MONTHLY REPORT
OCTOBER 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% |

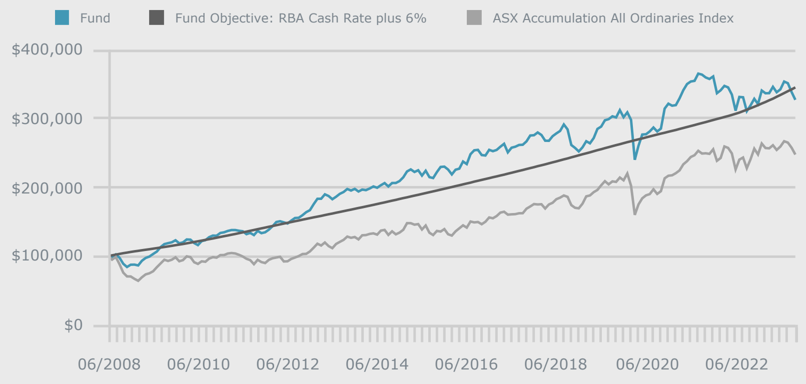
## PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 31 Oct 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 | -3.3% | 2.6% | 4.7% | 4.6% | 5.2% | 8.0% |
| Fund Objective: RBA Cash Rate plus 6% | 0.8% | 9.6% | 7.5% | 7.2% | 7.6% | 8.4% |
| ASX Accumulation All Ordinaries Index | -3.9% | 2.9% | 8.6% | 7.4% | 6.8% | 6.1% |

## 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% |
| Consumer Staples | 7.1% |
| Financials | 26.9% |
| Health Care | 14.3% |
| Industrials | 4.5% |
| Materials | 14.6% |
| Real Estate | 1.8% |
| Communication Services | 6.9% |
| Utilities | 3.5% |
| Options | 0.5% |
| Cash | 8.9% |

## CAPITALISATION BREAKDOWN

| | |
|---|---|
| ASX 1-50 | 54.3% |
| ASX 51-100 | 14% |
| ASX 101-300 | 9.8% |
| All Ordinaries | 5.8% |
| Non ASX | 6.7% |
| Derivatives | 0.5% |
| Cash | 8.9% |

## CUSTOM SECTOR BREAKDOWN

| | |
|---|---|
| Defensive | 46.6% |
| Financials | 22.6% |
| Consumer Discretionary | 11.8% |
| Resources | 9.6% |
| Options | 0.5% |
| Cash | 8.9% |

# DEFENSIVE POSITIONING AND ELEVATED CASH YIELD UNDERPINS THE PORTFOLIO'S MEDIUM TERM INVESTMENT TARGETS

## COMMENTARY

The Fund generated a -3.3% return in October. By way of comparison, the Australian stock market declined by -3.9%, whilst the (annual) return of the RBA cash rate plus 6% equated to approximately +0.8%. Calendar year to date, the Fund has achieved a return of +1.9%, which compares favorably to the Australian stock market at -0.04%, although following the recent overall market correction, is tracking below the cash plus 6% benchmark of +8.1% for the 10 months.

Recent months have proven to be a challenging environment for equities however we continue to believe that the Fund is well positioned to navigate the existing volatility and deliver on our objective of cash plus 6% in the medium term, given its defensive positioning and focus on businesses with solid balance sheets that are generating cash now. By month end the portfolio was generating a cash yield of 7% – which is to say if the companies that we are invested in meet our forecasts, they will generate an incremental 7% of the portfolio's value in free cash over the next 12 months. Together with earnings growth and capital returns, this elevated cash yield underpins our medium term investment objectives.

Following a third consecutive monthly drawdown in October, the market is now trading near 12-month lows. Index losses during the month were broad based with Financials in particular weighing on performance. Healthcare continued its recent struggles, as did the Industrial space more broadly. Resources provided a mild positive offset in the month. Global markets continued to be challenged, with the increasing weight of higher bond yields continuing to bear down on the valuation of equities, compounded by a spike in geopolitical tensions in October. US and Australian Bond yields continued to rise through October amidst expectations of higher rates for a longer period. Domestically retail sales data surprised on the upside, as did the Q3 CPI print, resulting in market pricing for a November rate hike rising from just 15% probability at the start of the month to near 70% probability by month end.

Credit Corp was a material detractor for the Fund during the month. Whilst the market had digested a subdued environment in the core Australian debt purchasing business in August, we had underestimated the challenges facing the same business in the US, where Credit Corp has in recent years established a presence and a growing debt portfolio. In light of challenging conditions affecting the relevant consumer groups in the US, management took the decision in October to impair the value of that portfolio, and the reaction by investors appears to have overshot what we consider to be the true impact of the impairment. We have discussed the matter at length with management and remain confident in the longer-term prospects of both the US and Australian operations, however, the immediate market reaction did create a significant headwind for performance during the month.

The other main detractor in the month was CSL, which along with RMD continued to be weighed down by ongoing speculation around the impact of GLP-1 weight loss drugs on their respective markets. Noteworthy developments since month end have included i) CSL global peers reporting strong earnings, causing CSL shares to increase almost 10% from their October lows; and ii) comments from the CEO of Novo (manufacturer of GLP-1 drug Ozempic) stating his view that the sell-off for companies in dialysis (CSL) and sleep apnoea (RMD) has been overdone. He further stated that GLP-1 drugs are not a cure-all, with patients still requiring treatment for such conditions. We are in agreeance with CEO Jorgensen and continue to believe both CSL and RMD offer compelling value at these levels.

On the positive side, the Fund benefited from its holding in Evolution Mining, with its attractive valuation and exposure to Gold proving a steadying influence on the Fund during the month, and another strong period of performance from Super Retail Group following a solid trading update at its AGM.  Super Retail is continuing to prove a more resilient business than the broad brush macro view that the market continues to ascribe to its valuation.  Further benefits were provided by the Fund's put option position during the month.

The main trading activity in the month focused on establishing a stake in CSR, whose building products business we believe provides an attractively valued exposure to the housing shortage theme domestically, and adding to the existing holding in Amcor having re-established a position in September.  Amcor's recent Q1 update, along with peers, provided visibility of stabilisation in tough trading conditions in the near term and we think is well positioned for a calendar 2024 recovery.  Disposals centred around taking profits into strength in Super Retail Group (managing position size) as well as trimming positions in NAB and BHP.

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.

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$ 1.6526 |
| FEES * | Management Fee: 1.025%<br>Performance Fee: 10.25% |
| MINIMUM INITIAL INVESTMENT | A$10,000 |
| FUM AT MONTH END | A$ 594.83m |
| 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.

## PENGANA AUSTRALIAN EQUITIES FUND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