

Pengana Australian Equities Core Fund

August 2010 Update, by Rhett Kessler



1 of 2

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\$1.1771	Redemption Price at Month End	A\$1.1713
Style	Fundamental	FUM at Month End	A\$16.1m
Investors	Wholesale Clients only	Management Fees²	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%
2010/11	5.1%	1.1%											6.2%

The Fund's return for August was a satisfactory positive 1.1%³ after all fees and cost. By way of comparison the Australian All Ordinaries was down -0.7% for the month and the prevailing cash rate during February was 0.4%.

For the 26 months since inception the Fund has protected capital and provided investors with a satisfactory total return of 23.1%³ (annualised 10.1%³) versus the 9.4% cash rate (4.2% annualised) and the negative market return generated by the Australian All Ordinaries of -8.3% (-3.9% annualised).

As at the 31st of August, the cash position of the Fund's NTA stands at **21%**. 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 Graincorp, McMillan Shakespeare, RCG, Credit Corp and Ramsay Healthcare. The significant detractors included Westpac, Mermaid Marine and Resmed. The Fund took advantage of ongoing negative sentiment toward the Australian banking sector to increase its holdings in ANZ, CBA and Westpac. Additions were made to existing holdings in McMillan Shakespeare and The Seven Group. Two new holdings were acquired namely the communications solutions provider - Salmat, and the listed investment company - Century Australia. The Fund disposed of its holdings in Aquarius Platinum and Customers.

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

Net Returns to 31 st August 2010 ³			
	Pengana Core	Cash Rate	All Ordinaries
1 Month	1.1%	0.4%	-0.7%
3 Months	3.6%	1.1%	0.8%
6 Months	2.7%	2.2%	-2.6%
1 Year	8.9%	3.9%	2.7%
2 years annualised	9.6%	4.0%	-3.6%
25 Months since Inception	23.1%	9.4%	-8.3%
Annualised return Inception	10.1%	4.2%	-3.9%

Market Commentary

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 Managers' 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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2 of 2

Market Review

August proved to be a difficult month for Global equity markets as investors worried about the prospect of a "double dip" recession in the US. The ASX All Ordinaries Accumulation Index finished down -0.7% in spite of significant support from robust dividend announcements by corporate Australia. Staples (+6%), Real estate (+4%) and Industrials (+2%) were the positive performing sectors while Telcos (-9%), Banks (-4%) and Materials (-2%) were weak.

One of the ongoing difficulties associated with offshore flows into (and out of) our market is the fact that global investors are treating the resilience of the Australian economy (and financial systems) with high levels of cynicism. Given the ongoing structural challenges in their home economies and the risks associated with sustaining the current levels of Chinese economic growth, any signs of potential weakness in our economy provide a focal point for selling pressure. The most closely watched indicators in the domestic economy include: The sustainability of residential property market prices, the ability of the big four banks to fund their loan books offshore and the iron ore spot price.

Investment Outlook

The medium term economic outlook for OECD Group countries remains subdued. However the robust GDP growth forecasts for the emerging economies including China, India, Brazil and most of South East Asia stands in sharp contrast. The ability of these countries to sustain regional growth without the larger developed economies (The much discussed "decoupling effect") represents a key investment variable for Australia. Concrete evidence of Australia's competitive advantage in providing significant quantities of high quality, low cost **coal** and **iron ore**, (with **wheat** potentially bolstering FY11) to these "growth markets" was provided by the recent released June trade surplus.

These positive factors continue to drive the underlying domestic economy on an expansionary path assisted by: a stable financial system, unemployment levels that continue to defy pessimistic expectations and above trend population growth. **However, the domestic equity market has begun to re-price these opportunities into share prices, highlighting the need for caution.**

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.

An example of this investment philosophy is represented by the Fund's large holding in News Corporation. The company represents a diversified (both by media type and geographical exposure) group of world class media assets. Earnings are dominated by the valuable content based business of Cable (includes Fox News, Fox Sports and the Discovery Channel) and the 20th Century Fox studio. In addition the group owns the distribution Pay TV companies - BSkyB, Sky Italia and Sky Deutschland. The robust cash flows from these businesses provide a solid underpin to the attractive valuation particularly given the combination of a strong balance sheet and competent management team.

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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