

Pengana Australian Equities Core Fund

May 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.

Since inception in June 2008 the Fund has consistently protected capital and provided investors with a robust total annualised return of 11.3% versus the cash rate (4.2% annualised) and the flat market return generated by the Australian All Ordinaries (0.6% annualised).

Fund Features

Application Price at Month End	A\$1.3001	Redemption Price at Month End	A\$1.2936
Style	Fundamental	Current FUM Fund/Strategy	A\$38m / A\$58m
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%	0.0%	-0.8%		18.0%

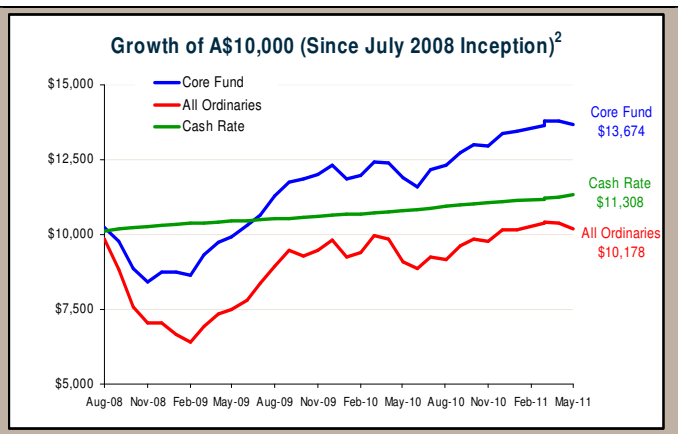
The Fund fell 0.8%² during May, net all fees and costs. By way of comparison the Australian All Ordinaries was down 1.9% for the month and the prevailing cash rate stood at 0.4% during the same period.

As at May 31st, cash represented **21%** of the fund. The top five holdings by value are: **DUET, NIB Holdings, CBA, McMillan Shakespeare and Seven Group Holdings**. Large positive contributors to the past month's performance included McMillan Shakespeare, DUET, Telstra, Salmat and NIB Holdings. The detractors included Credit Corp, ANZ, CBA and Mortgage Choice.

Significant acquisitions to existing holdings during May included NAB, Mortgage Choice, NIB Holdings and Metcash. The Fund disposed of its holdings in ANZ Bank, Customers and CSG Group.

Net Returns to 31st May 2011²

	Pengana Core	Cash Rate	All Ords	Std Dev	Sharpe Ratio
1 Month	-0.8%	0.4%	-1.9%	N/A	N/A
3 Months	0.2%	1.2%	-1.8%	N/A	N/A
6 Months	5.5%	2.3%	4.2%	N/A	N/A
1 Year	15.1%	4.6%	11.9%	7.0%	1.49
Annualised Since Inception	11.3%	4.2%	0.6%	12.0%	0.59



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

The domestic market (Australian All Ordinaries) fell 1.9% against a backdrop of weak global equity markets. In addition the Australian Dollar declined 2.7% to close at A\$/US\$1.07. Understandably the better performing sectors were the defensive Telecoms (+4.1%), Industrials (+1.0%), Consumer Staples (+0.5%), and Utilities (+0.0%). Financials ex Reits (-6.1%), Consumer Discretionary (-3.0%) and Information Technology (-1.7%) were the largest decliners.

Investment Outlook

Investors globally have become increasingly jittery as important economic indicators continue to deteriorate. Probably the most worrying aspect of this trend is the pervasiveness of negative economic news. At a macro level, the level of government indebtedness amongst the larger industrialised economies has reduced their available options for re-stimulating (or even protecting) their fragile economies. High levels of unemployment continue to sap consumer confidence and defer any meaningful recovery in retail sales. In addition, the "currency war" (or race to the bottom currently being won by the US dollar) has generated the nasty side effect of sharply higher commodity prices as investors seek safety in "hard assets". At a micro level, many consumer focussed business are enduring a tough combination of subdued revenues, higher input costs and tighter lending conditions.

Several Asian economies, (critical drivers of global growth) are being tested as their pegged currencies create a difficult environment of high inflation and negative real interest rates. While we continue to be impressed by the ability of the Chinese authorities to manage these complex stresses, the margin for error continues to shrink. In a nutshell, they are being asked to navigate a very narrow path between 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.

Australian exports remain well placed to benefit from a stronger Chinese currency although we question whether current record levels of demand can 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. However the "China Dividend" continues to put enormous pressure on the domestic economy through higher interest rates, a robust Australian Dollar and the negative consequences for tourism, education and retail sectors.

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 very high capacity levels. 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.

This worrying trend is most evident in the Australian Retail Sector. It has been our view for some time that the "retail value chain" is unstable and faces an extended period of declining revenues and pressure on profitability. The advent of mainstream online retailing has become a powerful driver of consumer "price discovery". In an ironic twist, the Australian retail sector has become a victim of its own success as its past ability to keep price points high is inviting consumers to sample en masse significantly cheaper goods and services online. The Fund continues to avoid these sectors, focussing instead on companies with pricing power, resilient business models and competent management.

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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