MONTHLY REPORT
SEPTEMBER 2023

PENGANA AUSTRALIAN EQUITIES FUND

DESCRIPTION

The Pengana Australian Equities Fund aims to enhance and preserve investor wealth over a 5- year period via a concentrated core portfolio of principally Australian listed securities. The Fund uses fundamental research to evaluate investments capable of generating the target return over the medium term. Essentially, we are in the business of seeking to preserve capital and make money – we are not in the business of trying to beat the market. We remain focused on acquiring and holding investments that offer predictable, sustainable and well-stewarded after-tax cash earnings yields in excess of 6% that will grow to double digit levels as a percentage of our original entry price in five years. We believe that building a well-diversified portfolio of these "gifts that keep on giving" represents a meaningful way to create and preserve financial independence for our co-investors.

STATISTICAL DATA

VOLATILITY[3]	NUMBER OF STOCKS	BETA[4]	MAXIMUM DRAW DOWN
11.5%	26	0.63	-23.1%

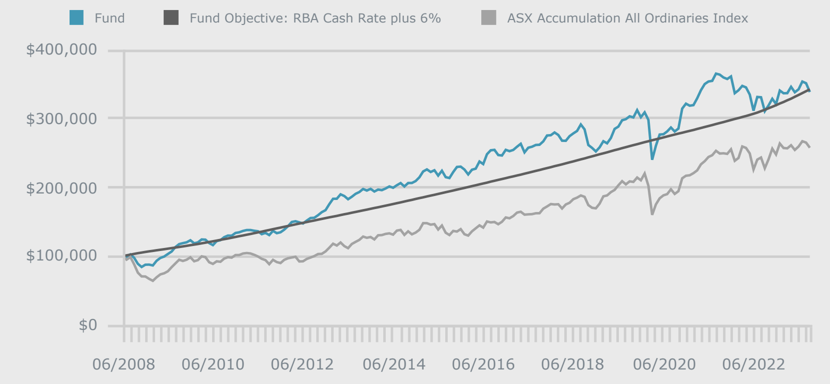
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 30 Sep 2023[1]

	1 MTH	1 YEAR	3 YEARS P.A.	5 YEARS P.A.	10 YEARS P.A.	SINCE INCEPTION P.A.
Australian Equities Fund	-3.7%	8.9%	6.4%	3.6%	5.8%	8.3%
Fund Objective: RBA Cash Rate plus 6%	0.8%	9.5%	7.4%	7.2%	7.6%	8.4%
ASX Accumulation All Ordinaries Index	-2.8%	13.1%	10.8%	6.8%	7.6%	6.4%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

BHP Group Ltd	Materials
CSL Ltd	Health Care
Evolution Mining Ltd	Materials
Medibank Pvt Ltd	Financials
National Australia Bank Ltd	Financials
nib holdings Ltd/Australia	Financials
ResMed	Health Care
SG Fleet Group Ltd	Industrials
Telstra Group Ltd	Communication Services
Woolworths Group Ltd	Consumer Staples

SECTOR BREAKDOWN

Consumer Discretionary	11.2%
Consumer Staples	7.2%
Financials	28.5%
Health Care	14.8%
Industrials	4.2%
Materials	12.6%
Real Estate	1.9%
Communication Services	6.5%
Utilities	3.4%
Options	0.2%
Cash	9.5%

CAPITALISATION BREAKDOWN

ASX 1-50	54.4%
ASX 51-100	13.3%
ASX 101-300	10.2%
All Ordinaries	5.6%
Non ASX	6.9%
Derivatives	0.2%
Cash	9.5%

CUSTOM SECTOR BREAKDOWN

Defensive	46.1%
Financials	24%
Consumer Discretionary	10.7%
Resources	9.5%
Options	0.2%
Cash	9.5%

EVER HIGHER COST OF MONEY WEIGHS ON EQUITY VALUATIONS – UNDERLYING CASH EARNINGS REMAIN KEY

COMMENTARY

The Fund generated a -1.2% return in the September quarter, following a -3.7% return in the month of September. By way of comparison, the Australian stock market declined by -0.7% in the quarter and -2.8% in the month, whilst the (annual) return of the RBA cash rate plus 6% equated to approximately +2.4% and +0.8% respectively. Calendar year to date, the Fund has achieved a return of +5.4%, which compares favourably to the Australian stock market at +4.0% and, following the challenging month of September, is now below the cash plus 6% benchmark of +7.2% for the 9 months.

After a positive July and a softer August, markets took a greater step down in September with the increasing weight of higher bond yields bearing down on equity valuations. US and Australian Bond yields increased by almost 50bps in September on elevated oil prices, a modest increase in inflation, and a subsequent reversion of expectations towards rates remaining higher for longer, following the more recent narrative focused on the timing of rate cuts.

At a market level, Energy was the only positive sector on the ASX in September (+2.2%) and materially outperformed over the quarter (+11.6%). REIT stocks (-8.5%) underperformed on the bond yield rally in September as did the Tech sector (-7.7%), whose valuations are more sensitive to longer-term rate assumptions (higher rates = lower valuations). Over the quarter, Financials (+2.3%) and Consumer Discretionary stocks (+5.6%) were also positive, whilst Healthcare (-9.0%) was the main underperformer, with CSL and RMD negatively impacting sector performance.

ResMed was a material detractor for the Fund during the quarter. Share price weakness, which started in August and continued through September, was driven by two primary factors. Firstly, a lack of operating leverage in the FY23 results, where strong top-line growth failed to translate fully to profit growth – a dynamic that disappointed us but, understanding the dynamics, we remain confident in our longer-term cash flow projections. The second factor relates to the broader adoption of a drug (GLP-1 RA) for the treatment of obesity, which is recognised as a significant contributor to sleep apnoea. We believe the threat this poses to ResMed's potential target market has been significantly overestimated due to a number of factors including cost of treatment, various side effects, and significant weight regain following withdrawal from the drug. An increasing number of academics in the relevant field have expressed their concerns around the widespread use of the drugs for obesity, whilst other commentators suggest that it could accelerate the penetration of sleep apnoea treatment (from the existing low base). Given what we view as solid underlying fundamentals and an overreaction to GLP-1, we added to our RMD holdings on the weakness during the quarter.

Other detractors over the quarter included **CSL**, who guided to a slower recovery of gross margins in their core business following COVID, and **Telstra** where solid underlying performance from the key mobile division was offset by disappointment from management's decision not to monetise the recently separated infrastructure arm of the business. We believe Telstra management presented a sound argument to retain 100% ownership, however, recognise that a subset of the investor base was invested for that event alone, and transitioned its way out of the register. With the core elements of our investment thesis validated, we remain positive and have more recently added to our position at these more attractive levels.

On the positive side, the Fund benefited from its holding in NAB, SG Fleet, and ongoing contributions from discretionary names such as Accent Group and Super Retail Group. The main trading activity in the month focused on establishing a stake in Stockland Group (largely on the theme of domestic housing shortages), adding to existing holdings in Resmed on share price weakness, and accumulating positions in ANZ (on valuation of its quality institutional banking franchise) and Metcash (attractively valued exposure to domestic supermarket and hardware). Disposals centered around exiting our position in Amcor early in the quarter, before re-establishing a position at significantly lower valuations towards the end of September, and trimming positions in CBA, James Hardie, and SG Fleet.

Thematically, we expect inflation to continue to percolate through the global economy. Whilst inflation may have peaked, we expect it to remain elevated and therefore see little scope for rate relief in the medium term. From a valuation perspective, this environment typically favours portfolios whose valuation is predominately focused on current earnings and cash flows (such as this Fund), as opposed to those whose valuations are more dependent on future earnings and cash flows. Our cash balance remains healthy and ready to deploy should future opportunities present.

The consumer has remained remarkably resilient amidst escalating cost of living pressures and higher interest rates, benefiting from accumulated savings through the COVID period, ongoing high employment rates, and wage inflation which continues above trend. We expect macro pressures to weigh further on households, however, the evidence increasingly suggests a managed (possibly soft) landing scenario as opposed to the greater fear associated with a consumer "cliff" scenario.

At a corporate level, we expect revenue growth to moderate and remain challenged in the medium term, with ongoing price increases to become more difficult to pass through, and unlikely to offset volume weakness. We expect inflationary pressures to continue through the cost of doing business lines, with the main culprits being wage growth of circa 5%, increasing rents, energy, insurance, and so on. As a result, our default expectation is for negative operating leverage to play a greater role in corporate earnings for FY24. We expect that the elevated cost of debt will create winners v losers, with the key differentiation being balance sheet leverage. With this in mind, we are focusing on companies with strong pricing power and resilient demand/market share profiles. We are trying to identify and preference companies with meaningful productivity enhancements or controllable cost bases. And we are focused on businesses with net cash balance sheets, or at least a long-term fixed cost of debt.

We remain as focused as ever on our primary objectives of capital preservation and generating a reasonable real return for our investors. We continue to believe this is best served by a disciplined approach and consistent investment methodology. A variety of good businesses run by honest and competent management teams at the right price will create a well-diversified portfolio of ever-growing cash earnings streams.

FEATURES

APIR CODE	PCL0005AU
REDEMPTION PRICE	A$ 1.7097
FEES *	Management Fee: 1.025% Performance Fee: 10.25%
MINIMUM INITIAL INVESTMENT	A$10,000
FUM AT MONTH END	A$ 626.06m
STRATEGY INCEPTION DATE	1 July 2008
BENCHMARK	The RBA Cash Rate Target plus Australian equity risk premium.

FUND MANAGERS

Rhett Kessler
CIO and Senior Fund Manager

Anton du Preez
Deputy CIO and Fund Manager

1. Net performance figures are shown after all fees and expenses, and assume reinvestment of distributions. The benchmark of cash rate plus 6% p.a. is included in the chart as it relates to the Fund's investment objective and performance fee. The Fund may invest up to 100% of its assets in equity securities. The greater risk of investing in equities is reflected in the addition of a margin above the cash rate. No allowance has been made for buy/sell spreads. Please refer to the PDS for information regarding risks. Past performance is not a reliable indicator of future performance, the value of investments can go up and down.
2. Inception 1st July 2008.
3. Annualised standard deviation since inception.
4. Relative to ASX All Ordinaries Index. Using daily returns.

*(including GST, net of RITC) of the increase in net asset value subject to the RBA Cash Rate & High Water Mark. For further information regarding fees please see the PDS available on our website.

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