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

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$1.1558	**Redemption Price at Month End**	A$1.1500
Style	Fundamental	**FUM at Month End**	A$15.4m
Investors	Wholesale Clients only	**Management Fees [2] (monthly)**	1.00% p.a. of NAV
Benchmark	The time weighted average of the target Australian Cash Rate used by the RBA	**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%	1.1%	3.6%	-0.2%	-4.0%		**15.4%**

The Fund's return for May was -4.0%[3] after all fees and costs. By way of comparison the Australian All Ordinaries was down -7.6% for the month and the prevailing cash rate during May was 0.4%. **For the 23 months since inception the Fund has protected capital and provided investors with a satisfactory total return of 18.8% (annualised 9.4%) versus the 8.1% cash rate (4.2% annualised) and the negative market return generated by the Australian All Ordinaries of –9.1% (-4.8% annualised).**

As at the 31st of May, the cash position of the Fund's NTA stands at 19%. 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. (Note that the effective cash position is higher at **21**% due to the cash inflows from new investors on the 1st of June 2010.)

Large positive contributors to the month's performance were McMillan Shakespeare, Resmed, Ramsay Healthcare, BHP Puts and the large Cash position. The largest detractors were: Sonic Healthcare and the three bank holdings Westpac, CBA and NAB.
No new holdings were acquired during the month. The strong cash inflows were applied to increase selective existing holdings in the Fund. These included: McMillan Shakespeare, NIB Holdings, Westpac, Mermaid Marine and News Corporation. The Fund trimmed its holdings in NAB, Ramsay Healthcare and disposed its holding of the BHP Put options realising significant gains.

As at 31st May 2010 the top five holdings by value in the Fund were: Westpac, NIB Holdings, News Corporation, CBA and Macmillan Shakespeare.

Net Returns to 31st May 2010 [3]

	Pengana	Cash Rate	All Ordinaries
1 Month	-4.0%	0.4%	-7.6%
3 Months	-0.9%	1.0%	-3.3%
6 Months	-1.0%	1.9%	-3.9%
12 Months	19.7%	3.5%	21.4%
23 Months since Inception	**18.8%**	**8.1%**	**-9.1%**
Annualised return Inception	**9.4%**	**4.1%**	**-4.8%**

[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.

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

Market Commentary

Market Review

During May the ASX All Ordinaries Accumulation Index absorbed the following litany of bad news – "a Eurozone Debt crisis, a Euro crash, a carry trade crash, VIX, LIBOR, a Wall St " 1000pt flash crash", China tightening, a volcano, an oil spill, North Korea vs. South Korea, UK change of Government, RBA rate hike, The Henry tax review, Resources Super Profits Tax, Greek and Thai riots, a class action against Australian Banks, a failed terrorist attack in New York and Goldman Sachs being charged with fraud"[1] – and closed down -7.6%. The worst performing sectors were Industrials (-11%), Financials (-11%) and Utilities (-7%) while Consumer Staples (-1%), Healthcare (-4%) and REITS (-4%) were the month's "better performers".

[1] [Attributed to Charlie Aitken of Southern Cross Equities]

Importantly it should be noted that global investors are finding the resilience of the Australia economy hard to believe given the ongoing structural challenges in their home economies and the risks associated with Chinese economic growth. This scepticism has been exaggerated by sovereign risk associated with the government's proposed retrospective taxes on resource companies.

Investment Outlook

The medium term economic outlook for OECD Group countries is for an extended period of low growth (sub 2%). The broader European community has been forced to bail out its weaker (and less fiscally disciplined) members with a massive package that could lower even this bleak medium term outlook. While the Asian (ex Japan) economies and China's economy in particular are expected to continue growing at robust levels, investors are becoming more cautious given the early warning signs of inflationary pressures, weakening credit environment, and property "bubbles".

While the proximity of these "growth markets" should allow Australia to leverage its competitive advantage in providing high quality, low cost coal and iron ore volumes, spot prices of these commodities have fallen significantly below their 1 year contract prices. **In addition, the complex tiers of China's government and opaque levels of debt at every level create uncertainty around the sustainability of growth at these rates.**

Domestically, the underlying economy remains on an expansionary path assisted by a positive backdrop of: a stable financial system, unemployment levels which continue to defy pessimistic expectations, above trend population growth, and a sharply improved trade balance. **However, the hangover from last year's stimulus and its impact on this quarter's retail sales is highlighting the need for caution**.

The recent improvements in the medium term outlook for the underlying Australian and major global economies appear to be running out of steam. This recent deterioration needs to monitored closely to ensure that recent developments represent a temporary pause rather than a deterioration. Importantly, while the outlook for earnings has become more uncertain, valuation multiples have come off sharply. Consequently pockets of opportunity have emerged.

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 higher earnings and cash flows in the future, irrespective of whether the markets are higher or lower.

In addition the Fund successfully employed three risk mitigation strategies. Firstly, having a quarter of the Fund's value in cash provided the firepower to take advantage of the value emerging from sharply lower share prices. Secondly, a focus on acquiring good companies with non-Australian dollar earnings streams at a significant "discount" due to a robust A$ above US$0.93. Thirdly, the Fund's position in BHP put options, taken out as insurance against a slow down in China's growth, worked well. It was closed out during the month realizing a significant gain. The position was helped by negative market sentiment which occurred after the announcement of the Resources Super Profits Tax.

Other examples of this can be found in several defensive companies with competent management, dominant market shares, pricing power and robust balance sheets. Lower share prices in a weak equity market provide more attractive entry points for the Fund which is focussing on after tax cash earnings yields.

Contact Details

Pengana Capital Limited ▪ Level 29, 20 Bond Street, Sydney, NSW 2000, Australia ▪ T +61 2 8524 9900 ▪ F +61 2 8524 9901
ABN 30 103 800 568, AFSL 226566

For further information, please visit our website at **www.pengana.com** or contact:

Private Clients:	Tom Curtis,	+61 2 8524 9986, tom.curtis@pengana.com
	Gale Ruttanaphon	+61 2 8524 9918 gale.ruttanaphon@pengana.com
	Juliet Dunworth,	+61 2 8524 9984, juliet.dunworth@pengana.com
Advisors:	Justin Brooks,	+61 3 8663 7906, justin.brooks@pengana.com