PENGANA CAPITAL GROUP

MONTHLY REPORT
MAY 2022

PENGANA HIGH CONVICTION PROPERTY SECURITIES FUND

DESCRIPTION

A Property Fund focussed on capital security, income yield, and sustainable growth.

The Fund believes each security has an underlying or intrinsic value and that securities become mispriced at times relative to their value and each other.

The Fund seeks to exploit such market inefficiencies by employing an active, value based investment style to capture the underlying cashflows generated from real estate assets and/or real estate businesses.

The Fund believes that responsible investing is important to generate long term sustainable returns. Incorporating ESG factors along-side financial measures provides a complete view of the risk/return characteristics of our property investments.

The Fund is benchmark unaware. All positions are high conviction and assessed on a risk-reward basis, resulting in a concentrated portfolio of 10-20 securities.

STATISTICAL DATA

VOLATILITY[3]	NUMBER OF STOCKS	BETA[4]	MAXIMUM DRAW DOWN
	16		-19.2%

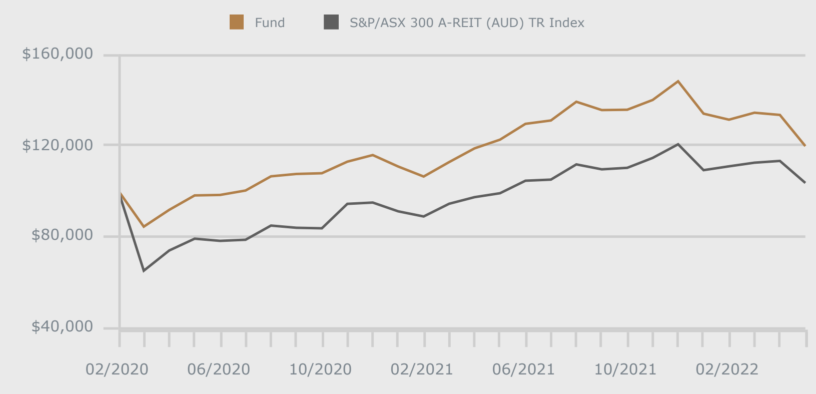
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 31 May 2022[1]

	1 MTH	1 YEAR	2 YEARS P.A.	SINCE INCEPTION P.A.
High Conviction Property Securities Fund	-10.3%	-2.3%	10.5%	8.3%
S&P/ASX 300 A-REIT (AUD) TR Index	-8.6%	4.6%	14.5%	1.5%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

Charter Hall Group	Real Estate
Goodman Group	Real Estate
GPT Group	Real Estate
Mirvac Group Property Trust	Real Estate
Shopping Centres Australasia Property Group	Real Estate

SECTOR BREAKDOWN

Retail REITs	14.5%
Diversified REITs	32.8%
Specialized REITs	7.2%
Industrial REITs	22.7%
Internet Services & Infrastructure	2.7%
Residential REITs	4.4%
Real Estate Development	8.4%
Health Care REITs	2.8%
Cash	4.5%

WHICH AREIT SUB-SECTOR TO BE IN WITH RISING RATES

COMMENTARY

The AREIT sector was under pressure in May, down 8.7% following the RBA's interest rate hike of 0.25% during the month. The Fund returned -10.3%, with the weakness driven by our overweight positions in Charter Hall Group (CHC) and Centuria Group (CNI).

We recently held a Portfolio and Investment Update webinar. Financial planners may complete a short questionnaire available HERE for CPD points.

AREITs have been a key beneficiary of cap rate compressions and falling interest rates in the past 10 years. With the RBA raising rates for the first time since 2010, and a volatile and rising long bond yield of 3.3%, market sentiment towards the sector has been negatively impacted.

With this in mind, we have assessed the outlook for asset values for each of the sub-sectors. Compared to long-run averages, cap rate spreads to real yields are elevated for retail, on par for office and below average for industrial. Thus, on the surface, industrial assets have the most downside risk – however, this does not take into account rental growth and structural tailwinds from the growth in e-commerce.

The sector we actually see with the biggest downside risk in is the office sector. The slow rebound to physical occupancy (40% of pre-COVID levels), vacancy rates of over 12% in major cities and 30% tenant incentives are placing further pressure on rents. In addition, with the flight to quality we see an increase in capex for older assets dragging on operating income in the near term. As a result, we have factored in a 50-basis point cap rate expansion for office assets from an average of 5.0% to 5.5%.

For discretionary retail, we have factored in a lower level of cap rate expansion of 30-basis point to an average of 5.6%. This is based on better-than-expected trading performance (sales up 10% on pre-COVID levels), the ongoing roll off of retail abatements and return of ancillary income to centres. However, some challenges remain as market rents are still down 8% for regional centres since the start of COVID. With the increase in cost of living and diminishing consumer sentiment due to rising inflation, we continue to prefer well-run non-discretionary retail centres.

Industrial cap rates are currently at 4.4% and are now only a +360bps spread to the 10-year real bond rate vs. historical averages of between 400bps to 600bps. However, the sector has ongoing tailwinds with a positive outlook for rental growth based on continued demand and limited supply. This has driven rental growth to record levels, which are now up ~10% year-on-year in several eastern seaboard infill markets. Whilst growth will moderate, we expect high single digit growth to remain over the next 2-3 years, offsetting any pressure from higher rates.

Based on the latest quarterly company updates, the only sectors that reported an increase in valuations (or cap rate compressions) are childcare, healthcare and non-discretionary retail. This is due to their certainty of earnings, which continues to attract capital flows. For example, reported June 2022 preliminary valuation increases on December 2021, were +7.8% for Arena REIT, +4.1% for HomeCo Wellness REIT and +4.6% for HomeCo Daily Needs REIT.

Although rising bond yields may be a headwind to asset values, we believe alternative assets such as childcare, healthcare, seniors living and defensive retailing will continue to be relatively insulated due to their certainty of income based on demand driven by secular trends and long term stable tenancies.

FEATURES	
APIR CODE	PCL8246AU
REDEMPTION PRICE	A$ 1.1261
FEES *	Management Fee: 0.70% Performance Fee: 15%
MINIMUM INITIAL INVESTMENT	A$10,000
FUM AT MONTH END	A$ 12.08m
STRATEGY INCEPTION DATE	11 March 2020
BENCHMARK	S&P/ASX 300 A-REIT Total Return Index

FUND MANAGERS

Amy Pham
Portfolio Manager

Jade Ong
Investment Specialist

1. Net performance figures are shown after all fees and expenses, and assume reinvestment of distributions. The Fund incepted on March 11th 2020. Index performance calculations include a complete month's performance for March 2020. 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 11 March 2020.
3. Annualised standard deviation since inception.
4. Relative to S&P/ASX 300 A-REIT TotalReturn Index.

* For further information regarding fees please see the PDS available on our website.

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