

Pengana Asian Equities Fund

28 Feb 2010

The Pengana Asian Equities Long Short Fund (the Fund) is an absolute return orientated fund utilising a contrarian long / short strategy to provide investors access to the superior economic growth prospects of Asian equity markets (including Australian & Japan).

Operating a bottom-up fundamental investment approach with a macro and technical overlay the Fund seeks to reduce short term volatility through its use of active shorting and currency management. In Zenith's view it is this product structure, the philosophy behind it, and the Manager's ability to deliver on this objective (albeit over a relative short timeframe since inception) which is one of its most appealing features. Where the Manager does let itself down is in the document evidence sitting behind their investment process and portfolio construction, which is weak and appears largely subjectively driven.

The Fund will comprise of between 40-80 stocks (30-50 long & 10-30 short) and have net market exposure between -50% and +150%. With this equating to a maximum 200% gross exposure the Fund can utilise borrowing up to a maximum 1 time leverage although it is expected it will be infrequently used. Individual stock positions tend to average 1%-2% in size and comprise of directional long / shorts and pair trading. Generally speaking risk management within the portfolio is strong while a capital preservation mindset is clearly evident within the absolute return psyche of the Manager.

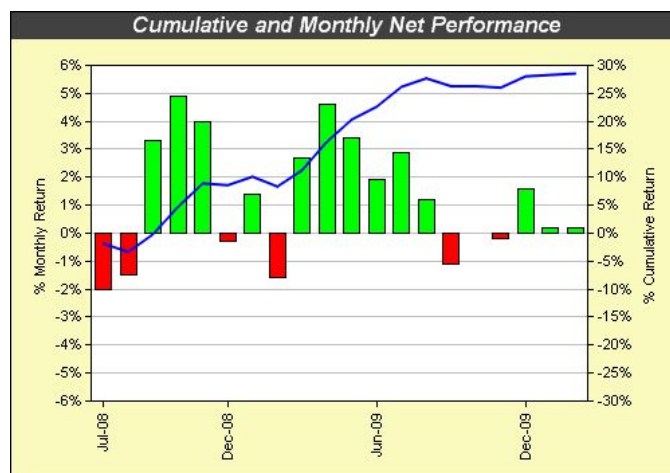
Volatility of returns is expected to be lower than its long only Asian fund peers, in part due to its lower net market exposure and higher cash weighting, with the latter having average 22% since its launch. The Manager's active use of currency management also assists in de-risking the approach with it aimed at protecting the equity portfolio during periods of higher volatility. It's important to note that Pengana isn't taking a view on currency nor seeking to add value from currency positioning but rather using this as a tool to manage beta or risk. During market up-trends, equity exposure is used to increase market participation and currency exposure is carefully managed to limit the impact on equity returns.

The investment team is an eclectic group of complementary skill sets but in Zenith opinion this has come about as a result of the closure of the Pengana Real Estate capability (which is where Elan Miller and Tim Shaw previously sat), as opposed to this having been undertaken independently and as the a result of achieving the best team structure. While the Manager has been able to work this to their favour in part by playing to their strengths and maintain a typical high exposure to REIT's and Japanese equities, we believe this is to the detriment of a well rounded Asian equities offering. Team depth of experience and expertise is strong, as is the overall resources dedicated to this strategy (5 team members headed by Diane Lin) relative to their competitors.

Other more minor aspects Zenith feels hold back the Fund from achieving a higher rating include its high fees (base management fee 1.54%, performance fee of 20.5% above RBA Cash Rate) and low funds under management (which increases investor diversification client risk and risk of longevity of strategy).

Overall Zenith believes the Pengana Asian Equities Long Short Fund has "potential" but in its current form falls short of some of its Recommended peers and as such has been assigned an APPROVED rating.

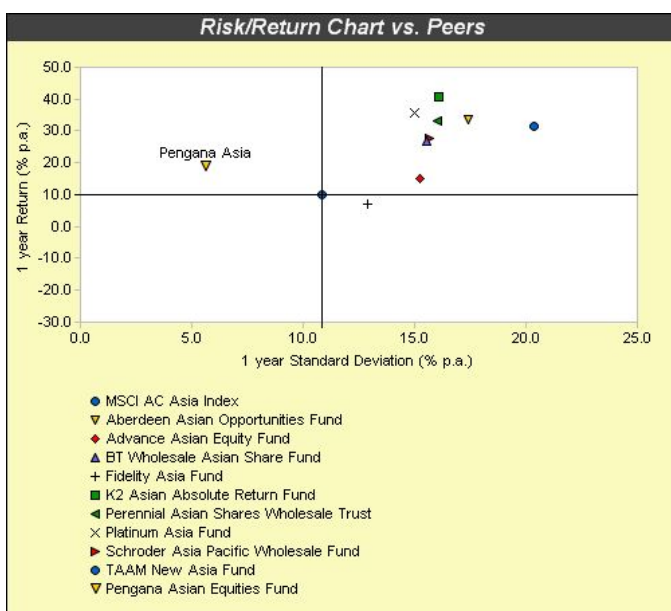
| Key Features | Description |
|----------------------------------|----------------------|
| APIR Code | PCL0002AU |
| Asset Class | International Shares |
| Sub-Asset Class | Regional |
| Investment Style | Long/Short |
| Benchmark | MSCI AC Asia Index |
| Recommended Investment Timeframe | 5 + years |
| Fund Manager | Diane Lin |
| Investment Team Size | 6 |



| Performance Statistics | 1 Yr (% p.a.) | 6 Mths (%) | 3 Mths (%) |
|-------------------------|------------------|---------------|---------------|
| Performance - Fund | 18.67 | 0.68 | 2.01 |
| Performance - Benchmark | 10.06 | -2.48 | 3.41 |

| Consistency Statistics | 1 Yr |
|---|--------|
| History of Monthly Excess Return (%) | 66.67 |
| History of Monthly Excess Return (Rising Mkts %) | 20.00 |
| History of Monthly Excess Return (Falling Mkts %) | 100.00 |

| Risk / Return Statistics | 1 Yr |
|------------------------------------|------|
| Information Ratio - Fund | 1.12 |
| Sharpe Ratio - Fund | 2.68 |
| Standard Deviation (% p.a.) - Fund | 5.67 |
| Tracking Error (% p.a.) - Fund | 7.67 |



Investment Personnel

| Name | Title | Time with Manager |
|-----------------|--------------------|-------------------|
| Diane Lin | Fund Manager | 2 Yr(s) |
| Charles Stodart | Fund Manager | 2 Yr(s) |
| Tim Shaw | Fund Manager | 3 Yr(s) |
| Elan Miller | Fund Manager | 6 Yr(s) |
| Douglas Isles | Executive Director | 1 Yr(s) |
| Tobias Yao | Investment Analyst | 2 Mth(s) |

Organisation

Pengana Capital (Pengana) is a diversified funds management business offering innovative alternative investment strategies to the market. Founded in early 2003, Pengana has offices in

Sydney, Melbourne, Singapore, Edinburgh, Chicago and Connecticut and funds under management (FUM) of approximately \$840 million (as at June 2009). The three dominant funds, as a % of total FUM, are the Pengana Credo European Property Trust (16%), the Pengana Emerging Companies Fund (28%) and the Pengana Global Volatility Strategy (31%).

Pengana Capital is a 100% owned subsidiary of Pengana Holdings, which in turn is 49.9% owned by NabInvest (part of national Australia bank, acquired in May 2008) and 50.1% owned by other investors (predominately directors and staff). A total of 15 non-investment personnel operate at Pengana, including Russel Pillemer (CEO) and Katrina Glendinning (COO) while 25 investment professionals exist across the equity, credit, volatility and multi-manager strategies.

Zenith is more comfortable with the stability, financial security and distribution prospects of Pengana as a funds management entity post National Australia Bank becoming a significant minority shareholder.

Investment Team

The Pengana Asian Equities investment team comprises 6 investment professionals, 5 based in Sydney and a single resourced located in Singapore.

The investment team is headed by portfolio manager of the Fund, Diane Lin, who has over 15 years experience in financial services and funds management, predominately in the Asian equities arena. Prior to moving to Australia in 1998 Lin was based in London and held Asian equity roles at both Nomura International and UBS. Upon arriving to our shores she continued to apply her craft, firstly with Platinum Capital (portfolio manager / analyst) and then at Perennial Investment Partners (Head of Asian & Japanese Equities). She subsequently joined Pengana in 2008 to establish the Asian Equities Long Short Fund. Lin is fluent in Japanese, Mandarin and Cantonese and is adept at the cultural intricacies of the region which has assisted in access and information flow into the process.

Zenith regarded Lin's experience, expertise and track record in this asset class highly, with her having worked within some high quality domestic boutiques (experienced at running offshore mandates from a local domicile), having been immersed in Asian equities for many years and having managed long short strategies previously (Rubicon Asia Fund - a Pan-Asia long short vehicle during her time at Perennial Investment Partners).

The remaining members of the investment team comprise Charles Stodart, Tim Shaw, Elan Miller, Douglas Isles and Tobias Yao.

Charles Stodart moved across to Pengana with Lin having worked alongside her during his tenure at Perennial Investment Partners (2000-2008) in a variety of roles including - as a senior analyst in global equities (telecom & technology sectors), as portfolio manager for the Rubicon Global Fund (a long / short strategy) and as Deputy Portfolio Manager for the Asian Equity Fund. Before coming to Australia in 2000, Stodart spent 5 years in international equities at Murray Johnstone Ltd, a Glasgow-based investment firm, with GBP4 billion in funds under management.

Tim Shaw joined Pengana in 2007 as Head of Research & Strategy in the Global Property Team, to work alongside Stuart

Stuckey (who at the time was based in London and subsequently departed in February 2009). At its peak the Pengana Property team totalled 9 investment professionals including 3 based in Singapore. Prior to joining Pengana, Shaw was co-head of Real Estate Investment Banking Australia at Deutsche Bank, where he was responsible for client coverage across the Australian listed real estate sector (1999 - 2007).

Another existing Asian equity team member who has moved internally is Elan Miller, who originally joined Pengana in 2004 to manage the Asia Pacific and Australian Real Estate trust portfolio. This was his first foray into the REIT sector having come from a hedge funds background (equity-orientated non-directional and arbitrage portfolios). Prior to joining Pengana Miller was a portfolio manager with Gensec, the investment bank subsidiary of South African financial services group Sanlam.

Douglas Isles is an Executive Director for Pengana based out of Singapore having joined the Group in November 2008 with 13 years experience in financial service and funds management. He divides his time between marketing and product development for the Group and providing on-the-ground research for the Asian Equities Long Short Fund. His background includes starting his career as a marketing analyst (Scottish Equitable), before moving into investment management (Aegon Asset Management - equities analysis, CBA - product actuary, Platinum Asset Management - global industrials / airlines analyst).

The most recent addition to the investment team is investment analyst Tobias Yao who joined Pengana in January 2010. Yao was born and raised in Shanghai, China and is fluent in Mandarin. While an "entry level" role it is envisaged Yao will spend 6-12 months in the Sydney office before moving to Shanghai and providing the investment team a greater "on the ground" presence in the region.

Responsibilities within the team are as follows - Diane Lin (macro & strategy, industrials & consumer discretionary), Charles Stodart (technology, telecoms & utilities), Tim Shaw (financials & real estate), Elan Miller (technical & quantitative analysis), Douglas Isles (marketing & information research) and Tobias Yao (investment research, modelling & analysis).

The investment team is an eclectic mix of individuals from a wide variety of backgrounds and while on face value this structure forms part of its potential appeal, Zenith is of the opinion it has been formed in part out of an internal restructure and as a result its composition is not ideally suited to managing a long / short strategy in Asian equities. While having a strong capability and track record in the real estate investment trust sector and Australian / Japan equities, its broader country and sector background within the team is relatively low when compared with some of its Asian equity peers. This bias in terms of expertise and background is borne out in the portfolio composition.

One of its strengths however is the fact that both Lin and Stodart have managed long / short strategies previously, which when coupled with Miller's background in hedge funds (including operating as a trader), means the investment team is not seeking to transition from running long only mandates and has a meaningful track record in long / short strategies. Investment team size at six investment professionals is solid when compared with other domestic based managers offering locally managed Asian equities (i.e. Treasury Asia - 6,

Platinum - 4, Perennial - 3, K2 - 4), although in reality we envisage the five domestically based team members make up the majority of the capability in this asset class, with Isle's role split between providing on-the-ground research (25%-30% of his time at best) as well as marketing and development support for the broader Group. The investment team structure is flat which is a positive and promotes idea exchange on a daily basis. Outside this dialogue, on Mondays a broader Pengana investment team meeting occurs which allows cross fertilisation across the 8 different teams and 25 investment professionals.

Investment Process

The Pengana Asian Equities Long Short Fund provides investors with equity exposure to companies within the Asia Pacific region. Pengana believes Asian equity markets are likely to produce solid return over the long term, with their superior economic growth prospects compared to developed countries. However, market volatilities remain high due to the markets' liquidity-driven nature and the region's highly cyclical economic structure.

In aiming to achieve long term sustainable returns the Manager believes it is critical to protect against downside risks and reduce short term volatility. Due to the strong correlation between currency and equity market performance in the region, Pengana uses currency management to protect the equity portfolio during periods of higher volatility. During market up-trends, equity exposure is used to increase market participation and currency exposure is carefully managed to limit the impact on equity returns.

Philosophically, Pengana believes that markets behave irrationally at times, either under or over estimating growth prospects and risk profiles of certain sectors and companies. They believe this can lead to volatility and mis-pricing of listed securities, offering attractive opportunities to experienced and disciplined investors. With a firm focus on fundamental research, as well as technical analysis to understand market sentiment, Pengana believes it is possible to identify market trends and investment opportunities for both long and short strategies.

Pengana's investment style utilises both bottom and top down input as it believes one investment style is unlikely to continuously generate alpha throughout a variety of economic scenarios. Pengana believes in a stable economic environment a bottom-up stocking picking investment style is likely to produce higher alpha as companies earnings are easier to forecast and consequently valuations are more readily determined. However, during a period of economic uncertainty generating alpha with a purely bottom-up approach is problematic because information gathered at the micro-level will have limited relevance when the business environment is in constant change.

Security Selection

The Fund has a fairly broad investment mandate in that it may invest in securities such as ordinary shares, units, preference shares, synthetic equity swaps, convertible securities and other securities of an equity or hybrid equity nature. These securities must either be listed, or be intending to list on an approved stock exchange in the Asia Pacific region. The Fund may also invest in securities listed outside an Asia Pacific exchange but where the entity has substantial operations in the region. It may also hold cash, derivatives (for example options, futures and swaps) and currency contracts.

The Fund primarily employs two core investment strategies:

1. Directional long and short positions - this strategy relies primarily on fundamental company research and an understanding of the markets in which companies operate; and
2. Pairs trading - in which similar stocks are identified, but where a disparity in valuation can be quantified (the Fund will benefit when this disparity reduces, this is typically undertaken on a market neutral basis and executed by Elan Miller).

The investment process comprises three key steps - idea generation, information gathering and financial modelling. Idea generation starts with a screening process to identify under-valued or over-valued sectors or countries. This process includes qualitative idea generation from brokerage recommendations (extensive use of local brokers in Japan, China / HK and Taiwan. i.e. CICC - where 90% of reports are written in Cantonese which the team able to utilise given Lin's bilingual capability), industry research as well as quantitative screening using an in-house database. The in-house database consists of approximately 1,500 listed securities in the Asia Pacific region (approximately 50% Asia, 50% Japan) with criteria including consensus earnings outlook, balance sheet strength indicators and various valuation metrics (including technical analysis). Some of these specific 40 different criteria which are considered include price earnings (0, 1 & 2 years), earnings per share growth (1 & 2 years), yield (1 year), operating profit margin, price to book, return on equity, return on assets, net debt to equity, relative strength indicator and beta etc. No formal ranking exists on the screens but rather it is used to "eye ball" where Pengana should focus their research effort. Currently approximately 165 companies sit on the Asia Watch List (excluding Australia) and 55 companies sit on the Japan Watch List.

The second stage of the investment process involves information gathering where the results of the screening process are analysed to identify any common characteristics. Fundamental research through communication with companies / industry analysts is then implemented to pinpoint causes of the markets optimistic or pessimistic view point and what catalysts might result in a change in the markets view. Pengana's company visitation program tends to be more geared around "site" visits, which is then coupled with contact to other parts of the value chain (i.e. suppliers, customers etc), than a company management meeting in their office. During calendar year 2009 four members of investment team undertook visits into the region - Lin (3 trips), Shaw (2), Miller (2) and Stodart (3).

The final stage of the investment process involves financial modelling, which is a 3-5 year discounted cash flow (DCF). Both Lin and Stodart have been using this same approach for 8 years and its focus is on attaining an estimate of "fair value" and to understand what the market is discounting. While 40%-50% of research work is generated internally, Pengana implements its own original assumptions and forecasts in its models. Approximately 50-60 stocks are fully modelled by the team with a further 15-25 additional stocks modelled but would require 1-2 days work to make current. From this stage of the analysis the Manager establishes a focused list of long and short ideas suitable for entry in the portfolio.

Portfolio Construction

The Fund uses fundamental (covered in "investment process" section), macro and technical indicators in order to determine

buy and sell decisions. Macro analysis seeks to understand the current state of the economic cycle while technical analysis seeks to better understand market sentiment and the different stages of market momentum.

The macro overview is provided by Diane Lin and includes analysis of the current economic development within the cycle, government policy (fiscal & monetary), industry development and catalysts for macro change in respect to companies/sectors on the Focus list. Lin will also undertake a strategy overview which looks at global financial markets to identify broad market trends and the risk profile to decide equity exposure. For example, if the companies under coverage show extremely stressed valuations with depressed sentiment, but the Manager can identify a catalyst for change in such extreme sentiment, the Fund's market exposure will be raised accordingly and vice versa. The Fund's net exposure can range between -50% to +150% although over the period June 2008 to August 2009 it averaged 22% (net) and 54% (gross). While the Fund will be typically not be geared, its maximum gross exposure is 200% and hence 1 times leveraged.

One of the cornerstones of the Pengana process is understanding strong correlations between currencies and equities and careful currency management of outstanding cash positions to protect the equity portfolio during down trends while maximising equity return through up trends.

Technical and quantitative analysis is undertaken by Elan Miller and includes understanding liquidity conditions of broad markets, technical analysis on specific securities to assist with market timing (10 & 20 day moving averages, trend analysis, relative strength indicators, mean revision & money flow) and monitoring news flow and corporate events of companies on the Focus list.

The Fund will typically hold between 30-50 stocks on the long side and 10-30 stocks on the short side and given its absolute return focus it does not track an index and is therefore not bound by any country or sector allocations. While the Fund does not have any intended capitalisation bias, given the better liquidity it tends to invest more prominently in large companies. The average position size in the portfolio is 1% to 2% with an average holding period of approximately 3-6 months although this will be dependent on market conditions and on how quickly securities achieve their price targets. An investment position showing a negative return of more than 15% will trigger monitoring and the average holding period on losing positions is 1-3 weeks. Since inception the Fund's portfolio turnover has been 6 times per annum which is higher than what the team experienced at Perennial and while this may be slightly inflated due to recent market conditions, it is unlikely to ever fall below 3 times. The Fund makes use of direct market access systems and its average brokerage rate is 0.15%-0.20%.

While Zenith regards the Pengana portfolio construction process as sound, it appears very subjectively driven and we would prefer to see greater documentary evidence around the macro, strategy and technical analysis undertaken which forms part of portfolio construction. The Manager also doesn't model all stocks in the portfolio which Zenith regards as a weakness.

Risk Management

| Portfolio Constraints | Description |
|---|--------------|
| Portfolio Stock Numbers | 40 to 80 |
| No. stock longs | 30 to 50 |
| No. stock shorts | 10 to 30 |
| Maximum Individual Long Stock Position (%) | max: 10% |
| Maximum Individual Short Stock Position (%) | max: 10% |
| Target Net Market Exposure Range (%) | -50% to 150% |
| Maximum ASEAN Emerging Market Exposure (%) | max: 30% |
| Target Maximum Gross Exposure (%) | max: 200% |
| Maximum individual ASEAN Country Exposure (%) | max: 10% |
| Maximum Stock Exposure - market cap <US\$500m (%) | max: 20% |

Pengana's risk management process is one of the strongest components of its offer:

- Short selling** - hedges against broad market risks, sector specific risk and is used as alpha generation tool. Pengana appears to have a clear objectives in place in terms of position execution and a solid risk control mechanism in place through ongoing monitoring of positions;
- Currency management** - actively managed currency exposure by reducing volatilities during the market down-cycles. This is a trait Zenith has observed at Platinum Asset Management (Platinum) over numerous years and given Lin's time spent with the Manager it is not surprising to see it as part of the Pengana risk management process;
- Portfolio diversification** - solid diversification in terms of individual stocks, market exposure, emerging country exposure and market capitalisation. Although no developed country or tracking error limits exist within the Fund, which we would prefer to see;
- Net exposure** - the Fund's objective is not to be fully invested at all times and will vary its net exposure to prevailing market conditions. A capital preservation mindset is clearly evident within the absolute return psyche of the Manager.

The table above outlines in more detail some of the specific risk guidelines the Fund has in place.

Risks of the Fund

As is the case with all global equities based products, the biggest risk to the Fund is a significant downturn in its region, which could lead to periods of negative performance. Asian markets remain highly volatile due to the liquidity driven nature of markets and the region's highly cyclical economic structure.

This risk of negative performance can be significantly reduced by investors adopting a medium to long-term (5+ years) investment time frame when investing in this Fund. The Fund's ability to short stocks / indices, actively use currency management and hold significant levels of cash also offers further protection in weak markets, particularly relative to long

only Asian fund peers. On the flipside, the relatively low net market exposure of the portfolio may lead to underperformance of the benchmark and median long-only Asian equities fund during strong bull market conditions, although absolute returns should remain strong in such periods.

Another key risk to performance relates to Pengana's ongoing ability to correctly select stocks and identify themes in equity markets. Furthermore the Fund has only been in existence since July 2008 and as at the time of our review (January 2010) its 12 month absolute return was ranked 10th out of a possible 14 funds (this improves to 3rd on a risk adjusted basis given its lower volatility), so some risk around sustainability of performance exists until a longer track record can be verified.

Given that the Manager utilises a dual pronged investment strategy (directional long / shorts & pair trading) and these are typically under the guidance of different fund managers, key person risk is perceived to be less of an issue at Pengana than those funds management organisations with a single investment process and single decision maker. In Zenith's view, however the departure of Dianne Lin (in particular) would be a material loss for Pengana, and would instigate a re-assessment of our current rating of this Fund. It should also be noted that we would prefer to see greater clarity around the ownership of equity in the Pengana Capital business from within the Asian Equity team with current transparency not allowing for verification that the current key staff are adequately "tied" to the Manager.

The Fund was internally seeded with A\$2.0 million and its current funds under management isn't too much higher than its initial level (although the pool size is at approx. A\$18.0m total if you include the Cayman structure). With this brings some client diversification risk until such time the Fund reaches a more meaningful size. Zenith would like to see the Fund at a minimum A\$10 million and preferably A\$20 million. While capacity is clearly not an issue for the Fund presently, the Manager believes this will be capped at USD\$500 million based on using no more than 30% of daily liquidity and still being able to implement a 2% position on a daily basis.

While Pengana Capital's total fund under management is circa A\$840 million across the Group, some heightened corporate risk exists on investing with a boutique asset manager (although the NablInvest "tie up" has strengthened its distribution capabilities).

Applications of the Fund

| 1 year Excess Correlation Table | |
|--|--------------------|
| Fund Name | Excess Correlation |
| Aberdeen Asian Opportunities Fund | -0.40 |
| Advance Asian Equity Fund | 0.02 |
| BT Wholesale Asian Share Fund | -0.24 |
| Fidelity Asia Fund | -0.15 |
| K2 Asian Absolute Return Fund | 0.16 |
| Perennial Asian Shares Wholesale Trust | -0.08 |
| Platinum Asia Fund | 0.07 |
| Schroder Asia Pacific Wholesale Fund | -0.04 |
| TAAM New Asia Fund | -0.12 |

For investors that construct global equity portfolios by combining regional products, Zenith believes Pengana is a solid option on offer to Australian investors to gain exposure to Asian equities.

While Zenith prefers to utilise the skills of a highly rated global manager to make regional allocation decisions, we believe there is merit in choosing regional specialists if they demonstrate a higher propensity to outperform in their region relative to global managers. This is usually based on greater understanding of a region based on a more focused approach.

Alternatively, Pengana could be used as a satellite exposure around a core global equities funds for investors with a strong positive view on the Asian market, however, Zenith stresses to investors that it is difficult to time the markets.

Zenith advises against the use of the Fund as a standalone investment as it does not provide adequate diversification across global equities regions. While we have confidence in Pengana's ability to enhance risk adjusted returns for investors, Zenith believes the Fund is best used as part of a blended investment portfolio, based on its regional focus and long / short investment approach.

Zenith believes a key attraction of Pengana is its benchmark unaware approach. That is, Pengana only spends the portfolio's risk budget on stocks in which it has strong conviction. This is not always the case with benchmark aware managers, which often seek to protect relative performance to ensure they do not underperform their peers by too great a margin. If a fund manager does not like a stock Zenith would prefer to see them not hold it.

Given the Fund's long / short (average net exposure since inception of 22%) and contrarian approach Zenith believes this product will suit investors seeking the superior long term economic growth prospects of the region but within a risk controlled framework. While we would like to see evidence over a longer timeframe, this more conservative and capital preservation mindset is visible in the Fund's volatility (it was the second least volatile fund on a standard deviation measure over the 12 months ending 31 January, out of a total peer universe of 15 funds).

The Fund is a high turnover product (6.4 times p.a. since inception) and as such much of the return may come back to

investors in the form of capital with a substantially amount not discounted, which may not suit all investors.

Fees

While the Fund's fees (1.54% base management fee & 20.5% performance fee above RBA Cash Rate) are comparable to the K2 Asia Absolute Return (1.72% base management fee & 20.5% performance fee above 6% hurdle), it is significantly inferior to Platinum and Treasury Asia Asset Management (TAAM).

By way of comparison Platinum has two options on its Asia Fund - a straight base management fee option at 1.54% or a base management fee and performance fee option (base at 0.79% & performance fee of 16.5% above the MSCI All Country Asian ex Japan \$A). TAAM has a base management fee of 1.025% and a performance fee of 10.25% (again above an equities benchmark).

Zenith would prefer to see an equity benchmark hurdle rate used by Pengana and while the argument as why this has been done will be the Fund has a long / short strategy and often less than 100% market exposure, Platinum adopts a similar strategy and we believe their fee structure is fair and reasonable and better aligns fund manager and investors interests. A 0.25% buy / 0.25% sell spread also exists on the Pengana Asian Equities Long Short Fund.

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