

# Pengana Australian Equities Core Fund

## December 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%<sup>1</sup> 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

<b>Application Price at Month End</b>	A\$1.1959	<b>Redemption Price at Month End</b>	A\$1.1899
<b>Style</b>	Fundamental	<b>FUM at Month End</b>	A\$10.9m
<b>Benchmark</b>	The weighted average of the target Australian Cash Rate used by the RBA	<b>Management Fees<sup>2</sup> (monthly)</b>	1.00% p.a. of NAV
<b>Investors</b>	Wholesale Clients only	<b>Performance Fees<sup>2</sup> (quarterly)</b>	10% of increase in net asset value subject to the Australian Cash Rate and High Water Mark
<b>Inception Date</b>	30 June 2008	<b>Minimum Initial Investment</b>	A\$100,000

### Fund Commentary

#### Fund Performance (A\$, net of fees)<sup>3</sup>

	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%	<b>3.0%</b>
2009/10	3.5%	6.1%	3.8%	1.2%	1.0%	2.5%							<b>19.4%</b>

The Fund generated a return of 2.5%<sup>3</sup> after all fees and costs during December against the backdrop of a 3.7% performance by the Australian All Ordinaries and the prevailing cash rate of 0.3%.

**For the 18 months since inception the Fund has protected capital and provided investors with a satisfactory total return of 23% (annualised 14.7%) in the difficult environment of a 6.3% cash rate (4.1% annualised) and a negative market return by the Australian All Ordinaries of -1.9% (-1.2% annualised).**

As at the 31<sup>st</sup> of December, 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 included three of the Fund's holdings with significant exposure to the US\$: News Corporation, Sonic Healthcare and Resmed. Westpac and Aquarius Platinum were also in the top 5. The largest detractors were NIB Holdings, Lihir Gold, Customers and AWB.

The Fund acquired a significant holding in NAB, supplementing its existing holdings in the Australian banking industry - CBA and Westpac. Several holdings were increased including Westpac, Customers, and Ramsay Healthcare. The Fund's holdings in AWB, TFC and VDM Group were sold.

As at 31<sup>st</sup> December 2009 the top five holdings by value in the Fund were: Telstra, Westpac, CBA, Ramsay Healthcare and News Corporation.

#### Net Returns to 31<sup>st</sup> December 2009<sup>3</sup>

	Pengana	Cash Rate	All Ordinaries
<b>1 Month</b>	2.5%	0.3%	3.7%
<b>3 Months</b>	4.8%	0.9%	3.7%
<b>6 Months</b>	19.4%	1.6%	26.1%
<b>12 Months</b>	40.7%	3.3%	39.6%
<b>18 Months since Inception</b>	23.0%	6.3%	-1.9%
<b>Annualised return Inception</b>	14.7%	4.1%	-1.2%

<sup>1</sup> 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.

<sup>2</sup> Plus GST and net of reduced input tax credits. Please refer to the information memorandum for a more detailed explanation.

<sup>3</sup> 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 Commentary

#### Market Review

After a lacklustre start to the month (and the quarter), The ASX All Ords Accumulation Index rallied sharply to finish with a robust monthly return of + 3.7% for December. The first signs of stability in the US economy triggered a rally in the US\$ driving the share prices of those companies with US\$ based earnings streams higher. This saw stronger performances by the Information Technology (+7.3%), Industrials (+7.0%), Healthcare (+4.3%) and Materials (+4.3%) sectors. The Telecommunications (+1.0%) and Consumer Staples (+2.0%) and REITs (+2.0%) continued to underperform.

The medium term economic outlook for OECD Group countries is for an extended period of low growth (sub 2%) as consumer and now public sector deleveraging limits their ability to bounce back from the recent low point of the cycle. Asia (ex Japan) and China in particular are expected to continue growing at robust levels as governments take advantage of their massive reserves to maintain high levels of economic stimulus.

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 Asia and China in particular 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 unsustainably low levels.

#### Investment Outlook

The medium term outlook for the underlying Australian and global economies continues to improve. Several economic fundamentals, including unemployment levels, credit spreads, housing starts and retail sales have all stabilised thereby providing more clarity around future earnings risk. However valuation multiples have also increased sharply, particularly in the economically sensitive sectors. Consequently, the overall investment risk remains high.

Many market participants seem obsessed by whether the "market" is headed higher or lower. The Pengana Australian Equities Core Fund continues to focus on identifying companies with competent management and resilient business models that can take advantage of secular trends to generate significantly higher earnings and cash flows in the future, irrespective of whether the markets are higher or lower.

One example is represented by the Fund's holding in NIB Holdings Ltd, a domestic health insurer. While the company's innovative product and marketing strategies are providing robust and profitable growth within an attractive market several factors have contributed to this not being reflected in the share price. As a recently demutualised small insurance company it has not attracted meaningful coverage or analysis. Furthermore its already large surplus capital position distorts the traditional valuation methodologies. This company provides an attractively priced exposure to a rapidly growing healthcare sector.

Other examples 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 continues to take advantage of the value emerging in these "boring and defensive" sectors to increase its equity investments, particularly in the Healthcare, Agricultural and Banking sectors.**

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