

Pengana Australian Equities Core Fund

June 2010 Update, by Rhett Kessler



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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.

Two important Fund milestones were achieved this month. In addition to the anniversary of our second positive year since inception, the Fund was awarded a Three Star rating by Standard & Poor's Fund Services*.

Fund Features

Application Price at Month End (Cum distribution)	A\$1.1271	Redemption Price at Month End (Cum distribution)	A\$1.1215
Style	Fundamental	FUM at Month End	A\$15.4m
Investors	Wholesale Clients only	Management Fees² (monthly)	1.00% p.a. of NAV
Benchmark	The weighted average of the target Australian Cash Rate used by the RBA	Performance Fees² (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%	-2.5 %	12.5%

The Fund's return for June was -2.5%³ after all fees and costs. By way of comparison the Australian All Ordinaries Index was down -2.6% for the month and the prevailing cash rate during February was 0.4%.

For the 24 months since inception the Fund has protected capital and provided investors with a satisfactory total return of 15.9% (annualised 7.6%) versus the 8.6% cash rate (4.2% annualised) and the negative market return generated by the Australian All Ordinaries of -11.4% (-5.9% annualised).

As at the 30th of June, the cash position of the Fund's NTA stands at 23%. 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.

Large positive contributors to the month's performance were Metcash, Customers, McMillan Shakespeare, Credit Corp and Telstra. The largest detractors were: Downer EDI Group, Newscorp and the two bank holdings Westpac and CBA. The Fund took advantage of negative sentiment to acquire two new holdings during the month: Utility infrastructure provider DUET and ANZ Bank. In addition increases to existing holdings included Westpac, NIB Holdings, CBA and News Corporation. The Fund disposed of its holdings in Telstra, NAB, Sonic Healthcare and Downer Group.

As at 30th June 2010 the top five holdings by value in the Fund were: Westpac, NIB Holdings, CBA, News Corporation and Macmillan Shakespeare.

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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Net Returns to 30 th June 2010 ³			
	Pengana	Cash Rate	All Ordinaries
1 Month	-2.5%	0.4%	-2.6%
3 Months	-6.6%	1.1%	-11.0%
6 Months	-5.8%	2.0%	-9.7%
12 Months	12.5%	3.7%	13.8%
24 Months since Inception	15.9%	8.6%	-11.4%
Annualised return Inception	7.6%	4.2%	-5.9%

Market Commentary

Market Review

The ASX All Ordinaries Accumulation Index extended its quarterly decline in June (-2.6%) as concerns over global growth weighed on sentiment. The worst performing sectors were Industrials (-8%), Financials (-6%) and Consumer Discretionary (-5%) while Telecoms (+10%), Utilities (+1%) and Consumer Staples (+1%) were the leading sectors for the month.

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. Other macro factors affecting sentiment included the lifting of sovereign risk associated with the government's proposed retrospective taxes on resource companies due to the change in Prime Minister and the low levels of consumer confidence highlighted by the weak discretionary retail sales.

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

The Fund's holding in the Metcash group represents an exposure to an attractively priced, well managed, non discretionary wholesaler to the independent supermarket industry. The group's sound cost control and ongoing ability to find significant pockets of new business that enhance the existing high levels of profitability have delivered excellent shareholder returns. The resilient business model relies on its non-economically sensitive revenues and low working capital intensity nature.

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.

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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

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