

Pengana Asian Equities Fund Quarterly Update (December 2011)



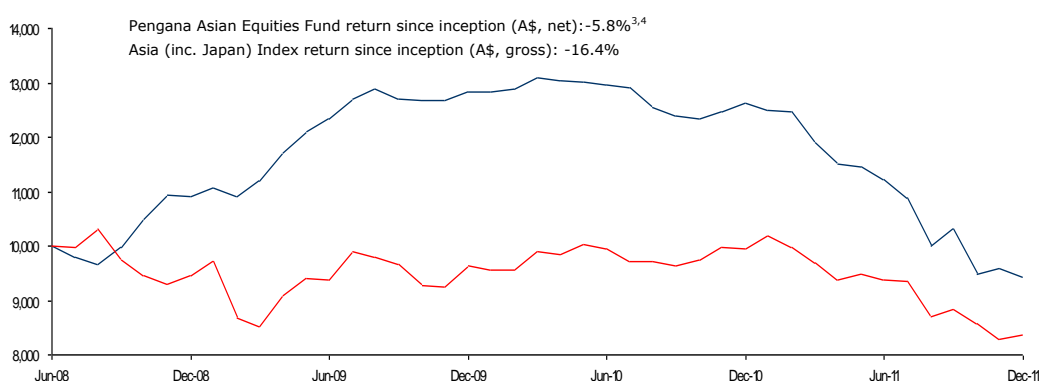
1 of 5

Fund Features

Style	Long/Short Equity	Management Fees ¹ (monthly)	1.54% p.a.
Comparative Benchmark	Asia (inc. Japan) Index	Performance Fees ¹ (semi-annually)	20.5% of any increase in Net Asset Value subject to RBA target cash rate hurdle
Investors	Open	AUM at Month End	A\$11.7m
Minimum Initial Investment	A\$20,000	Application Price at Month End	A\$0.7610
Inception Date	01 July 2008 ^{2,4}	Redemption Price at Month End	A\$0.7572

Fund Commentary

Fund Performance (A\$, %, net of fees) ^{3,4}													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2011	-1.1	-0.3	-4.6	-3.1	-0.5	-2.0	-3.0	-8.2	3.2	-8.0	1.0	-1.7	-25.4%
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	-1.6%
2009	1.4	-1.5	2.7	4.6 ⁴	3.5	2.0	3.0	1.2	-1.3	-0.2	-0.1	1.3	17.7%
2008							-2.0	-1.5	3.3	5.4	4.1	-0.2	9.1%
Asia (inc. Japan) Index (A\$, %)													
2011	2.3	-2.0	-2.8	-3.4	1.2	-1.1	-0.4	-6.8	1.5	-2.9	-3.5	0.9	-15.9%
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	3.1%
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	2.1%
2008							-0.3	3.5	-5.6	-2.8	-1.8	1.6	-5.6%



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

² 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

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

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

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Pengana Asian Equities Fund

Quarterly Update (December 2011)



2 of 5

Performance

The Fund returned -1.7%³ net of fees for the month to December 2011 and -8.6%³ for the quarter, compared to 0.9% and -5.4% by the Asia (inc. Japan) Index. Since inception in July 2008, the Fund returned -1.7%³ per annum net of fees, compared to -5.0% by the Index.

During the month, despite encouraging economic data showing a strong economic recovery in the US, Asian equities underperformed the US and Europe, returning a mere 0.5% in local currency terms. China onshore shares and India lost 6% for the month. The Fund underperformed the Index with a return of -1.6%³ in local currency terms, largely due to its limited holdings in financials, in particular banks, which are heavily weighted in the Index and lifted the Index to positive territory for the month.

Portfolio positions were broadly unchanged with a tilt towards China and Japan, the two cheapest markets in the region- trading 10x expected earnings - and IT and industrials sectors. We are also keeping our healthcare exposure in China unchanged as a long-term structural holding to benefit in China's growing demand for healthcare.

For the year, the Fund underperformed the market with an annual return of -25%³, compared to -16% by the Index. This is primarily due to the underperformance of the equity portfolio, which returned -24% in local currency terms, compared to -17% by the Index. The Fund's tilt towards China and Japan, with limited exposure in the energy/materials-heavy Emerging ASEAN markets such as Indonesia, Thailand and the Philippines was the cause of the underperformance. For 2011, Greater China (China, Hong Kong, Taiwan) as well as Japan were the worst performers, losing nearly 20% for the year, while Emerging ASEAN markets generated positive returns.

Secondly, the Fund's fundamental and valuation focused investment approach was simply unable to produce results in a macro event and momentum-driven market. While the Fund successfully protected investor's capital during the global financial crisis in 2008 and participated in the recovery in 2009, with a positive return of 9%³ for the six months to December 2008 relative to -6% by the Index, and 18%³ for 2009 compared to 3% by the Index, 2011 proved to be a very challenging year. Our investment style, which is focused on fundamental research and valuations, helped us navigate volatility and generate strong returns previously, but was unable to produce returns last year, as financial markets were constantly driven by macro events and quant model driven trading. According to a style analysis by Macquarie Capital Securities, a valuation style, which worked successfully in the past both in Asia ex-Japan and Japan, substantially underperformed a momentum style from the second half of 2010 and in 2011. While this analysis concluded that a period of momentum-style outperformance typically lasts two years, we are already witnessing a performance recovery by many value stocks year-to-date. With the US economy recovering and policy makers worldwide implementing accommodative policies to support the economy, we expect stock selection focused on companies with structural growth and attractive valuations to outperform going forward.

Top Five Performers	Bottom Five Performers
ANGANG STEEL (China Steel, Long)	7 DAYS GROUP (China Leisure, Long)
CHINA COSCO (China Shipping, Long)	MITSUI FUDOSAN (Japan Real Estate, Long)
ANHUI CONCH (China Cement, Short)	TCL COMM TECH (China Tech, Long)
EPISTAR CORP (Taiwan Tech, Long)	IBIDEN (Japan Tech, Long)
SITC (China Logistic, Long)	SHANGHAI PHARM (China Healthcare, Long)

Pengana Asian Equities Fund Quarterly Update (December 2011)



3 of 5

Investment Outlook

Entering 2012, Europe's sovereign credit issue continues to dominate investors' minds and depress market sentiment. While it will take time to solve such a structural issue, we expect volatility to subside, with stability returning to financial markets in the short term following the European Central Bank's (ECB) decision to extend an unlimited amount of loans to European banks last November. The fact that the ECB will extend loans with a three-year maturity while significantly widening the range of collateral accepted will greatly reduce the financing pressure many European banks face this year. Through the first batch last December, ECB issued over US\$600 billion of loans, equivalent to two thirds of their financing needs for the whole of 2012. This liquidity injection has successfully stabilised the credit market and at the most recent bond auction, the Italian and Spanish governments issued bonds at costs nearly half of those at the December auction. We remain tactically positive for the short term.

Through 2012, China will remain our key focus in Asia. Of particular interest will be how it will rebalance its economy to promote domestic consumption and offset the weakness in external demand. This will have profound implications for all regional economies and companies. In order to support the economy, the Chinese government will implement an expansionary fiscal policy via tax reduction and a looser monetary policy, including cuts in required reserve ratio (RRR) for banks and interest rates. We expect that the worst of the credit tightness in China has passed and liquidity will continue to flow back to financial markets. However, the most important factor this year is China's financial reform, including Renminbi convertibility. At the January financial conference, which is held every five years to set the agenda for China's financial industry reform, targets were set for interest rate deregulation and bond market development. Renminbi convertibility on capital account has also been mentioned by the prime minister in his concluding speech.

Looking back on China's achievements since its inaugurate financial conference in 1997 (restructuring of the state banks' bad debts in 1997, reform of the state banks with the successful public listing in Hong Kong of the top state banks including Bank of China, ICBC, China Construction Bank in 2002, and the establishment of China's first sovereign wealth management company China Investment Corp in 2007), we can see the path China is taking to reform its banking industry. As China is becoming increasingly integrated into the global economy and financial markets, modernising its financial system has become a pressing issue. Current issues include over-reliance on bank financing and over-regulation of interest rate pricing. Control of both lending and deposit rates cripple the banks' willingness and ability to price credit appropriately, leading to over-lending to large state-owned companies and limited exposure to SMEs. In addition, limited availability of investment products has led to speculation in property market by households. The lack of development of bond markets for corporate and local government bonds has also led to over-dependence on bank financing by the overall economy, increasing the risk of instability in the banking system. Through recent reshuffles of top officials at the banking regulation council, securities regulation body and insurance authority, policy makers are showing their determination to reform the capital markets - and in particular the equity market - by promising to improve transparency and protection of individual investors while toughening punishment of market manipulators. There is an understanding among top policy makers of the importance of having a healthy and developed capital market.

The significance of the reform of China's financial sector cannot be under-estimated as this will lead the country into its second phase of economic development. During the first phase of development from its opening up to the world in the 1980s to the present, China experienced substantial economic growth, with an annual growth rate of well over 10% driven by massive expansion in heavy industries, infrastructure and housing investment and exports. This could not have been achieved without support the banks had offered by channelling cheap capital to local government projects and large state-owned enterprises (SOEs), typically in

Pengana Asian Equities Fund Quarterly Update (December 2011)



4 of 5

the heavy industries. However, with little consideration for return on capital, over-investment has become evident, threatening the banking system's stability over the long term if left uncontrolled. By deregulating interest rates, banks will be forced to price credit appropriately and channel capital to SMEs, most of which are concentrated in the service industry. With the government's tax reform to reduce tax on new industries and SMEs, this will help the country re-balance its economy from manufacturing and export to service and domestic consumption. In addition, bond market development will also increase investment alternatives for households and reduce pressure on speculation, particularly in the property market. Recently, the government has announced it will further open up its financial sector to foreign investors and allow foreign capital in financial services such as leasing. This is a clear attempt to guide foreign investment towards service and technology industries and away from the traditional manufacturing-for-export sectors. Japan's opening up of its financial markets in the early 1980s by deregulating interest rates and developing bond markets was successful in allowing the country to produce economic growth through productivity growth in the late 1980s. We expect China to follow a similar path, entering a new phase of productivity growth-driven economic development. On the other hand, economic growth will be slower and it is expected the new growth target this year will be 7.5%, compared to 8% previously. This shift of focus towards quality of growth (productivity growth) instead of quantity (capacity expansion) will create a very constructive environment for equity investors as they invest in corporate profits rather than GDP growth.

We remain cautious on Chinese banks despite their low valuations of 8-9x expected earnings due to their unattractive growth prospects over the long term. As interest rates deregulation and bond market development will facilitate higher deposit rates and lower lending returns (as large customers will be able to raise capital in the bond market), banks will face rising costs of capital. This was experienced by Japan in the 1980s and in order to sustain earnings, Japanese banks were locked into intense competition for lending to SMEs and over-extended loans, thus contributing to the late 80s asset bubble. On the other hand, securities companies will be the major beneficiaries of China's financial reform. Currently, most of these companies' earnings are dependent on equity market performance as over 60% of their earnings are commissions from equity trading. Going forward, with the bond market development, these investment banks will benefit from rising revenue from bond underwriting both onshore and offshore (Chinese companies issuing bonds outside China, mainly in Hong Kong currently). The expansion of the bond market will also create a new income stream in bond trading. Instead of investing in banks, we invested a small position in Citic Securities, China's largest investment bank (listed in Hong Kong) as our main financial exposure. Trading at 1.5x book value, similar to the big banks, it has greater potential to expand its return on equity. Besides our constant holdings in China healthcare and alternative energy, we have built a basket of industrial companies with strong balance sheets but trading at 4-5x earnings and less than 1x book value (largely due to concerns about a hard landing of China's economy). Outside China, we focus on companies that can benefit from China's new development, including industrial parts and electronic component companies in Japan, energy efficiency plays in Korea and Taiwan as well as logistics and asset managers in Singapore.

Pengana Asian Equities Fund Quarterly Update (December 2011)



5 of 5

Exposure by Sector	Long	Short	Net	Exposure by Country	Long	Short	Net
Growth Sectors							
Energy & Materials	11%	-1%	10%	HK & China	36%	-11%	25%
Ind., Con. Discretionary & Tech	39%	-8%	31%	Taiwan	4%	0%	4%
Financial & Real Estate	12%	-4%	9%	South Korea	1%	-2%	-1%
Defensive Sectors				Singapore	3%	0%	3%
Con. Staples & Healthcare	7%	-1%	7%	EM ASEAN	0%	-3%	-3%
Telecom & Utilities	0%	0%	0%	Japan	25%	-2%	23%
Futures	0%	-4%	-4%	Australia	1%	0%	1%
Total	70%	-18%	52%	Equities	70%	-18%	52%

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