's objectives, fee structure and portfolio characteristics; and the manager's business management.

Fund Rating Definitions	
FUND RATING ★★★★★	Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
FUND RATING ★★★★☆	Standard & Poor's has high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
FUND RATING ★★★☆☆	Standard & Poor's has conviction that the manager will generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
FUND RATING ★★☆☆☆	Standard & Poor's has conviction that the manager will not generate risk-adjusted fund returns in in-line with its relevant investment objectives and relative to its peers.
FUND RATING ★☆☆☆☆	Standard & Poor's has high conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
ON HOLD	Issues that may affect the fund's management have emerged; and the fund rating is temporarily suspended, pending clarification.
SELL	Significant issues exist that potentially will adversely affect the fund's performance. Investors should consider obtaining advice on switching or redeeming funds.
Fund Rating Subscript	
- NEW -	The investment process, fund manager, or the fund has a relatively short history, or the analytical team has changed significantly, but a relevant and demonstrable track record is shown on similar funds.

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