PENGANA CAPITAL

MONTHLY REPORT
MARCH 2022

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
11.3%	31	0.63	-23.1%

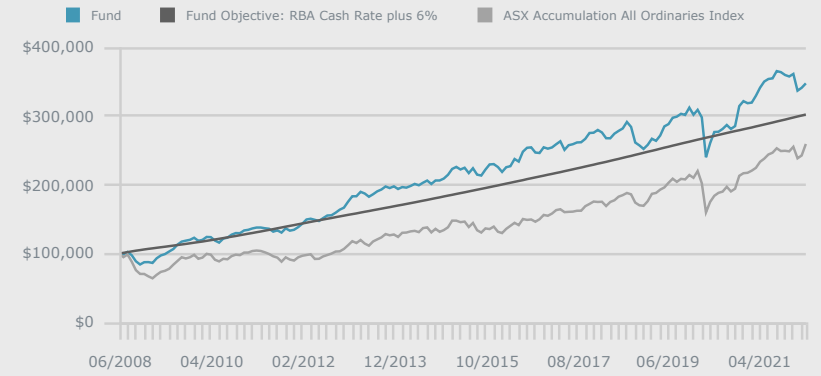
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 31 Mar 2022[1]

	1 MTH	1 YEAR	3 YEARS P.A.	5 YEARS P.A.	10 YEARS P.A.	SINCE INCEPTION P.A.
Australian Equities Fund	1.9%	5.5%	9.6%	6.1%	8.8%	9.5%
Fund Objective: RBA Cash Rate plus 6%	0.5%	6.1%	6.4%	6.8%	7.6%	8.4%
ASX Accumulation All Ordinaries Index	6.9%	15.5%	11.5%	9.8%	10.2%	7.2%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

Amcor PLC	Materials
Aristocrat Leisure	Consumer Discretionary
CBA	Financials
Credit Corp	Financials
CSL	Health Care
Evolution Mining	Materials
Mirvac Group Property Trust	Real Estate
NAB	Financials
Telstra	Communication Services
Woolworths	Consumer Staples

SECTOR BREAKDOWN

Consumer Discretionary	10.5%
Consumer Staples	3.8%
Financials	27.6%
Health Care	14.5%
Industrials	8.3%
Materials	14.7%
Real Estate	3.8%
Communication Services	7%
Utilities	2.3%
Options	0.3%
Cash	7.2%

CAPITALISATION BREAKDOWN

ASX 1-50	54.4%
ASX 51-100	4.6%
ASX 101-300	19.5%
All Ordinaries	6.9%
Non ASX	7.1%
Derivatives	0.3%
Cash	7.2%

CUSTOM SECTOR BREAKDOWN

Defensive	47.3%
Financials	27.8%
Consumer Discretionary	7.8%
Resources	9.5%
Options	0.3%
Cash	7.2%

DIVERGING EQUITY MARKET OUTCOMES

COMMENTARY

The Fund generated a -3.8% return in the March quarter. By way of comparison, the (annual) return of the RBA cash rate + 6% equated to approximately +1.5% for the quarter, whilst the Australian stock market grew by +1.6% over the same period. The Australian market was a standout performer globally in the March quarter. With the exception of the FTSE, all other global benchmarks experienced declines.

Overall performance in the March quarter benefited from our positioning for inflation and rate rises, however it was negatively impacted by a larger than usual participation in the market correction early in the period, and a lower participation in the resource and energy led market recovery toward the end of the period.

That said, large dividend receipts have bolstered cash levels and provided capacity to acquire additional holdings at attractive levels. Furthermore, the underlying cash flows in the portfolio remain intact, evidenced by a generally strong corporate reporting season in February. With an after tax cash yield of 7.6% at the end of March, the Fund continues to be attractively valued and well positioned for what we believe will be fundamental themes throughout 2022 of elevated inflation and the inflection point in the rate cycle.

Two prevailing thematics impacted both global and domestic markets in the quarter, however important distinctions resulted in the diverging equity market outcomes.

Firstly, inflation arrived. Inflationary forces that have been in play for some time, proved not only to be '*not transitory*', but continued to accelerate through the March quarter, accentuating an environment of negative real rates globally and putting increased pressure on central banks to respond by raising rates. This dynamic was particularly evident in the US where inflation accelerated to over 7% mid quarter prompting the Federal Reserve to raise rates earlier than it had expected. In Australia, whilst we too witnessed a step up in inflation, it remains at levels well below the US, and just above the RBA's targeted 2-3% range. We see further inflation pressures in the domestic economy, however would argue Australia's fiscal position means it is much better placed to deal with the situation.

Secondly, the war in Ukraine, and the ripple effect on the global economy. When one of the world's largest energy producers engages in a war with one of the world's largest soft commodity producers, there is going to be substantial global supply disruption, further inflationary pressure and subsequent impacts on global growth. Without losing sight of the tragedy of the situation, Australia is perfectly positioned to benefit from the evolving commodity environment – not just with its major Iron Ore and Energy exports, but also with an expanded LNG capability and a strengthened soft commodity sector that has by and large benefited from consecutive strong growing seasons.

The benefit for the Australian equity market, where Resource (+15% Qtr) and Energy (+29%) stocks rose sharply, was compounded by the substantial upward index weighting of BHP in the quarter. Resources and Energy combined contributed around +4.4%, of the market's total 1.6% in the quarter. Excluding the Resource and Energy sectors, the Australian market declined by approximately 6.5% in the quarter.

The Fund entered the quarter positioned as it normally is with an overall defensive bias. With inflationary pressures and a rising interest rate environment in mind, we held healthy sized positions in Telcos, Financials (NAB and CBA), gold producer Evolution Mining and other businesses with strong pricing power in their value chains (such as

Woolworths and Healthcare companies Resmed and CSL).

Our positioning for this theme proved right – stocks such as Telstra, NAB and CBA performed strongly throughout the quarter. Whilst we were substantially "underweight" headline energy and resources, we did benefit from a smaller position in BHP, and more materially from our holding in Evolution Mining (held for inflation exposure). Our positioning in Health Insurers (NIB and MBF) also contributed positively given their propensity to benefit as interest rates rise.

On the other hand, there are three main factors we have identified that we consider we got wrong, or worked against us in the quarter. **1) Our cash holdings were too low**. Management of cash holdings is a bottom-up process for us, it is an outcome of investment decisions and we do not target a cash holding. With a relatively high after-tax cash earnings yield for the portfolio at the start of January, selling existing positions was less obvious, and we had over a period continued to identify what we considered to be attractive opportunities to deploy cash. Adding to the above was the Fund's midyear distribution to unit holders at the beginning of January. **2) Put Options expiry**. The Fund had held put options throughout 2021 with a final position due for expiry in January 2022. As expiry date approached, we assessed the market pricing to roll forward however given increased levels of volatility, option pricing had risen substantially, to a level that was not commensurate with our disciplined process for renewing. As a result, our put options expired prior to the market correcting, leaving the Fund without 'insurance' during that event. **3) Volatility from less liquid small caps**. The Fund has a small number of positions in less liquid small caps, which we consider to be good businesses, however in times of broad market corrections, these names can have a disproportionate negative impact on performance.

In summary, our overall performance in the March quarter benefited from our positioning for inflation and rate rises, however was negatively impacted by a larger than usual participation in the market correction early in the period, and a lower participation in the resource and energy led market recovery toward the end of the period.

That said, large dividend receipts throughout the period have bolstered cash levels and provided capacity to acquire additional holdings at attractive levels. Furthermore, the underlying cash flows in the portfolio remain intact, evidenced by a generally strong corporate reporting season in February. With an after tax cash yield of 7.6% at the end of March, we believe the Fund continues to be attractively valued and well positioned for what we believe will be fundamental themes throughout 2022 of elevated inflation and the inflection point in the rate cycle.

FEATURES

APIR CODE	PCL0005AU
REDEMPTION PRICE	A$ 1.9275
FEES *	Management Fee: 1.025% Performance Fee: 10.25%
MINIMUM INITIAL INVESTMENT	A$10,000
FUM AT MONTH END	A$ 895.2m
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. No allowance has been made for buy/sell spreads. 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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PENGANA CAPITAL LIMITED

ABN 30 103 800 568

AFSL 226566

CLIENT SERVICE

T: +61 2 8524 9900

F: +61 2 8524 9901

E: clientservice@pengana.com

PENGANA.COM