

Pengana Asian Equities Fund (Onshore) January 2010 Update



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Pengana Asian Equities Fund (Onshore)

The Pengana Asian Equities Fund (Onshore) (the "Fund") provides investors with equity exposure to companies within the Asia Pacific region. The Fund is managed out of Sydney, Australia. The Fund utilises a core strategy of being both long and short securities in order to reduce volatility and generate stable long term absolute returns.

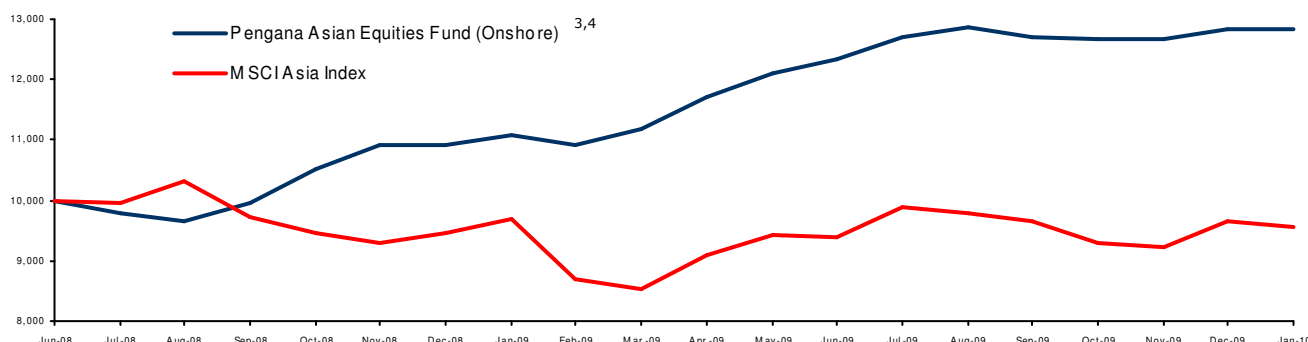
Fund Features

Style	Long/Short Equity	Management Fees ¹ (monthly)	1.54% p.a.
Comparative Benchmark	MSCI AC Asia Index	Performance Fees ¹ (semi-annually)	20.5% of any increase in Net Asset Value subject to RBA target cash rate hurdle
Investors	Open	AUM at Month End	A\$3.8m
Minimum Initial Investment	A\$20,000	Application Price at Month End	A\$1.0496
Inception Date	01 July 2008 ^{2,4}	Redemption Price at Month End	A\$1.0444

Fund Commentary

Fund Performance (A\$, %, net of fees) ^{3,4}

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2010	-0.1												-0.1%
2009	1.4	-1.5	2.7	4.6 ⁴	3.5	2.0	3.0	1.2	-1.3	-0.2	-0.1	1.3	17.7%
2008							-2.0	-1.5	3.3	5.4	4.1	-0.2	9.1%
MSCI AC Asia Index (A\$, %)													
2010	-1.0												-1.0%
2009	2.8	-10.5	-1.8	6.6	3.6	-0.3	5.3	-0.9	-1.5%	-3.8	-0.5	4.4	2.1%
2008							-0.3	3.5	-5.6	-2.8	-1.8	1.6	-5.6%



¹ All percentages include GST net of reduced input tax credits. Please refer to the PDS for a more detailed explanation.

² On 26 August 2009 the Fund became a registered scheme, with a PDS. Identification codes for the Fund are: ARSN: 138 943 709; APIR: PCL 0002AU

³ Net performance, after all fees and charges, and assuming reinvestment of all distributions. Past performance is not a reliable indicator of future performance.

⁴ On 22 April 2009 the Fund expanded its investment universe from the Asia region to the Asia Pacific region.

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	Fund Features since Inception	Index Features since Inception
Annualised Return	17.0%	-2.9%
Annualised Volatility	7.8%	14.2%
Sharpe Ratio ⁵	1.6	-0.6
Maximum Drawdown ⁶	-3.5%	-17.3%
Max. Recovery Period	2 months	10 months + ⁷
Best Monthly Return	5.4%	6.6%
Worst Monthly Return	-2.0%	-10.5%
% of Up Months	58%	37%
Correlation to Index	0.23	

The Fund returned -0.08%³ net of fees for January 2010, compared to the -1.0% return of the MSCI Asia Index. Since inception in July 2008, the Fund has returned 17.0% p.a.^{3,4} net of fees, compared to the Index's -2.9% p.a. return.

Equity markets in the region experienced sharp sell-offs during the month after China tightened its monetary policy earlier than expected and raised the reserve requirement rate imposed on banks to 16%. Strict administrative guidance to control bank lending and targeted policies to clamp down on speculative activity in the housing market were also implemented. The MSCI Asia ex-Japan Index lost over 6% for the month in local currency terms, with China losing over 8%. Japan, on the other hand, outperformed, with a less than 1% loss. The Fund's favouring of Japan has reduced its risk in other regional markets, with the value of its equity portfolio declining by less than 0.5%. As the Australian Dollar depreciated against both the US Dollar and the Japanese Yen, the Fund's currency exposure generated positive returns, offsetting the equity portfolio's losses. The Fund generated a gross return of +0.05% for the month.

Main contributors for the month include long positions in Lenovo, China's largest PC company, and Great Wall Automobile, a mid-sized auto manufacturer in China, as well as Nintendo in Japan. Short positions in Chinese financials have also helped protect our property exposure in China. However, some long positions in technology, including TCL Media, one of the largest LCD TV manufacturers in China, and Sanyo Electric in Japan, disappointed with negative returns.

During the month, we reduced some exposure in Japan's real estate sector following the sector's strong performance earlier in the month. In order to reduce currency risk, we added some Japanese exporters in the equity short portfolio, such as Koito, a Toyota subsidiary and one of the world's largest auto lamp manufacturers, as well as industrials in China/HK, including Pacific Basin, a Hong Kong-listed dry bulk shipping operator.

Top Five Performers	Bottom Five Performers
Lenovo (China, long)	TCL Multimedia (China, long)
Nintendo (Japan, long)	China State Construction (China, long)
Bank of Communications (China, short)	LG Chemical (Korea, long)
Ping An Insurance (China, short)	Sanyo Electric (Japan, long)
Great Wall Motors (China, long)	Nisshinbo Holding (Japan, long)

⁵ Using 5% risk-free rate for Sharpe ratio

⁶ The worst period of 'peak to valley' performance, regardless of whether or not the drawdown consisted of consecutive months of negative performance

⁷ Not yet returned to prior peak level

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Market Outlook

The first month of 2010 reminded investors of the bumpy road ahead for the global economy as well as the accompanying market volatility as governments and central banks worldwide (except Japan) are looking for the right timing to exit their stimulus packages. China's earlier-than-expected economic policy tightening triggered a sell-off, not only of Chinese equities but also in developed markets and in commodities and currencies, such as the Australian Dollar, typically the asset classes exposed to China growth. The Australian Dollar lost nearly 4% against the Japanese Yen and over 1% against the US Dollar during the month. With developed economies experiencing slow growth and global liquidity chasing growth in emerging economies, the correlation between all asset classes, including equity, currency and commodities has increased substantially. Diversification is becoming harder to achieve and volatility is rising.

The table below shows how closely correlated the Australian equity market has become with the world and Asia ex-Japan equity markets in recent years. The S&P/ASX Index correlation with the MSCI World Index has increased to 0.70 over the last three years, compared to 0.61 over a 10-year period. This would indicate that, by simply investing in international equities, Australian investors may not be able to achieve the diversification they are aiming for.

Interestingly however, the Japanese equity market and in particular the Japanese banks, which broadly represent the domestic sectors of Japan, have a very low correlation with the Australian equity market and other major indices, such as the MSCI Asia ex-Japan Index. In fact, Japan's Banking Index has a slight negative correlation with the Australian equity market. This may be due to Japan's uninspiring growth particularly when compared with China's emergence in recent years. This has led international investors to abandon the Japanese market, thus making an investment in Japanese domestic companies a potential diversification option for Australian investors.

Correlation (A\$)	S&P/ASX 200 Index	MSCI World Index	MSCI Asia ex-Japan Index	MSCI Japan Index	Topix Banking Index (Japan)
(Jan 2007 to Jan 2010)					
S&P/ASX 200 Index		0.70	0.77	0.22	-0.03
MSCI World Index	0.70		0.73	0.66	0.22
MSCI Asia ex-Japan Index	0.77	0.73		0.34	0.08
MSCI Japan Index	0.22	0.66	0.34		0.60
(Jan 2000 to Jan 2010)					
S&P/ASX 200 Index		0.61	0.69	0.27	0.04
MSCI World Index	0.61		0.72	0.57	0.20
MSCI Asia ex-Japan Index	0.69	0.72		0.36	0.04
MSCI Japan Index	0.27	0.57	0.36		0.74

Source: Bloomberg, Pengana Capital

China's tightening cycle has only started and recent macro data shows that inflationary pressures are building, following the sharp appreciation of property prices last year. According to a property index developed in-house by China International Capital, China's second largest investment bank, January property prices in nine of the largest cities were up 39% on the previous year. The Chinese government will face major challenges this year in terms of controlling inflation and restraining the excessive liquidity created last year to protect the local economy from the global financial crisis, all this without hurting economic growth. The task is to lessen the economy's dependence on fixed asset investment in favour of consumption and shift domestic investment from housing and heavy industries, which are high consumers of raw materials and energy, to higher value-add industries. The government effort to control housing prices will also lead to slower housing investment activities and weaken demand for materials. Uncertainty about

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the nature and impact of this new policy is likely to cap equity market performance in the region. We believe subdued growth in sectors exposed to China's housing investment activity, such as materials (steel, cement) and construction machinery, as well as its negative downstream wealth effect (auto and high end consumption) are likely to lead to slower growth this year. We do not believe current share price levels, particularly in markets outside China, have fully discounted such risks.

While inflation is becoming a risk to China's growth and the emerging markets, it can be a positive for the Japanese equity market. After two decades of deflation, the return of inflation creates welcome opportunity for Japanese domestic companies to regain pricing power. From a diversification perspective, Japanese equity, especially domestic sectors such as banks, could be a hedge against inflation over the long term.

Exposure by Sector	Gross	Net	Exposure by Country	Gross	Net
Growth Sectors			HK & China	26%	4%
Energy & Materials	7%	-4%	Taiwan	2%	2%
Ind., Con. Discretionary & Tech	42%	12%	South Korea	3%	0%
Financial & Real Estate	53%	21%	Singapore	13%	5%
Defensive Sectors			EM ASEAN	0%	0%
Con. Staples & Healthcare	14%	5%	Japan	46%	17%
Telecom & Utilities	2%	2%	Australia	29%	4%
Futures	2%	-2%	Equities	120%	33%
Total	120%	33%			

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