

Product Facts

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|----------------------------|----------------------|------------------------|------------------------|-------------------------------|-----------|
| Investment adviser: | Pengana Capital Ltd. | Peer group: | Alternative Strategies | Fund type: | Retail |
| Responsible entity: | Pengana Capital Ltd. | Specialisation: | Asian Equities | Min. investment (A\$): | A\$20,000 |
| APIR code: | PCL0002AU | Strategy type: | Equity Long/Short | Inception date: | July 2008 |
| Fund status: | Open | Directionality: | Long/Short (Long bias) | Domicile: | Australia |

Standard & Poor's View

S&P has awarded this fund a three-star rating based on its conviction that risk-adjusted returns can consistently meet relevant investment objectives and returns of peer funds.

The fund now has a one-year live track record and has performed strongly with returns originating from both stock selection and active currency management. S&P is comfortable that the experienced team has the requisite skill set to manage a product of this type. The product mandate provides the opportunities to generate absolute returns and meet the fund's target 15% returns.

S&P notes that the process incorporates some features that ensure the fund offers something different to other Asian-focused funds. The key difference is the active currency management which allows the manager to manage short-term volatility by using lowly correlated currencies when markets fall. This is not an alpha source, but does assist the fund during these inevitable periods. As Asian investing is particularly subject to sentiment and liquidity-driven elements, the ability to go long and short and to implement directional and "pairs" trades gives the manager more tools to be able to generate opportunities. Further macro and technical analysis overlays assist in finding thematic and help differentiate between companies that are temporarily and permanently impaired. We feel that the risk constraints are comprehensive and appropriate for the strategies.

The product's features are in line with most peer funds. Fees are above average but this also reflects the limited capacity targeted by the strategy in the first instance. A cash hurdle rate is welcomed and is consistent with peer products. The small current fund size is noticeable, but should not hinder the effective implementation of the strategy.

Key Risks

- Short track record - the fund has been live for one year and net exposure levels have been relatively low compared to its limits.
- Small fund size – the fund is currently A\$2.5 million in size representing all internal money. Although this should not hinder implementation, the strategy will not be able to run at its most effective levels until this amount is increased.
- Volatility – Asian markets have a high level of relative volatility. With its ability to gear, the fund may accentuate these levels.
- Short positions - the fund is long/short and may take short positions up to a net exposure of -50%. As pairs trading may occur, this is the chance for the fund to be wrong on both legs thereby producing a greater loss.
- Leverage – the fund may use a gross exposure of up to 200% which may be by options, swaps, and other derivatives.
- Currency risk – although all international equity investments have currency risk, the fund actively manages the positions which may provide a return other than that of equities investing.

Fund Objectives

| | |
|----------------------------|-----------|
| Target return (% p.a.) | 15%+ |
| Target volatility (% p.a.) | 8% to 12% |

Adviser Fees

| | |
|---------------------------|-------------------------|
| Upfront establishment fee | At Pengana's discretion |
| Trail fees | At Pengana's discretion |

Fund Fees

| | |
|---|---------------|
| Total cost (%) assuming objective of 15% is achieved | 3.70 |
| Management fee (% p.a., incl. GST) | 1.50 |
| Reclaimable expenses (% p.a.) | N/A |
| Other fees (note, swap, fx, etc.) | None |
| Performance fee (% p.a.) | 20 |
| High water mark (Y/N) | Yes |
| Hurdle rate | RBA Cash Rate |
| Buy/sell spread (%) | 0.25 |

Fund Characteristics

| | |
|--|-----------------|
| Current/Max leverage at fund level (x) | None/2x |
| Redemption period | Daily |
| Notice period for redemptions | 1 day |
| Redemption payments received | Within 5 days |
| Limit on redemptions (gate) | None |
| Distribution frequency | Annual |
| Distribution payment date | Within 60 days |
| Currency management | Active |
| Capacity | US\$500 million |

Product Features

The fund charges an above average level of fees but these do include all normal operating expenses. There is a high water mark and a cash hurdle rate which is common in this peer group. This results in a quarter of the return being paid in fees should the fund meet its objectives.

The fund may gear its exposure up to 200% of net assets and has the ability to implement positions using derivatives. The flexible mandate and active currency management should, in S&P's view, give this fund an advantage in implementation compared to peer funds.

The retail offer has daily liquidity with one day's notice which is appropriate given the strategy and securities involved.

Investment Style

The fund provides absolute returns by providing equity exposure to companies in the Asia-Pacific region or those companies listed outside the region that have substantial operations within the region. It aims to offer this participation in the growth of the region while minimising short-term volatility by managing the equity and currency exposures.

The fund has the ability to go long and short (although it will maintain a long bias) and may use derivatives to implement and to provide hedging to the portfolio. Leverage may be used to a maximum of 200% of net assets. A return objective of over 15% per year is targeted with a volatility of between 8% and 12%. The fund aims to have a high degree of upside participation in strong markets yet provide protection when they are weak.

The fund will be structured with a concentrated portfolio of positions. Portfolio construction is by stock selection and not country and sector allocations. The manager will select stocks that are mispriced by the cyclical, liquidity-driven markets in the region. The positions are then implemented either directionally or by pairs trades.

Investment Team

A four-person Sydney-based team works on the fund. Three of the team joined Pengana in 2008 to create this product, but they take advantage of analysts who work across sectors in other Pengana products. All of the team members are named as fund managers, although Diane Lin appears to take the lead role. The team has good tenure in the markets with an average of over 13 years of experience in equities markets. This results in a flatter structure than is typical and one where each member is given full responsibility for the research and decision making of their stock coverage. Ms. Lin, together with Charles Stodart, came to Pengana in 2008 to establish the fund. Both Ms. Lin and Mr. Stodart previously worked together at Perennial Investment Partners, where Ms. Lin had Asian portfolio management responsibilities. Mr. Stodart focused on researching equities in technology and telecoms sectors before being appointed to a deputy portfolio manager role with some Asian funds. At Perennial, both Ms. Lin and Mr. Stodart were involved in long/short equity portfolio management; therefore S&P has some comfort in their familiarity with this process and breadth of mandate.

Three others are listed as fund managers at Pengana and are involved in this product. Tim Shaw has extensive real estate investment banking experience, particularly with listed real estate. In his 16-year career, his main focus has been on Australia, but this has incorporated Asian markets and interrelated foreign exchange, rates, and equity transactions. Elan Miller has been with Pengana since 2004, and in that time he has been working on real estate investment trust (REIT) portfolios on a long/short basis. Much of Mr. Miller's focus has been on strategies in those markets such as relative value, pairs trading, and directional exposures, rather than fundamental REIT evaluation. His experience in strategy implementation will be useful to the team and he is also providing quantitative analysis. Douglas Isles is based in Singapore and provides research for the fund as well as marketing and product development for the wider Pengana group in the region. Prior to Pengana, Mr. Isles was involved with Platinum Asset Management as an analyst in the global industrials and airlines sectors. Although this was mainly with the international fund, there were some regional exposures within that product.

There are around 20 investment professionals in its equities strategies team (35 in the wider group), and with eight products on offer, there is an overlap of responsibilities between products. S&P is keen to see that there is adequate ongoing support in place before Pengana increases its range any further. This is paramount, given the product closures and alterations to the previous product range in recent years.

Investment Process

The investment process is not too dissimilar to other Asian equities managers, but the product has been designed with some extra features which should give the portfolio managers the opportunity to outperform their peers. The management team is aware that these markets are often liquidity-driven and cyclical, and therefore they need the ability to reduce volatility. This is done in this product by managing currency exposures during negative markets. Given the inherent liquidity, volatility, and cyclical factors in the market, there may be times when prices are irrational. Additionally, market sentiment may adjust quickly in the region. By structuring the fund to take advantage of these movements on a long and short basis, and by using both directional and pairs trading strategies, a further opportunity set is opened for the manager. Another differential is the use of technical indicators to identify entry points and excess liquidity in the markets. While these also offer unique risks, the increased scope available to the manager should allow the generation of absolute returns, and also provide dampened volatility.

There are no top-down country or sector allocations with stock positions being driven from a bottom-up fundamental approach, generally quality, growth, and valuation together with a small value bias. Idea generation is determined by a screening process used to identify undervalued or overvalued sectors or countries. The usual sources are used such as brokers, industry research, and an in-house quantitative screen. There are around 1,500 eligible securities in the Asia-Pacific region (or in other regions where a company has significant Asian operations). The team uses consensus earnings outlook, and balance sheet and valuation metrics to begin reducing the size of the investable universe.

Likely fundamental criteria will include quality, growth, and valuation. Quality includes balance sheets, management, and competitiveness. Growth will consist of sustainable growth prospects over the mid-term whereas valuation metrics are scenarios where growth or turnaround prospects have not yet been fully anticipated.

Once a small subset of opportunity has been found, common factors are found to explain the market's viewpoint with a fundamental approach being taken to understand that view. Further catalysts and reasons for this view to change are also identified before a list of investment ideas on both the short and long side is generated. This opportunity set may also include thematic and will differentiate companies that are temporarily out of favour with those experiencing greater problems.

Pengana's process is different in that it then applies a set of technical and macro analyses to establish the current state of the cycle. This is important, given the cyclical nature of Asian investing. Technical analysis can further enhance the understanding of market sentiment as well as provide a clearer determination of entry and exit positions. It also allows for the capture of trends on both the long and short side of the market.

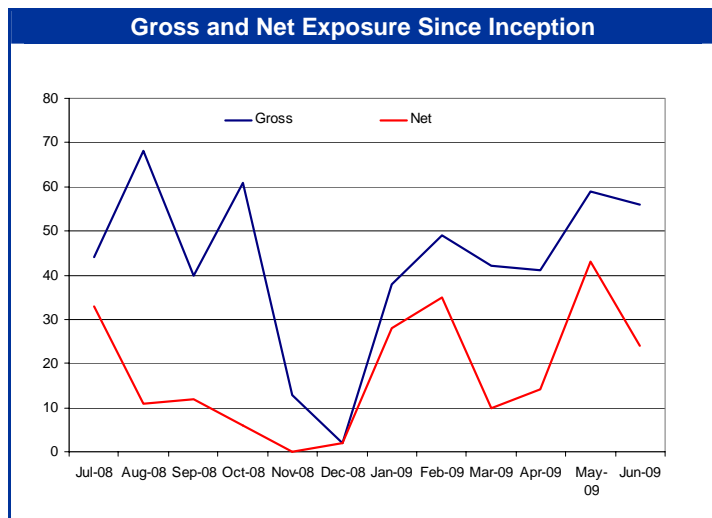
The actual implementation is carried out in two different ways, either a directional position or by a pairs or spread trading relationship between two securities where a valuation differential has been identified.

Currency Management

The fund aims to make use of currency management to protect the fund during down markets; it is not an intention to use it as an alpha source although this may be a consequence of the policy. During up markets, the fund will manage the exposure to minimise any drag on performance.

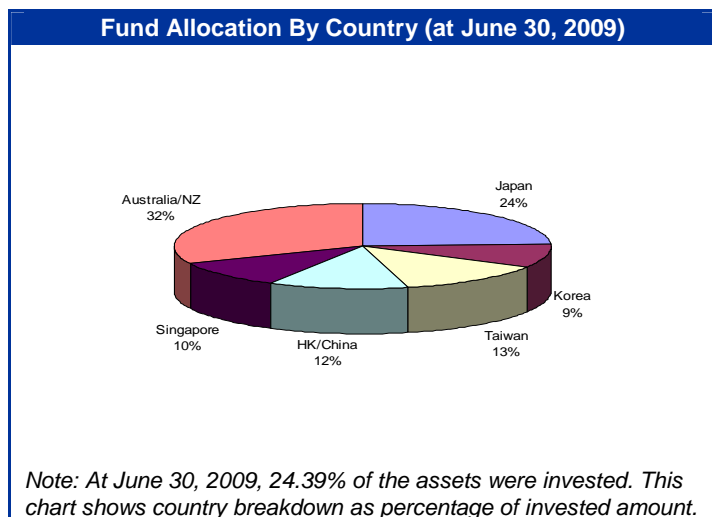
The main philosophy around the currency management is that when markets are falling it is hard to make absolute returns without net short positions. As the Australian dollar exhibits growth characteristics, such as a high correlation with negative equity markets, the manager can preserve capital by using lowly correlated

currencies to protect the portfolio as these currencies often appreciate when markets fall. Maintaining the fund in Australian dollars allows the manager to express a cautious, neutral, or bullish view depending on the sentiment of equity markets.



Current Portfolio Holdings

The number of stocks in the portfolio will range between 40 and 80. The full use of this range will occur as the FUM increases from its current A\$2.5 million. At June 30, 2009, the fund was around 76% in cash. Australia was the largest country weighting at 7.8% followed by Japan at 5.9%. Industry wise, the portfolio is dominated by financials, property trusts, and information technology. This is to be expected given the background and focus of the research team as well as the relative attractiveness of these sectors at the time of writing.



Performance

The fund started trading in July 2008, and has produced a strong net return of 22.5% in the first year. This result has been achieved with positive returns occurring in eight of the 12 months. The fund aims for absolute returns, but the fund's comparative benchmark, the MSCI AC Asia Index A\$, has returned -6.1% over the same period. Given the short track record, it is hard to make any commentary other than to observe that when the fund has had negative months they have been contained to less than 2% showing that the defensive characteristics of the strategy are being implemented. As would be expected given the

time of the launch, the worst drawdown came in the first two months of trading when it reached 4%, but was recovered within two months.

Detailed attribution has been provided, but again it is hard to form any strong views. Long positions were detrimental in the second half of 2008, but have been strong in 2009. The opposite has been the case with short positions, which together with currency, had a strong 2008 and negative 2009. However, this is consistent with the currency management position where a move away from the Australian dollar is favoured during negative markets.

Risk Management

The fund has a number of formalised constraints including maximum security positions of 10% of net assets (both long and short). However, the expected position size is expected to be 1%-2% with around 40 to 80 securities in the fund. As gross exposure may be up to 200% (with a range of -50% to +150%), this allows for a high conviction view to be expressed. Emerging Asian or ASEAN countries are limited to 30% of net assets with 10% in any one country. This is prudent and allows for a good level of contribution from ASEAN countries while limiting the potential for this to detrimentally affect returns across the whole portfolio. Small-cap stocks are also limited with a maximum 20% of net assets allowed to be placed in stocks with a market capitalisation of less than US\$500 million. All cash amounts will be held in custody at the prime broker, Citigroup, which will also determine the interest rate on any borrowings by the fund.

The fund managers may use derivatives for both alpha generation and risk management. Index futures may be used as hedges to dampen short-term volatility whereas individual stock derivatives can be used in markets where physical exposure is hard, excessively expensive, or local regulations make it difficult to obtain. However, physicals are used wherever possible.

In its first year of operation, gross exposure has varied between 2% and 68% with net exposures of between 0% and 43%. These levels can fluctuate materially month to month due to the manager's active monitoring and management of these levels.

Loss-making investments are normally reviewed when negative returns of more than 15% occur, although they are continuously monitored. If this limit is reached, the manager will decide whether to exit, hedge, or add to the position. Generally, a shorter holding period of around 1-3 weeks is used for these trades compared to the usual 3-6 months. All risk management is also conducted independently of the manager by Nick Griffiths, chief investment officer of Pengana.

Management Group Profile

Pengana was founded in 2003 as a diversified funds management business. It has evolved to offer a range of alternative investment strategies, generally equity-based. Pengana, headquartered in Sydney, now has over 50 staff members and runs eight funds. Although it is majority owned by staff and directors, the National Australia Bank took a minority strategic stake in May 2008. This has helped provide a stable balance sheet and distribution opportunities through the bank's internal channels.

Assets under Management

The fund had A\$2.4 million in FUM at July 31, 2009. This represents internal money and comprises the initial seed money plus the performance to date. As the fund now has a 12-month track record, Pengana is opening the fund to external investors.

Analyst(s): Simon Scott; Sheela Veerappan.

Release authorised by: Leanne Milton.

S&P Fund Rating Reference Information

Reference Material

Sector Reports

www.standardandpoors.com.au/funds

Reader's Roadmap

www.standardandpoors.com.au/funds

Glossary

www.standardandpoors.com.au/funds

Guide to S&P Qualitative Fund Ratings

www.standardandpoors.com.au/funds

Fund Rating Team Biographies

www.standardandpoors.com.au/funds

Fund Rating Peer Groups by Sector

| Australian Equities | International Equities | International Fixed Interest | Alternative Assets |
|----------------------------------|-----------------------------------|-----------------------------------|--------------------------------------|
| Large Cap Diversified | Diversified Equities | Diversified Fixed Interest | Commodities |
| Large Cap Income | Emerging Markets | Diversified Fixed Interest Income | Multi-Sector |
| Large Cap Indexed | Emerging Markets Asia ex Japan | Fixed Interest | Private Equity Listed |
| Large Cap Industrials | Emerging Markets China | Fixed Interest High Yield | Private Equity Unlisted |
| Long Short | Emerging Markets India | Fixed Interest Income | Infrastructure Listed |
| Small Cap | Large Cap Diversified | Mortgages | Infrastructure Unlisted |
| Specialist | Large Cap Income | Mortgages High Yield | Alternative Strategies |
| Australian Fixed Interest | Large Cap Indexed | Mortgages Conventional | Single Manager Funds Multi Strategy |
| Cash | Large Cap Industrials | Mortgages Hybrid | Single Manager Funds Single Strategy |
| Cash Enhanced | Long Short | International Property | Multi Manager Funds Multi Strategy |
| Fixed Interest | Long Short Specialist | Direct Commercial | Multi Manager Funds Single Strategy |
| Fixed Interest Income | Long Short Regional | Direct Development | Multi-sector |
| Mortgages | Regional Japan | Direct Diversified Direct | Capital Guaranteed |
| Mortgages High Yield | Regional UK/Europe | Direct Industrial | 20 |
| Mortgages Conventional | Regional US | Direct Residential | 40 |
| Mortgages Hybrid | Regional Asia | Direct Retail | 60 |
| Australian Property | Small Cap | Direct Rural | 80 |
| Direct Commercial | Specialist Healthcare | Direct Specialised | 100 |
| Direct Development | Specialist Information Technology | Diversified Property | Equity |
| Direct Diversified Direct | Specialist Resources | Listed | Other |
| Direct Industrial | | | |
| Direct Residential | | | |
| Direct Retail | | | |
| Direct Rural | | | |
| Direct Specialised | | | |
| Diversified | | | |
| Listed | | | |








Fund Rating Philosophy

A star rating is a forward looking assessment of a manager's ability to consistently generate superior risk-adjusted fund returns, net of fees, relative to relevant investment objectives and 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

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|--|--|
|  | Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of relevant investment objectives and relative to peers. |
|  | Standard & Poor's has high conviction that the manager will consistently generate risk-adjusted fund returns in excess of relevant investment objectives and relative to peers. |
|  | Standard & Poor's has conviction that the manager can generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers. |
|  | Standard & Poor's has conviction that the manager will not generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers. |
|  | Standard & Poor's has high conviction that the manager will not generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers. |
|  | Issues potentially affecting the management of the fund have emerged, and the fund rating is temporarily suspended, pending clarification. |
|  | A manager with significant issues that have the potential to adversely impact performance. Existing investors should consider obtaining advice regarding switching or redemption. |

Fund Rating Subscript

 Where the investment process, fund manager or analytical team has changed significantly, or where the fund has a relatively short history, but a relevant and demonstrable track record can be shown on similar funds.

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