

Pengana Australian Equities Core Fund

February 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 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 32 months since inception the Fund has protected capital and provided investors with a robust total annualised return of 12.4% versus the cash rate (4.3% annualised) and the flat market return generated by the Australian All Ordinaries (1.4% annualised).

Fund Features

Application Price at Month End	A\$1.2975	Redemption Price at Month End	A\$1.2910
Style	Fundamental	Current FUM Fund/Strategy	A\$36.4m / A\$57m
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%	1.5%					17.8%

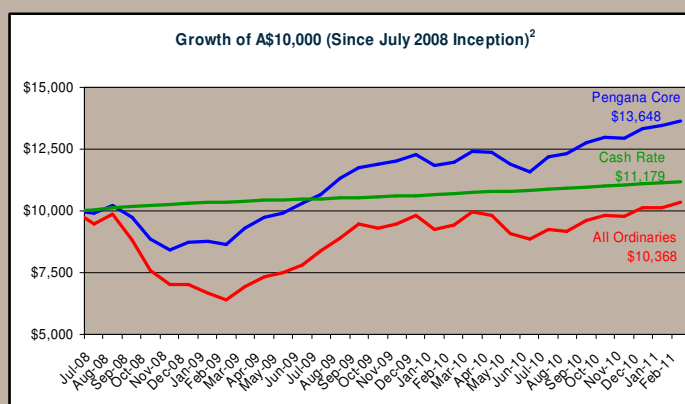
The Fund generated a satisfactory return of 1.5%² during February after all fees and costs. By way of comparison the Australian All Ordinaries was up 2.2% for the month and the prevailing cash rate during February was 0.4%.

As at the 28th of February, the cash portion of the Fund's NTA stood at 25%. The top five holdings by value in the Fund were: **CBA, NIB Holdings, ANZ Bank, McMillan Shakespeare, and DUET**. Large positive contributors to the month's performance included Credit Corp, McMillan Shakespeare, News Corporation, NIB Holdings and CBA, The larger detractors included Salmat and CSG Limited.

A new holding was acquired in Duet Group, providing exposure to a diversified Australian infrastructure fund that generates a 12% plus per annum pre-tax earnings yield. Other significant purchases included additions to existing holdings in CSL, Telstra, Metcash and Seven Group Holdings. The Fund disposed of its holdings in Graincorp and Westfield Retail Trust.

Net Returns to 28th February 2011²

	Pengana Core	Cash Rate	All Ordinaries
1 Month	1.5%	0.4%	2.2%
3 Months	5.3%	1.2%	6.1%
6 Months	10.9%	2.3%	13.1%
1 Year	13.9%	4.5%	10.2%
2 years annualised	25.7%	3.9%	27.3%
Annualised return since inception	12.4%	4.3%	1.4%



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.

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Market Commentary

Market Review

The ASX All Ordinaries Accumulation Index benefited from robust commodity prices and demonstration by the four major Australian banks that their profitable oligopoly remains intact in spite of higher funding costs and lower credit growth. The Australian Dollar remained at near record levels closing up 2.4% for the month against the US\$. The resource sectors regained their leadership: Materials (+3%) and Energy (+3%) and REITS (+2%). Info Technology (-4%), Healthcare (-3%) and Utilities (-2%) were the weakest sectors.

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 inflationary 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.

The most recent addition to the Fund is Duet Group. The company represents a diversified portfolio of resilient gas and electricity distribution assets generating a sustainable pre-tax earnings yield of 13%. The recent sale of the US business has improved both the overall quality of the portfolio as well as the balance sheet. The new managing director has demonstrated his focus on simplifying the group structure while remaining disciplined with regard to investor returns. The main value constituent of the group (and our preferred asset) is its majority share in the Dampier to Bunbury natural gas pipeline.

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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