FUND DESCRIPTION AND FEATURES

The Pengana International Fund - Ethical is a long only fund that holds 30-50 companies across developed and developing markets, large and small companies.

The Fund predominantly invests in companies that deliver stable yet growing free cash flow throughout cycles (which we classify as ‘Core’ holdings) whilst also taking positions in more cyclical companies (‘Cyclical’) and those whose valuation has been materially misconstrued by the market (‘Opportunistic’).

We avoid investment in companies that are, in our opinion, harmful to people, animals or the environment.

Visit our website for more information on the Fund.

PERFORMANCE COMMENTARY

Aim

We aim to achieve superior AUD-denominated returns with low volatility. The superior returns aim can be disaggregated into (i) capital preservation; and (ii) capital appreciation. While these aims make no mention of the benchmark, we believe that fulfilling our aims will result in superior returns to the benchmark over the medium-to-long term. Since inception, the Fund has delivered compounded returns of 10.6% p.a., net of fees, while the benchmark delivered 8.8% p.a.

Quarterly Performance

The Fund delivered 4.9% in 1Q18 while its benchmark, MSCI ACWI (AUD), returned 0.9%. This performance was pleasing and supports our long held view that the Fund should perform best (relative to the benchmark) in sideways or declining markets due to the type of stocks held in the portfolio, portfolio construction and our use of portfolio insurance (put options on underlying indices).

During the quarter the key drivers of the positive relative performance were:

- **Stocks** – Flow Traders delivered 73% in 1Q18. Other strong performers were Bakkafrost, IAC and ITAU.
- **Portfolio insurance (put options)** – the puts provided some protection as equity markets declined.

The headwinds to performance included:

- **Cash** – the Fund held its cash in AUD, which depreciated against most major currencies.
- **Sector allocation** – the Fund had relatively low exposure to Information Technology (IT), which was the best performing sector and high exposure to Materials and Consumer Staples, which were weaker performing sectors.
- **Country allocation** – the Fund had little allocation to the better performing regions.
over 1Q18, including: Brazil, China and Taiwan. Meanwhile, the Fund had significant exposure to Europe, which was the weakest region.

**MARKET COMMENTARY**

In 1Q18, the MSCI ACWI (USD) was down 1.0% and up 0.9% in AUD terms as the AUD depreciated against most major currencies. The 1.0% decline in MSCI ACWI (USD) was the first quarterly decline in two years and was accompanied by a spike in volatility, as illustrated by a dramatic jump in the VIX.

The VIX is an index that is one measure of volatility. It is colloquially referred to as the ‘fear index’. A high VIX indicates fear and typically coincides with a stock market decline, while a low VIX indicates calmness and typically coincides with bull markets.

The VIX has been at abnormally low levels. This suggests that the market has been exceptionally sanguine and we think the VIX’s jump during Feb-18, indicates a return of some healthy risk aversion.

Despite the rebirth of some risk aversion, some things didn’t change and the best/worst performing sectors were a continuation of the same themes over the past two years.

IT was once again the best performing sector, a title it has held for the past five consecutive quarters. The second best performing sector in 1Q18 was Consumer Discretionary, which includes Amazon (12% of the index) and Netflix (3% of the index). Clearly, Tech appears the place to be.

The worst performing sectors during 1Q18 were Telecommunication Services and Consumer Staples, which were also the worst performing sectors over the past two years.

The best performing markets during 1Q18 were mainly emerging markets, including Brazil, Russia and Malaysia; while the worst performing markets largely were in Europe.

Commodities were generally strong as the oil price (Brent) rallied 3%, gold was up 2% and the broader commodity index, CRB Spot, was up 1%.

**PORTFOLIO**

The Portfolio is divided into three segments:

(1) Core (60-80% of the Fund) – Core is intended to provide a stable base for the Fund. Companies in this segment are growing, reasonably priced, have low business cyclicality, strong cash generation, dominant presence in their industries, strong management teams and favourable structural tail-winds.

(2) Cyclicals (0-30% of the Fund) – Cyclicals contains companies we expect to benefit from shorter duration trends. As these cycles tend to be transitory, timing is more important in our investment decisions than in Core. Cyclicals companies offer the potential for materially more substantial short-term gains than Core, however, they are also riskier. Financials, basic materials, and agriculture are examples of industries that may be represented in this segment.

(3) Opportunistic (0-20% of the Fund) – Opportunistic includes companies we believe are materially undervalued or whose growth has been under-appreciated. These companies offer potentially more attractive shorter term gains than Core, however, they also tend to be riskier. Examples of Opportunistic investments include companies in the midst of a takeover, earlier stage internet/health/retail companies and companies whose share prices have markedly declined.

The Fund’s positioning at 31 March 2018 is summarised as:

- 89% of the Fund was invested in equities and 10% was held in cash – 4% of the equities exposure was in gold-linked shares.
- Segment exposure continued to be 60-65% in “Core”, 20-25% in “Cyclical” and 5-10% in “Opportunistic”.
- The Fund had some put options (portfolio insurance) over the S&P500.
- The Fund had relatively low US exposure (33%), limited direct Asian exposure (9%), relatively high European exposure (39%) and some LatAm exposure (2%).
- 31% of the Fund was invested in small or mid-cap companies, 51% was in large-caps, and 7% was in mega-caps.
- Less than 6% of the Fund was invested in IT and today that figure is even lower.
- The Fund didn’t hold any US banks or insurers but 12% of the Fund was invested in European financials.

The most material changes to the Fund during the quarter were: (i) reduced exposure to IT from 14% to <6%; (ii) reduced exposure to Materials from 19% to 16%; (iii) reduced exposure to the US from 37% to 33%; and (iv) reduced exposure...
to mega-caps from 16% to 7%. Most of the above changes are related and basically refer to us fully exiting IAC, Apple, Alphabet (Google) and GoDaddy.

**OPINION PIECE: TECHNOLOGY**

In the last quarter we opined on the Fund’s shift out of the Technology (‘Tech’) sector. Given this is such a non-consensus position we think it is worthwhile returning to that subject.

At the start of 2017 more than 25% of the Fund was invested into Tech and for most of the year Apple, Alphabet (Google) and IAC were among the Fund’s largest positions. Following the strong upward march of these stocks we have exited all of them.

At the end of 1Q18, the Fund’s exposure to Tech (using GICS) was <6%. We believe that this figure overstates the true exposure because it includes companies like TomTom, Check Point and Sabre, which are not part of the fast moving Tech complex. We believe that our Tech exposure is dramatically lower than most of our peers.

Many Tech stocks have delivered explosive returns over the past two years and are now priced for perfection. This means a minor slip-up can result in a major share price decline. We think one of the most likely sources of this slip-up is regulation.

According to the New York Stock Exchange, consumer margin loans are currently at record highs. Given the strong performance of Tech and the fact that many of those companies are household names we anticipate that a lot of those margin loans relate to Tech investments.

Rich valuations, elevated expectations and high debt are a recipe for disaster. With these factors in mind we believe that the time for extreme prudence around Tech investments has arrived.

**STOCK FOCUS**

We built a position in Flow Traders (‘FLOW’) during the second half of 2017. We believe the stock adds value to our portfolio in two ways: (1) as a “Cyclical” (undervalued and under pressure, but close to the bottom of its business cycle); and (2) as a form of cheap downside protection for when the current bull market eventually runs its course.

FLOW makes money by capturing the “spread” between the price at which investors buy (or sell) an ETF and the price that it pays (or receives) for the underlying financial instruments. This business model means FLOW makes more money during volatile periods and less money during calm periods.

As we explained above, in recent years markets have been very calm, which has been a headwind to FLOW’s profitability.

With the above backdrop, there were four legs to our investment thesis:

1. The stock price had fallen well below fair value – the low volatility was a headwind to FLOW’s profitability and investors were losing sight of its longer-term growth prospects.
2. Historical trends demonstrated to us that we were getting very close to the bottom of the volatility cycle. To be clear: we did not know how long it would be until volatility would pick up; but we did know that, while we were waiting for the pickup, volatility couldn’t get much lower.
3. The stock should also provide our portfolio with some additional “protection” in the event of a market correction - a sell-off in markets almost always corresponds with a jump in volatility. This means FLOW’s earnings would recover while the market as a whole was suffering.
4. If volatility levels remained low for even longer, we would still receive compensation in the form of a healthy dividend yield.

As it turns out, volatility did remain low, and the stock remained under pressure, until Jan-18. However, the sharp correction in global markets in early February was accompanied by a major spike in volatility and FLOW rallied 67% in February alone.

The stock price is now better reflecting our estimate of the true value of the company. As such, FLOW has now largely fulfilled the “Cyclical” component of our investment thesis. However, against the backdrop of an increasingly jittery market we believe the stock can continue to provide our portfolio with downside protection.
FUND AND STRATEGY PERFORMANCE (NET OF RECALCULATED FEES¹)

A new strategy was implemented for the Pengana International Fund - Ethical from 1 July 2017 by the Pengana team. The financial information below refers to the strategy currently employed by the Pengana International Fund - Ethical. For full performance history of the Pengana International Fund - Ethical, please refer to the Pengana website.

### Net performance for periods ending 31 March 2018¹

<table>
<thead>
<tr>
<th>1 Month</th>
<th>1 Year</th>
<th>Since Inception p.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund and Strategy²</td>
<td>1.3%</td>
<td>21.2%</td>
</tr>
<tr>
<td>Benchmark</td>
<td>-0.6%</td>
<td>14.1%</td>
</tr>
</tbody>
</table>

¹ From July 2017, performance figures are those of the Pengana International Fund – Ethical’s (the “Fund”) class A units (net of fees). Between July 2015 and June 2017, performance figures have been recalculated by adjusting the Pengana International Equities Fund’s (ARSN 610 351 641) net returns to reflect the management fee of the Fund. From July 2017 the Fund has been managed by the same team and with the same strategy as the Pengana International Equities Fund. The Pengana International Equities Fund’s net track record data is historical. Past performance is not a reliable indicator of future performance. The value of the investment can go up or down.

### PORTFOLIO INFORMATION

#### Top 10 Stocks

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>China Mobile Ltd</td>
<td>Hong Kong</td>
<td>Telecommunication Services</td>
</tr>
<tr>
<td>Cigna Corp</td>
<td>United States</td>
<td>Health Care</td>
</tr>
<tr>
<td>Colgate Palmolive Usd1</td>
<td>United States</td>
<td>Consumer Staples</td>
</tr>
<tr>
<td>Deutsche Boerse Ag</td>
<td>Germany</td>
<td>Financials</td>
</tr>
<tr>
<td>Dollar General Corporation</td>
<td>United States</td>
<td>Consumer Staples</td>
</tr>
<tr>
<td>Flow Traders Bv</td>
<td>Netherlands</td>
<td>Financials</td>
</tr>
<tr>
<td>Howard Hughes Corp</td>
<td>United States</td>
<td>Real Estate</td>
</tr>
<tr>
<td>Newmont Mining Corp Usd</td>
<td>United States</td>
<td>Materials</td>
</tr>
<tr>
<td>Reckitt Benkiser Group Plc</td>
<td>United Kingdom</td>
<td>Consumer Staples</td>
</tr>
<tr>
<td>Wacker Chemie Ag</td>
<td>Germany</td>
<td>Materials</td>
</tr>
</tbody>
</table>

#### Largest 3 Contributors (for quarter)

- Flow Traders
- Wacker Chemie Ag
- Bakkafrost

#### Largest 3 Detractors (for quarter)

- Flow Traders
- Nutrien Ltd
- Interactive Corp

#### SECTOR BREAKDOWN

- Financials
- Materials
- Consumer Staples
- Consumer Discretionary
- Health Care
- Telecommunication
- Information Technology
- Industrials
- Real Estate
- Utilities
- Other
- Cash

#### CAPITALISATION

- Under 5bn (USD)
- In between 5bn - 10bn.
- Above 10bn (USD)
- Cash
- Other

- 16.56
- 15.56
- 16.08%
- 51.11%
- 12.68%
- 18.07%
- 7.12%
- 10.31%
- 0.72%
- 62.99%
- 20.32%
- 5.66%
- 10.31%
- 0.72%

#### GEOGRAPHIC

- Europe ex-UK
- North America
- UK
- Emerging Market - Asia
- Emerging Market - Latin America
- Cash
- Options

- 38.97%
- 32.50%
- 6.29%
- 2.04%
- 9.17%
- 10.31%
- 0.72%

### STATISTICAL DATA

#### Fund Portfolio Summary ¹

- Volatility ²: 9.93%
- Maximum Drawdown: -9.44%
- Beta ²: 0.84
- Number of stocks: 40

². Annualised standard deviation since inception. 3. Relative to the MSCI All Country World Total Return Index in AUD.

Pengana Investment Management Limited (AFSL: 219462) (“PIML”) is the issuer of units in the Pengana International Fund – Ethical (ARSN 093 079 906) (the “Fund”). A product disclosure statement for the Fund is available and can be obtained from our distribution team or website. 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 PIML 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 PIML nor its related entities, directors or officers guarantees the performance of, or the repayment of capital or income invested in, the Fund.

PENGANA CAPITAL GROUP LIMITED
ABN 30 103 800 568
Level 12, 167 Macquarie Street,
SYDNEY, NSW 2000
T: +61 2 8524 9900
E: clientservice@pengana.com