

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%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 12 months ended 30th September 2011, the Fund has protected capital and provided investors with a positive return of 2.4%. For the 3 year period, the Fund has generated a robust return of 10.2% 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) negative return of 0.0% p.a.

Fund Features

Application Price at Quarter End	A\$1.2097	Redemption Price at Quarter End	A\$1.2037
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 the increase in net asset value subject to the Australian Cash Rate & High Water Mark
Inception Date	30 June 2008	Minimum Initial Investment	A\$20,000

Fund Commentary

Fund Performance (A\$, net of fees)²

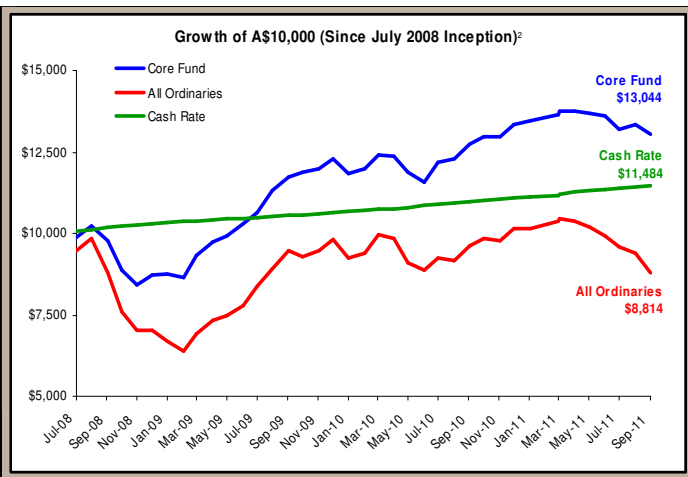
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
2008/9	-1.0%	3.5%	-4.7%	-9.0%	-5.3	3.9%	0.2%	-1.4%	7.9%	4.4%	2.2%	3.7%	3.0%
2009/10	3.5%	6.1%	3.8%	1.2%	1.0%	2.5%	-3.6%	1.1%	3.6%	-0.2%	-4.0%	-2.5%	12.5%
2010/11	5.1%	1.1%	3.6%	1.8%	-0.1%	3.0%	0.7%	1.5%	1.0%	0.0%	-0.8%	-0.5%	17.4%
2011/12	-3.1%	1.4%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

The Fund generated a negative return of **-4.1%**² during the September quarter, net of all fees and costs. By way of comparison the Australian All Ordinaries was down **-11.3%** for the quarter and the prevailing cash rate stood at **1.2%** during the same period. As at September, 30th, cash (including notes and preference shares) represented **13%** of the fund. The top five holdings by value as at the end of the quarter were: **DUET, NIB Holdings, NAB, CBA and McMillan Shakespeare.**

Large positive contributors to the quarter's performance included NIB Holdings, Telstra, News Corporation, Resmed and Mortgage Choice. The largest detractors were Seven Group Holdings, Seven West Media, NAB RCG Group and CBA. New holdings for the quarter included Seven West Media and Woolworths. Other significant purchases included increased holdings in NAB, XRF Scientific, and Duet Holdings. The Fund disposed of its holding in Wide Bay Australia. Other sales included the trimming of the Telstra holding.

Net Returns to 30th September 2011²

	Pengana Core	Cash Rate	All Ords	Std Dev	Sharpe Ratio
1 Month	-2.4%	0.4%	-6.3%	N/A	N/A
3 Months	-4.1%	1.2%	-11.3%	N/A	N/A
6 Months	-5.3%	2.4%	-15.6%	N/A	N/A
1 Year	2.4%	4.8%	-8.5%	6.1%	-0.38
2 Years annualised	5.5%	4.4%	-3.5%	8.1%	0.14
3 Years annualised	10.2%	4.2%	0.0%	11.6%	0.52
Annualised Return Since Inception²	8.5%	4.3%	-3.8%	11.7%	0.36



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 Accumulation Index) fell 6.3% during September to register a substantial fall of 11.3% for the quarter. As further evidence of the level of risk aversion, the Australian Dollar fell 10% in September alone, extending the weakness of domestic investments in global terms. The only positive sector was the defensive Telecoms (+7.1%). Materials (-19.3%), Energy (-17.3%) and Consumer Discretionary (-14.2%) were the largest decliners. Paradoxically the largest declining sectors have large non-A\$ revenue streams implying that investors have revised their A\$ value by almost 30%.

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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