

# Pengana Australian Equities Core Fund

## September 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%<sup>1</sup> 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 12 months ended 30<sup>th</sup> September 2011, the Fund has protected capital and provided investors with a positive return of 2.4%<sup>2</sup>. For the 3 year period, the Fund has generated a robust return of 10.2%<sup>2</sup> p.a., significantly higher than the Reserve Bank cash rate of 4.2% p.a. over the same period. This is particularly pleasing given the very difficult investment environment as evidenced by the Australian All Ordinaries Accumulation Index's (the share market's) return of 0.0% p.a.

### Fund Features

<b>Application Price at Month End</b>	A\$1.2097	<b>Redemption Price at Month End</b>	A\$1.2037
<b>Style</b>	Fundamental	<b>Current FUM Fund/Strategy</b>	A\$38m / A\$58m
<b>Investors</b>	Retail & Wholesale Clients	<b>Management Fees</b>	1.025% p.a. of NAV (including GST, net of RITC)
<b>Benchmark</b>	The average of the daily target Australian Cash Rate used by the RBA	<b>Performance Fees (quarterly)</b>	10.25% (including GST, net of RITC) of the increase in net asset value subject to the Australian Cash Rate & High Water Mark
<b>Inception Date</b>	30 June 2008	<b>Minimum Initial Investment</b>	A\$20,000

### Fund Commentary

#### Fund Performance (A\$, net of fees)<sup>2</sup>

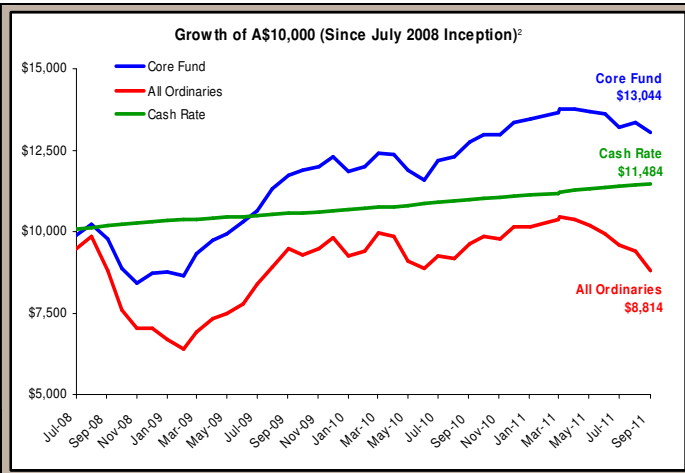
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
2008/9	-1.0%	3.5%	-4.7%	-9.0%	-5.3	3.9%	0.2%	-1.4%	7.9%	4.4%	2.2%	3.7%	<b>3.0%</b>
2009/10	3.5%	6.1%	3.8%	1.2%	1.0%	2.5%	-3.6%	1.1%	3.6%	-0.2%	-4.0%	-2.5%	<b>12.5%</b>
2010/11	5.1%	1.1%	3.6%	1.8%	-0.1%	3.0%	0.7%	1.5%	1.0%	0.0%	-0.8%	-0.5%	<b>17.4%</b>
2011/12	-3.1%	1.4%	-2.4%										<b>-4.1%</b>

The Fund generated a negative return of **2.4%**<sup>2</sup> for September, net of all fees and costs. By way of comparison the Australian All Ordinaries fell **6.3%** for the month and the prevailing cash rate returned **0.4%**. As at September, 30<sup>th</sup>, cash (including notes and preference shares) represented **13%** of the fund. The top five holdings by value are: **DUET, NIB Holdings, NAB, CBA and McMillan Shakespeare**.

Large positive contributors to the month's performance included CSL, CSG Group, Resmed and News Corporation. The largest detractors were Seven West Media, Seven Group, Salmat, CBA and NAB. Significant net acquisitions to existing holdings during September included Seven West Media, NAB and DUET. Two new positions were established in mining services group Emeco and the 5-year floating Australia Unity bond. The Fund lightened its holdings in Telstra and CSG Group.

#### Net Returns to 30<sup>th</sup> September 2011<sup>2</sup>

	Pengana Core	Cash Rate	All Ords	Std Dev	Sharpe Ratio
<b>1 Month</b>	-2.4%	0.4%	-6.3%	N/A	N/A
<b>3 Months</b>	-4.1%	1.2%	-11.3%	N/A	N/A
<b>6 Months</b>	-5.3%	2.4%	-15.6%	N/A	N/A
<b>1 Year</b>	2.4%	4.8%	-8.5%	6.1%	-0.38
<b>2 Years annualised</b>	<b>5.5%</b>	<b>4.4%</b>	<b>-3.5%</b>	<b>8.1%</b>	<b>0.14</b>
<b>3 Years annualised</b>	<b>10.2%</b>	<b>4.2%</b>	<b>0.0%</b>	<b>11.6%</b>	<b>0.52</b>
<b>Annualised Return Since Inception<sup>2</sup></b>	<b>8.5%</b>	<b>4.3%</b>	<b>-3.8%</b>	<b>11.7%</b>	<b>0.36</b>



<sup>1</sup> 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.

<sup>2</sup> 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 domestic market (Australian All Ordinaries Accumulation Index) fell another 6.3% during September to register its 6<sup>th</sup> consecutive monthly decline. As further evidence of the level of risk aversion, the Australian Dollar fell 10%, extending the weakness of domestic investments in global terms. The only positive sectors were the defensive Telecoms (+2.2%) and Consumer Staples (+1.2%). Materials (-13.6%), Energy (-7.9%) and Industrials (-6.5%) were the largest decliners. Paradoxically the latter three sectors have large non-A\$ revenue streams implying that investors have revised their A\$ value by high double digit percentages.

**Global equity markets were also down. The most notable aspect of the last two months has been the extreme daily volatility in world wide equity markets. Given the combination of large trading volumes and massive moves (in both directions) on almost a daily basis, it is hard to imagine that UBS is the only casualty amongst professional investors.**

### Investment Outlook

Many global investors appear to have capitulated as important economic indicators continue to deteriorate. 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. Europe is particularly vulnerable. High levels of unemployment continue to sap consumer confidence and defer any meaningful recovery in retail sales. At a micro level, many consumer focused businesses 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. **It is increasingly my view that this latter course of action will eventuate as the likely outcome, increasing the Chinese buying power for Australian exports.**

These factors enhance the position of Australian exports 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 and a robust Australian Dollar resulting in negative consequences for tourism, education and retail sectors.

While we are probably more bearish than most on the global macro outlook, the recent broad based (and in our opinion – indiscriminate) sell-off by nervous investors has created many attractive investment opportunities for the Fund. The share prices of many high quality companies with solid balance sheets, pricing power and largely economically insensitive business models have been sold off to very compelling levels. **The recent sell-off in the A\$ has (finally) validated our view that investing significantly in companies with non-A\$ earnings streams would offer some protection. While News Corporation, CSL, Resmed and Seven Group Holdings are attractive investments in their own right, the added benefit of diversification away from the A\$ as a means for preserving global wealth has substantial merit.**

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