

# Pengana Asian Equities Fund (Onshore) Quarterly Update (March 2011)



1 of 4

## Fund Features

<b>Style</b>	Long/Short Equity	<b>Management Fees <sup>1</sup> (monthly)</b>	1.54% p.a.
<b>Comparative Benchmark</b>	MSCI AC Asia Index	<b>Performance Fees <sup>1</sup> (semi-annually)</b>	20.5% of any increase in Net Asset Value subject to RBA target cash rate hurdle
<b>Investors</b>	Open	<b>AUM at Month End</b>	A\$14.7m
<b>Minimum Initial Investment</b>	A\$20,000	<b>Application Price at Month End</b>	A\$0.9602
<b>Inception Date</b>	01 July 2008 <sup>2,4</sup>	<b>Redemption Price at Month End</b>	A\$0.9554

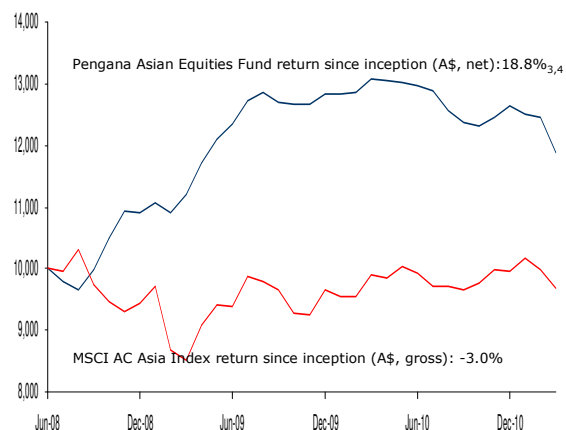
## Fund Commentary

### Fund Performance (A\$, %, net of fees) <sup>3,4</sup>

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2011	-1.1	-0.3	-4.6										<b>-5.9%</b>
2010	-0.1	0.3	1.6	-0.3	-0.2	-0.4	-0.5	-2.6	-1.4	-0.4	1.1	1.3	<b>-1.6%</b>
2009	1.4	-1.5	2.7	4.6 <sup>4</sup>	3.5	2.0	3.0	1.2	-1.3	-0.2	-0.1	1.3	<b>17.7%</b>
2008							-2.0	-1.5	3.3	5.4	4.1	-0.2	<b>9.1%</b>

### MSCI AC Asia Index (A\$, %)

2011	2.3	-2.0	-2.8										<b>-2.5%</b>
2010	-1.0	0.1	3.5	-0.5	1.8	-0.8	-2.3	0.0	-0.7	1.1	2.4	-0.4	<b>3.1%</b>
2009	2.8	-10.5	-1.8	6.6	3.6	-0.3	5.3	-0.9	-1.5	-3.8	-0.5	4.4	<b>2.1%</b>
2008							-0.3	3.5	-5.6	-2.8	-1.8	1.6	<b>-5.6%</b>



Since Inception	Fund <sup>3,4</sup>	Index
Annualised Return	6.5%	-1.1%
Annualised Volatility	7.6%	11.4%
Sharpe Ratio <sup>5</sup>	0.2	-0.5
Maximum Drawdown <sup>6</sup>	-9.1%	-17.3%
Max. Recovery Period <sup>7</sup>	0 mths+ <sup>8</sup>	24 mths+ <sup>8</sup>
Best Monthly Return	5.4%	6.6%
Worst Monthly Return	-4.6%	-10.5%
% of Up Months	45%	39%
Correlation to Index	0.24	

<sup>1</sup> All percentages include GST net of reduced input tax credits. Please refer to the PDS for a more detailed explanation.

<sup>2</sup> On 26 August 2009 the Fund became a registered scheme, with a PDS. Identification codes for the Fund are: ARSN: 138 943 709; APIR: PCL 0002AU

<sup>3</sup> Net performance, after all fees and charges, and assuming reinvestment of all distributions. Past performance is not a reliable indicator of future performance.

<sup>4</sup> On 22 April 2009 the Fund expanded its investment universe from the Asia region to the Asia Pacific region.

<sup>5</sup> Using 5% risk-free rate for Sharpe ratio

<sup>6</sup> The worst period of 'peak to valley' performance, regardless of whether or not the drawdown consisted of consecutive months of negative performance

<sup>7</sup> Time taken to eclipse prior peak following Maximum Drawdown

<sup>8</sup> Not yet returned to prior peak level

# Pengana Asian Equities Fund (Onshore) Quarterly Update (March 2011)



2 of 4

## Performance

In the first quarter of 2011, regional events led to increased volatility in Asian equity markets: rising concerns about inflation initially, then the disastrous earthquake and tsunami in Japan. Asian equity markets ex-Japan experienced dramatic swings in fund flows from international investors, with a sharp outflow in February followed by a record high fund inflow in March. In line with this, these markets were pushed sharply lower in February, then saw dramatic outperformance in March.

The Fund returned -5.9% for the quarter net of fees, compared to -2.5% by the MSCI Asia including Japan Index. The Fund's absolute return was hurt by the sharp appreciation of the Australian Dollar. Despite rising volatility in regional financial markets, the Australian Dollar continued to appreciate against the US Dollar and most regional currencies. The Fund's equity portfolio returned -3.8% in local currency terms, compared to the -1.8% by the Index. The underperformance was to the result of a small number of short positions, including in cement in China and in auto in Korea. The currency exposure returned -1.8% relative to the -1.4% of the Index.

## Change to the portfolio

Through the quarter, the Fund gradually increased its exposure in China, from around 30% to 50%, by reducing some of its short positions, particularly in cement. The Fund also added two new positions in the healthcare sector, China Shineway and Lijun International Pharmaceutical, following a sharp correction in the sector as the Chinese government announced new policies to cap drug prices. While China's healthcare industry is still in a structural growth phase, government regulation to control excessive prices is likely to induce a sector-wide consolidation, leading to improved manufacturing methods and greater pricing power. This will benefit smaller drug companies with strong balance sheets and products with core market positions. This will also increase demand from pharmaceutical companies for outsourcing services. Wuxi Pharmatech, a Chinese company focused on R&D outsourcing for international pharmaceutical companies such as Pfizer and Takeda, is currently trading at 13x 2011 expected earnings, with expected annual growth of over 20% in the next few years. It will not only benefit from rising demand for R&D outsourcing from foreign firms but also from domestic companies, as the new government regulation will put local Chinese pharmaceutical companies under pressure to change their business model from producing generic drugs to developing patent drugs.

In Japan, following the sharp sell-off in the aftermath of the tragic earthquake and tsunami, we have closed most of our short positions, leading to an increase in net exposure to 20% from less than 10% in the previous quarter. We focus most of our Japan exposure on exporters, particularly the technology sector. While it is still too early to quantify the full impact of the earthquake and resulting power shortages on production levels and earnings, based on our model, many companies - in particular auto companies - have already discounted a dramatic fall in earnings for fiscal 2011. Many auto parts companies have priced in a 20% sales drop and a 50%+ fall in profits for 2011. As Japanese companies start to report their earnings for 2010 and their outlook for 2011 towards the end of April, we are carefully monitoring the timing and progress of production resumption, which will offer a catalyst for earnings recovery expectations and favour an overweight position in Japanese equities.

Since the March 11 natural disaster, the Bank of Japan has injected over US\$300 billion into the financial system, with further supply of liquidity in coming months to support the economy. As of the end of March, Japan's central bank's balance sheet had grown by 17% over the previous year. Such a substantial increase of liquidity is likely to cap the Yen's appreciation, particularly against regional currencies, improve the competitiveness and cushion the impact of production disruption for many export companies, specifically those directly competing with their Asian peers, such as auto parts and electronics manufacturers. We remain cautious on Korean electronics and auto companies, most of which are approaching all time high valuations and share prices.

# Pengana Asian Equities Fund (Onshore) Quarterly Update (March 2011)



3 of 4

Top Five Performers	Bottom Five Performers
ASIAINFO-LINKAGE (China, Long) SOLARGIGA ENERGY (China, Long) OCI (Korea, Long) CAPCOM (Japan, Long) CYBERAGENT (Japan, Long)	CHINA NATIONAL BUILDING (China, Short) ANHUI CONCH CEMENT (China, Short) KIA MOTORS (Korea, Short) DAINIPPON SCREEN (Japan, Short) STANLEY ELECTRIC (Japan, Long)

Exposure by Sector	Long	Short	Net	Exposure by Country	Long	Short	Net
<b>Growth Sectors</b>				HK & China	60%	-13%	47%
Energy & Materials	16%	-7%	9%	Taiwan	4%	0%	4%
Ind., Con. Discretionary & Tech	53%	-16%	37%	South Korea	0%	-4%	-4%
Financial & Real Estate	32%	-10%	22%	Singapore	5%	0%	5%
<b>Defensive Sectors</b>				EM ASEAN	0%	0%	0%
Con. Staples & Healthcare	13%	0%	13%	Japan	34%	-13%	21%
Telecom & Utilities	1%	0%	1%	Australia	12%	-8%	4%
Futures	0%	-4%	-4%	<b>Equities</b>	<b>115%</b>	<b>-37%</b>	<b>77%</b>
<b>Total</b>	<b>115%</b>	<b>-37%</b>	<b>77%</b>				

## Outlook

Following the US Federal Reserve's additional supply of liquidity in November 2010 (QE2), emerging Asian equities markets (e.g. India, Thailand and Korea) substantially outperformed developed Asia Pacific markets, such as Japan and Australia, as well as the China H-share Index. Many of these emerging markets have not only reached levels seen prior to the GFC in 2008 but are also exceeding previous highs recorded in 2007, all helped by the substantial liquidity created through a weaker US Dollar. With sharply higher commodities and energy prices compared to last year, inflation expectations are rising, not only in emerging economies but also in developed countries. This is demonstrated by the European Central Bank's (ECB) most recent decision to raise its benchmark rate by 25 basis points to 1.25%, the first increase since the GFC. It is expected that the ECB will continue to normalise its monetary policy and bring its benchmark rate back to 2%. Recent debate among US Federal Reserve decision makers also indicated a likely end of its QE2 program, which by its end in June will have injected US\$600 billion. We expect to see volatility, particularly in the asset classes that have outperformed on the back of a weaker US Dollar (such as emerging Asian equities, commodities and the Australian Dollar) as it may strengthen after the expiry of QE2. We remain cautious on ASEAN and Korean equities.

Neutralisation of monetary policies in Europe and the US is likely to trigger an appreciation of the Euro and the US Dollar against the Japanese Yen, particularly as the BOJ is aggressively releasing liquidity to offset the impact of the March earthquake. The movement of the Yen will be a key determinant of its equity market's performance going forward and we remain cautiously positive while monitoring currency movements closely. Following the Great Hanshin earthquake in January 1995, Japanese equity markets corrected by 20% in the first four months as a result of the 20% appreciation of the Yen against the US Dollar in the aftermath of the disaster. However, by the time of the one year anniversary of the event, Japanese equity markets had rallied by over 50%. After a coordinated intervention by the world's central banks in April 1995, the Yen peaked and the equity market bottomed out in June, followed by a rally led by exporters, including auto and tech. As the BOJ and the world central banks (including the ECB and the US Fed) intervened to stop the Yen's appreciation

# Pengana Asian Equities Fund (Onshore) Quarterly Update (March 2011)



4 of 4

much more quickly and decisively after the March earthquake, we might already have seen the peak of the Yen and the bottoming out of equities is likely to follow in the near future.

In China, recent data show a clear slowdown in economic activity, particularly credit growth, indicating the effectiveness of the tightening policy implemented late last year. We expect China's monetary tightening to enter its final stage and inflation to peak in the second quarter of this year. As monetary policy turns from tightening to neutral, Chinese equities are expected to outperform as renewed focus from investors on fundamentals will highlight the oversold nature of many companies. We focus on China IT, healthcare and service sectors, which will benefit from the country's five year push towards a more balanced and domestic demand driven economy.

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