Pengana Australian Equities Core Fund January 2010 Update, by Rhett Kessler

PENGANA CAPITAL

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$1.1528	**Redemption Price at Month End**	A$1.1470
Style	Fundamental	**FUM at Month End**	A$10.9m
Benchmark	The weighted average of the target Australian Cash Rate used by the RBA	**Management Fees [2] (monthly)**	1.00% p.a. of NAV
Investors	Wholesale Clients only	**Performance Fees [2] (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%	1.2%	1.0%	2.5%	-3.6%						**15.1%**

The Fund generated a return of -3.6%[3] after all fees and costs during January against the backdrop of a -5.8% performance by the Australian All Ordinaries and the prevailing cash rate of 0.3%.

For the 19 months since inception the Fund has protected capital and provided investors with a satisfactory total return of 18.5%[1] (annualised 11.3%[1]) in the difficult environment of a 6.6% cash rate (4.1% annualised) and a negative market return by the Australian All Ordinaries of –7.6% (-4.9% annualised).

As at the 31st of January, the effective cash position of the Fund's NTA stands at 17%. 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 two significant positive contributors to the month's performance were Ramsay Healthcare and Credit Corp. The largest detractors were Newscorp, Westpac, Downer EDI, Graincorp and Lihir Gold.

The Fund acquired a significant holding in Westfield Holdings. Several holdings were increased including NAB, Downer Edi, Mermaid Marine and Customers.

As at 31st January 2010 the top five holdings by value in the Fund were: Telstra, Westpac, CBA, NAB and Ramsay Healthcare.

Net Returns to 31st January 2010 [3]

	Pengana	**Cash Rate**	**All Ordinaries**
1 Month	-3.6%	0.3%	-5.8%
3 Months	-0.2%	0.9%	-0.5%
6 Months	11.2%	1.7%	10.3%
12 Months	35.4%	3.2%	38.3%
19 Months since Inception	18.5%	6.6%	-7.6%
Annualised return Inception	11.3%	4.1%	-4.9%

[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 Commentary

Market Review

The ASX All Ordinaries Accumulation Index fell away sharply during the later part of January to end the month down a hefty 5.8%. Investor concerns were broad based with every sector generating a negative return. The Energy (-10%), Materials (-9%), Consumer Staples (-8%) and Healthcare (-6%) sectors led the declines.

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. However, the recent inflationary data out of China provided a catalyst for an indefinite pause in Chinese bank lending, creating high levels of uncertainty around Chinese growth outlook.

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 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 major global economies continues to improve. Several economic fundamentals, including unemployment levels, credit spreads (with the exception of Europe), 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 Ramsay Healthcare, the largest owner and operator of domestic private hospitals. It's portfolio of quality hospitals combined with its extensive medical practitioner relationships provide attractive exposure to a robust healthcare market. Several growth options enhance the company's earnings outlook including a) the entry by the baby boomer demographic to the pointy end of medical expenditure, b) an established foothold in the lucrative UK hospital market and c) an early position in the French market. Importantly the high calibre management team has an excellent track record.

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 have, until recently, been 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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