

Pengana Australian Equities Core Fund

January 2011 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 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.

For the 31 months since inception the Fund has provided investors with a robust total annualised return of 12.2%² versus the cash rate (4.3% annualised) and the flat market return generated by the Australian All Ordinaries (0.6% annualised).

Fund Features

Application Price at Month End	A\$1.2785	Redemption Price at Month End	A\$1.2722
Style	Fundamental	Current FUM Fund/Strategy	A\$34.6m / A\$55.3m
Investors	Retail & Wholesale Clients	Management Fees	1.025% p.a. of NAV (including GST, net of RITC)
Benchmark	The average of the daily target Australian Cash Rate used by the RBA	Performance Fees (quarterly)	10.25% (including GST, net of RITC) 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\$20,000

Fund Commentary

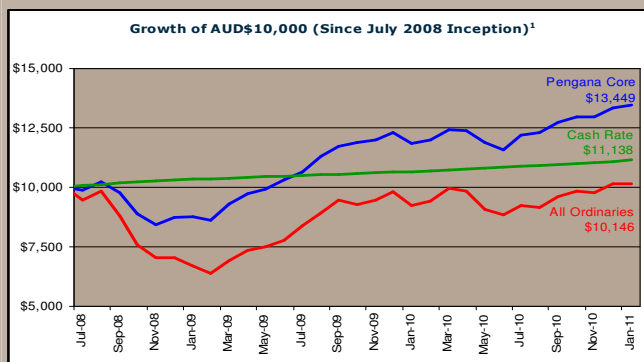
Fund Performance (A\$, net of fees) ²													
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
2008/9	-1.0%	3.5%	-4.7%	-9.0%	-5.3	3.9%	0.2%	-1.4%	7.9%	4.4%	2.2%	3.7%	3.0%
2009/10	3.5%	6.1%	3.8%	1.2%	1.0%	2.5%	-3.6%	1.1%	3.6%	-0.2%	-4.0%	-2.5%	12.5%
2010/11	5.1%	1.1%	3.6%	1.8%	-0.1%	3.0%	0.7%						16.1%

The Fund generated a satisfactory return of 0.7%² during January after all fees and costs. By way of comparison the Australian All Ordinaries was up marginally at 0.1% for the month and the prevailing cash rate during January was 0.4%.

As at the 31st of January, the cash portion of the Fund's NTA stood at **32%**. The top five holdings by value in the Fund were: **CBA, ANZ Bank, NIB Holdings, McMillan Shakespeare, and News Corporation**. Large positive contributors to the month's performance included News Corporation, Salmat, CBA, Graincorp and Credit Corp. The larger detractors included Resmed and CSG Limited. The Fund's significant additions to existing holdings included ANZ Bank, NIB Holdings, Australian Power Company and CBA. The Fund disposed of its holdings in Ramsay Healthcare.

Net Returns to 31st January 2011²

	Pengana Core	Cash Rate	All Ordinaries
1 Month	0.7%	0.4%	0.1%
3 Months	3.6%	1.1%	3.1%
6 Months	10.5%	2.3%	9.9%
1 Year	13.5%	4.4%	9.8%
2 years annualised	24.0%	3.8%	23.2%
Annualised return since inception	12.2%	4.3%	0.6%



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 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.

Pengana Capital Ltd (ABN 30 103 800 568, Australian financial services license number 226566) is the issuer of units in the Pengana Australian Equities Core Fund (ARSN 146 346 929) (the "Fund"). A product disclosure statement for the Fund is available and can be obtained from our distribution team. A person should obtain a copy of the product disclosure statement and should consider the product disclosure statement carefully before deciding whether to acquire, or to continue to hold, or making any other decision in respect of, the units in the Fund. This report was prepared by Pengana Capital Ltd and does not contain any investment recommendation or investment advice. This report has been prepared without taking account of any person's objectives, financial situation or needs. Therefore, before acting on any information contained within this report a person should consider the appropriateness of the information, having regard to their objectives, financial situation and needs. Neither Pengana Capital Ltd nor its related entities, directors or officers guarantees the performance of, or the repayment of capital or income invested in, the Fund.

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Market Commentary

Market Review

After initially rising 2% mid month, The ASX All Ordinaries Accumulation Index succumbed to the extreme flooding in Qld and higher oil prices due to Middle Eastern unrest to close flat for the month. The Australian Dollar consolidated its recent gains with a small decline of 2% against the US\$. The leading sectors were Consumer Discretionary (+2%), Financials (+2%) and REITs (+2%) while the resources sector took a much deserved breather - Information Technology (-4%); Materials (-3%) and Energy (-1%).

Investment Outlook

Although the global economy appears to have begun the long slow process of emerging from the hangover of the credit binge, several risks to sustained growth continue to worry us. These include the high unemployment levels in the US, the quantum of sovereign debt in many developed economies and the impact of higher energy prices. However, our biggest concern remains the currency conundrum facing the Chinese authorities. In a nutshell, they are being asked to choose between maintaining the Yuan at an increasingly unrealistic level to sustain employment levels in the critical export sectors VERSUS allowing the currency to appreciate providing some relief from the impact of sharply higher soft and hard commodity prices for their citizens. **In our view China's unsustainable combination (the proverbial "Magic Pudding") of low (if not negative) real interest rates, an undervalued currency and massive trade surpluses is beginning to show signs of reaching its "sell by date".**

Australian exports remain well placed to benefit from a stronger Chinese currency although we question whether current record levels of demand could be maintained. Certainly Australia continues to be a major beneficiary of its fortunate position (both geology and geography combining beautifully) as a low cost **coal** and **iron ore** supplier. Strong political and business leadership is required to meet the **challenge of converting our massive "Resource Dividend" into an enduring non-cyclical benefit for Australian citizens.**

The Fund remains well positioned to participate in the medium term structural wealth creation generated by strong, gainfully-employed population growth. However, we are becoming increasingly concerned about the implications of a domestic economy operating at a high capacity level that is overly dependent on the mining sector. The robust demand for our exports and the strong A\$ have made domestic living extremely expensive on a global basis. We are being forced to question whether current price points for Rent, Labour and Property are sustainable and how much risk these represent for Australian corporate earnings.

Consequently the Fund has increased its exposure to companies with significant non-A\$ earnings streams. In addition to being a prudent diversification away from a two speed economy, we feel that using a strong Australian Dollar to acquire companies with globally deployable intellectual property represents a good medium term investment strategy. These companies include News Corporation (Movie studios and cable channels), CSL (Blood fractionation), Resmed (Medical devices) and Westfield Holdings (US and UK shopping centres) and represent 15% of the portfolio's value.

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.

Examples of these 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 focussed on after-tax cash earnings yields.

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