

# Pengana Australian Equities Core Fund

## October 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%<sup>1</sup> over the medium term via a concentrated core portfolio of principally listed Australian securities. 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

<b>Application Price at Month End</b>	A\$1.2412	<b>Redemption Price at Month End</b>	A\$1.2350
<b>Style</b>	Fundamental	<b>FUM at Month End</b>	A\$18.6m
<b>Investors</b>	Retail & Wholesale Clients	<b>Management Fees</b>	1.025% p.a. of NAV (including GST, net of RITC)
<b>Benchmark</b>	The average of the daily target Australian Cash Rate used by the RBA	<b>Performance Fees (quarterly)</b>	10.25% (including GST, net of RITC) of increase in net asset value subject to the Australian Cash Rate and High Water Mark
<b>Inception Date</b>	30 June 2008	<b>Minimum Initial Investment</b>	A\$20,000

### Fund Commentary

#### Fund Performance (A\$, net of fees)<sup>2</sup>

	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%	<b>3.0%</b>
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 %	<b>12.5%</b>
2010/11	5.1%	1.1%	3.6%	1.8%									<b>12.0%</b>

The Fund's return for October was a satisfactory 1.8%<sup>2</sup> after all fees and costs. By way of comparison the Australian All Ordinaries was up 2.2% for the month and the prevailing cash rate during October was 0.4%.

**For the 28 months since inception the Fund has protected capital and provided investors with a satisfactory total annualised return of 11.8% versus the cash rate (4.3% annualised) and the negative market return generated by the Australian All Ordinaries (-0.7% annualised).**

As at the 31st of October, the cash portion of the Fund's NTA stands at **20%**. 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 included NewsCorp, ANZ Bank, RCG Group, Seven Group Holdings, and Clarius. The larger detractors included McMillan Shakespeare, CBA and Westpac. The Fund increased its holdings in CBA and Resmed. The Fund took advantage of an attractively priced secondary placement to acquire a new holding in Australian Power and Gas – a residential electricity and gas distribution company. The Fund also re-established a small holding in Customers – the non-bank ATM provider. The Fund trimmed its exposures to Ramsay Healthcare and Westpac.

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

#### Net Returns to 31st October 2010<sup>2</sup>

	Pengana Core	Cash Rate	All Ordinaries
<b>1 Month</b>	1.8%	0.4%	2.2%
<b>3 Months</b>	6.6%	1.1%	6.5%
<b>6 Months</b>	4.8%	2.2%	0.0%
<b>1 Year</b>	9.3%	4.2%	5.9%
<b>2 years annualised</b>	<b>20.9%</b>	<b>3.8%</b>	<b>13.9%</b>
<b>Annualised return Inception</b>	<b>11.8%</b>	<b>4.3%</b>	<b>-0.7%</b>

<sup>1</sup> 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.

<sup>2</sup> 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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2 of 2

### Market Commentary

#### Market Review

Global equity markets continued their rally during October buoyed ironically by the need to restimulate the US economy and the benefits of even more "cheap" money courtesy of the Fed. The ASX All Ordinaries Accumulation Index finished up 2.2% with another month of incremental gains for foreign investors in our market due to the ongoing strength in the A\$ (another 2% against the US\$). Materials (+6%) on top of last months 6% gain, Info Technology (+3%), and Telecommunications (+2%) were the strongest performing sectors while Healthcare (-1%), Real Estate (-1%) and Consumer Staples (-1%) were the only negative sectors.

The capitulation by investors who had been cynical of the underlying resilience in the Australian economy continued during October. Another important factor is the increased levels of corporate activity or "Economic Darwinism" as the stronger, well capitalised companies use their balance sheets to extend their businesses.

#### Investment Outlook

The medium term economic outlook for OECD Group countries (appropriately grouped under the reference of "HICS" – Heavily Indebted Countries) remains subdued. However the robust GDP growth forecasts for the emerging economies (or "BRICs") including Brazil, Russia, India and China and most of South East Asia stand 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" continues to be provided by the recent trade surpluses.

These positive factors are expected to support a strong domestic economy and enhance the virtuous circle of stable financial systems, low unemployment levels and above trend population growth (while not without exaggerating the imbalances of our two speed economy). **However, the combination of the sharp increase in equity prices and the Australian Dollar has gone some way towards capturing the upside from these opportunities, 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.

**One example is represented by the Fund's holding in NIB Holdings Ltd, a well capitalised domestic health insurer. Management have demonstrated an ability to price risk appropriately, generate above industry customer growth and focus successfully on improving operating efficiencies. Furthermore, its large capital surplus and unique status as the only listed health insurer provides an ability to grow both organically and by acquisition. The latter in particular is well suited to a fragmented industry with large, scalable business models.**

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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