

Pengana Australian Equities Core Fund

March 2011 Update, by Rhett Kessler



1 of 3

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.

Since inception in June 2008 the Fund has consistently protected capital and provided investors with a robust total annualised return of 12.4%² versus the cash rate (4.3% annualised) and the flat market return generated by the Australian All Ordinaries (1.6% annualised).

Fund Features

Application Price at Month End	A\$1.3098	Redemption Price at Month End	A\$1.3033
Style	Fundamental	Current FUM Fund/Strategy	A\$38m / A\$59m
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%	4.3%
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%	1.0%				17.6%

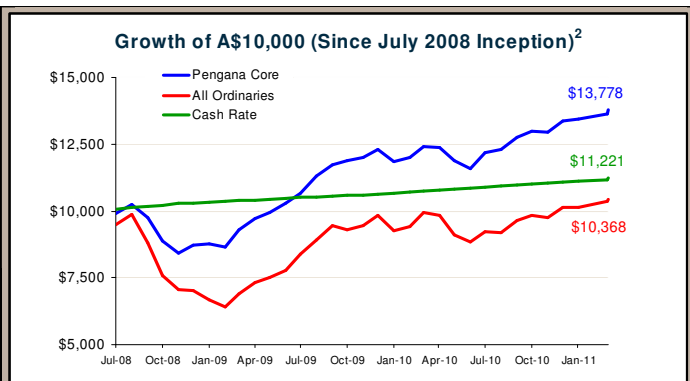
The Fund generated a satisfactory return of 1%² during March, net all fees and costs. By way of comparison the Australian All Ordinaries was up 0.6% for the month and the prevailing cash rate stood at 0.4% during the same period.

As at March 31, the cash portion of the Fund's NTA stood at 15%, demonstrating that the month was one of significant cash reserve deployment. The top five holdings by value are: **DUET, CBA, NIB Holdings, Seven Group, and ANZ Bank**. Large positive contributors to the past month's performance included DUET, CSG Group, Credit Corp, McMillan Shakespeare, NIB Holdings and the Seven Group. The detractors included Resmed and Salmat.

The acquisition of Mortgage Choice provided exposure to a well-managed player in the competitive residential mortgage market. Other significant purchases included increased holdings in DUET, Seven Group, CBA, MRM and Telstra. A prominent feature of the Fund's activity in March was the high level of purchases during the March market sell-off.

Net Returns to 31st March 2011²

	Pengana Core	Cash Rate	All Ords	Std Dev	Sharpe Ratio
1 Month	1.0%	0.4%	0.6%	N/A	N/A
3 Months	3.2%	1.1%	2.9%	N/A	N/A
6 Months	8.1%	2.3%	8.4%	N/A	N/A
1 Year	11.0%	4.5%	4.8%	8.6%	0.75
Annualised return since inception	12.4%	4.3%	1.6%	12.3%	0.67



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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2 of 3

Market Commentary

Market Review

Equity markets came under renewed pressure during March following the catastrophic events in Japan (earthquake/tsunami/nuclear radiation threat). Continued uncertainty and sovereign risk in MENA, and Libya in particular added upward pressure to already rising oil prices as concerns over supply intensified. In addition to the international uncertainties, the domestic December period earnings reporting season showed mixed results with a number of companies citing sluggish domestic trading conditions. This particularly affected companies in the non-bank Industrials sector. Increased volatility was also a constant feature of this month: the ASX200 Index shed more than 6% at its lowest March close and its high-low range was the widest since the Greek debt crisis of May 2010. However, once the radiation risk from the nuclear reactors in Japan was mitigated and the overall impact on global growth was determined to be minimal, the ASX200 Index recovered. The A\$ was also very volatile over the month; on intraday values it fell to 97c following the Japanese earthquake but finished the month at a record level of 103c against the greenback. The ASX All Ordinaries Accumulation Index finished the month marginally up (+0.7%). The Energy sector (+3.3%) benefited from strong crude prices as well as an anticipated increase in demand from Japan for gas to replace lost nuclear power capacity. Healthcare (+2%) benefited from the flight to defensives. REITS (-2.1%) and consumer discretionary (-1.6%) were the month's weakest sectors.

Investment Outlook

The global economy appears to have begun the long slow process of emerging from the hangover of the credit binge. However, several risks to the prospect of sustained growth continue to worry us. These include high US unemployment rates, the quantum of sovereign debt in many developed economies and the impact of higher energy prices. Yet our biggest concern remains the currency conundrum facing Chinese authorities; in a nutshell, they are being asked to choose between either maintaining the Yuan at an increasingly unrealistic level (to sustain employment levels in critical export sectors) or 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. Australia certainly continues to be a major beneficiary of its fortunate position (both geologically and geographically) 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 Australians.**

The Fund remains well positioned to participate in the medium term structural wealth creation spurred by a growing and gainfully-employed population. However, we are becoming increasingly concerned about the implications of a domestic economy that is dependent on the mining sector operating at a high capacity level. The robust demand for our exports and the strong A\$ have led to a very high cost-of-living, relative to comparable economies. We are being forced to question whether current rent, labour and property prices are sustainable and how much risk they represent for Australian corporate earnings.

Fund managers allocate capital to business managers who are expected to generate returns at a required rate. In selecting investments we not only evaluate the company's business models, but more importantly we take a view on the capabilities of the management teams to whom we have delegated this task. One such investment that your fund has made is in the **RCG Group - the holding company for Athletes Foot, Shoe Superstore and a strategic wholesale arm that (among others) distribute the Merrell brand of shoes.** Much has been said about the challenging retail environment ranging from a value-conscious consumer, aggressive discounting to the widely publicised threat of e-tailing. RCG has demonstrated that by offering a differentiated and value-added service whilst maintaining high levels of customer interaction (by contrast, most competitors have scaled down) they could grow market share and cash profits substantially above the industry.

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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3 of 3

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