



Product Review

Pengana Australian Equities Fund

ISSUE DATE 25-10-2022

About this Review

ASSET CLASS REVIEWED	AUSTRALIAN EQUITIES
SECTOR REVIEWED	AUSTRALIAN LARGE CAP
SUB SECTOR REVIEWED	ABSOLUTE RETURN
TOTAL FUNDS RATED	5

About this Fund

ASIC RG240 CLASSIFIED	NO
FUND REVIEWED	PENGANA AUSTRALIAN EQUITIES FUND
APIR CODE	PCL0005AU
PDS OBJECTIVE	TO ACHIEVE OVER THE MEDIUM TO LONG TERM AN INVESTMENT RETURN IN EXCESS OF THE RBA CASH RATE PLUS A MARGIN TO COMPENSATE INVESTORS FOR THE EXTRA RISK ASSOCIATED WITH INVESTING IN AUSTRALIAN EQUITIES
INTERNAL OBJECTIVE	RBA CASH RATE PLUS 6% (NET OF FEES) OVER 5 YEARS
STATED RISK OBJECTIVE	LESS VOLATILITY THAN THE S&P/ASX ALL ORDINARIES INDEX
DISTRIBUTION FREQUENCY	SEMI-ANNUALLY
FUND SIZE	\$789M (AUGUST 2022)
FUND INCEPTION	01-07-2008
MANAGEMENT COSTS	1.065% P.A. (INCL. EXPENSES)
PERFORMANCE FEE	10.25% (OF PERFORMANCE ABOVE RBA CASH RATE PLUS 6% P.A. SUBJECT TO HWM)
RESPONSIBLE ENTITY	PENGANA CAPITAL LIMITED

About the Fund Manager

FUND MANAGER	PENGANA CAPITAL LIMITED
OWNERSHIP	PENGANA CAPITAL GROUP LIMITED (ASX: PCG)
ASSETS MANAGED IN THIS SECTOR	\$789M (AUGUST 2022)
YEARS MANAGING THIS ASSET CLASS	14

Investment Team

PORTFOLIO MANAGER	RHETT KESSLER
INVESTMENT TEAM SIZE	5
INVESTMENT TEAM TURNOVER	LOW-MOD
STRUCTURE / LOCATION	ANALYSTS/SYDNEY

Investment process

STYLE	CORE / NEUTRAL
MARKET CAPITALISATION BIAS	ALL CAP
BENCHMARK	RBA CASH RATE PLUS 6%
TYPICAL NUMBER OF STOCKS	20-50
STOCK LIMITS	10% ON ACQUISITION, 15% AT MARKET
SECTOR / INDUSTRY LIMITS	UNCONSTRAINED
CASH LIMIT	MAXIMUM 100% (TYPICALLY 20%)
GLOBAL EQUITIES LIMIT	MAXIMUM 20%
DERIVATIVES	YES

Fund rating history

OCTOBER 2022	RECOMMENDED
OCTOBER 2021	RECOMMENDED
JULY 2020	RECOMMENDED

What this Rating means

The 'Recommended' rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

Strengths

- Logical Australian Equity strategy targeting total returns, with a focus on drawdown risk mitigation.
- Chief Investment Officer/Senior Portfolio Manager Rhett Kessler is a highly experienced absolute return portfolio manager.

Weaknesses

- The Fund has experienced recent missteps in its downside protection strategy along with increasingly elevated risk characteristics, albeit somewhat driven by broader market volatility. Nevertheless, these are viewed as being inconsistent with its capital preservation focus and track record.
- The Fund is managed by a relatively small investment team, albeit noting the targeted research approach.
- High key person risk in Kessler as CIO and lead Portfolio Manager.
- The Fund's aggregate fee load is considered to be high.

Fund Risk Characteristics

	LOW	MODERATE	HIGH
BUSINESS SUSTAINABILITY RISK		●	
CAPITAL VOLATILITY			●
FOREIGN CURRENCY RISK	●		
SECURITY CONCENTRATION RISK			●
SECURITY LIQUIDITY RISK			●

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

BIometrics

Aggregated risks

	1	2	3	4	5	6	7
STD RISK MEASURE						●	

A Standard Risk Measure score of 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20 year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

	LOW	MODERATE	HIGH
RISK TO INCOME		●	

We strongly recommend that potential investors read the product disclosure statement Lonsec Research Pty Ltd ABN 11 151 658 561 • AFSL No. 421 445 • This information must be read in conjunction with the warning, disclaimer, and disclosure at the end of this document. This report supersedes all prior reports.

ANALYST: MATTHEW FREEMAN | APPROVED BY: PETER GREEN

Pengana Australian Equities Fund

ISSUE DATE 25-10-2022

Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY			●
ESG		●	

Fee profile

	LOW	MODERATE	HIGH
FEES VS. UNIVERSE			●
FEES VS. ASSET CLASS			●
FEES VS. SUB-SECTOR		●	

Fee BIometrics are a function of expected total fee as a percentage of expected total return.

What is this Fund?

- The Pengana Australian Equities Fund ('the Fund') is a concentrated, absolute return product, investing predominately in Australian equities. The Fund is typically style neutral and has an investment objective to exceed the RBA Cash Rate plus 6% (net of fees) over rolling three to five-year periods. The Manager also has a focus on the preservation of capital and seeks a volatility of return less than that of the S&P/ASX All Ordinaries Index.
- The Fund is managed by Pengana Capital Group ('Pengana' or 'the Manager'), adopting a style neutral approach. The Manager adopts a high conviction, 'benchmark unaware' investment approach and will invest across the market cap spectrum. Thus, the portfolio may feature higher exposures to smaller market cap stocks relative to peers, provided there is sufficient liquidity.
- The Fund aims to enhance and preserve investor's wealth over a five-year period. Its investment objective is to achieve an investment return, over the medium to long term, including capital appreciation, dividends and interest, in excess of the risk free rate (RBA Cash Rate target) plus a margin to compensate investors for the extra risk associated with investing in Australian equities (also known as the 'equity risk premium'). The Manager believes an appropriate equity risk premium is 6-7% p.a., which currently translates to an internal absolute return target of 8-9% p.a. over five years. The Manager also seeks a volatility of return less than that of the Australian Equity market.
- The Fund will typically consist of 20-50 stocks with a focus on achieving absolute returns and the preservation of capital. The Fund utilises a bottom-up fundamental research approach to invest in listed Australian securities that can generate a sustainable cash earnings yield with a margin of safety. The broad investment mandate affords the Manager additional levers to be able to invest up to 20% of the Fund in International Equities, however, in practice the Fund has not invested overseas to a significant extent to date. The Fund may also invest in listed Australian hybrids, securities in exchange traded funds, listed bonds and derivatives. The Fund can also hold high levels of cash, up to 100%, in the absence of attractive investment opportunities. The Fund's neutral position has typically been 80% long and 20% cash. Additionally, portfolio turnover has been low historically, typically less than 30% p.a.
- Lonsec expects the Fund's performance to be largely driven by its active stock positions and the Fund's

allocation to cash, determined via bottom-up research and the Portfolio Manager's qualitative judgement. Investors should note that generally the Fund has a lower level of market exposure compared to more traditional long-only Australian Equity funds. Furthermore, the Fund is expected to outperform in declining markets, which is in line with its absolute return style and focus on capital preservation. In contrast, the Fund may underperform the broader market index during bullish economic conditions.

- As per the PDS dated 15 September 2022, the fee disclosure for the Fund is as follows – 1.065% p.a. Management Cost (including a management fee of 1.025% p.a., plus capped expense recovery fee of 0.04% p.a.) plus an additional estimated performance fee of 0.69% p.a. which represents the average performance fee amount incurred during the financial years from 1 July 2017 until 30 June 2022. Lonsec notes that in accordance with the Manager's interpretation of RG97, the performance fee has been disclosed for illustrative purposes only and the PDS acknowledges that the actual performance fee may be above or below this level. The performance fee is calculated as 10.25% of the increase in net asset value subject to the Australian cash rate plus 6% p.a and high water mark. Additionally, the Performance Fee cannot reduce the Fund's net return below the RBA Cash Rate plus 6% for the period.
- Net transaction costs for the 12 months ended 30 June 2022 were 0.017% of the NAV of the Fund. Net transaction costs are costs incurred in managing the Fund (include brokerage, settlement costs, bid-offer spreads on investments and currency transactions and any borrowing costs, clearing and stamp duty costs) that are not covered by the buy/sell spread.
- The Fund's buy/sell spread is +0.15/-0.15%. These costs are reflected in the unit price of the Fund and are borne by investors, but they are not paid to the Responsible Entity or the Manager. Buy/sell spreads are subject to change depending on market conditions. Refer to the Manager for current buy/sell spreads. Please refer to the PDS for further details on fees and costs.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- Lonsec notes that the Manager has produced a Target Market Determination (TMD), which forms part of the Responsible Entity's Design and Distribution Obligations for the Fund. Lonsec has collected the TMD that has been provided by the Manager and notes that this should be referred to for further details on the Target Market Summary, Description of Target Market and Review Triggers.
- The Fund is subject to equity market risks and movements (both positive and negative) in the prices of the underlying securities in the portfolio. Investors should be aware of, and comfortable with, the potential for the Fund to experience periods of negative returns, which result in capital losses being incurred on their investment. As such, the Fund will generally sit within the growth component of a diversified portfolio. Lonsec recommends that equity

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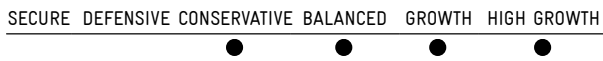
Pengana Australian Equities Fund

ISSUE DATE 25-10-2022

investments, given their volatility, are best suited for investors with a minimum investment horizon of five years.

- The Fund is managed with the aim of generating positive absolute returns and has the flexibility to vary the portfolio's asset allocation (i.e. global equities, hybrids, debt, derivatives and cash), which can introduce additional risks to investors. It is also expected that the Fund's performance may have a lower correlation to equity market indices than more traditional benchmark aware, long only Australian equity products. Lonsec considers it suitable for blending with other Australian equities strategies including core, value and growth style funds, small cap or benchmark aware products.

Suggested Lonsec risk profile suitability



For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

Changes Since Previous Lonsec Review

- Chris Tan, Investment Analyst, resigned from the Manager, effective November 2022.
- There have been no changes to the investment process since the last review.

Lonsec Opinion of this Fund

People and resources

- Kessler is the Chief Investment Officer and Senior Portfolio Manager who is ultimately responsible for the Fund. Kessler has over 27 years of investment experience, including eight years at IAG Asset Management ('IAGAM'), where he held roles including Head of Research and Portfolio Manager for the IAGAM Absolute Return Fund. Kessler is the founding principal of the strategy having launched the strategy at Pengana in October 2007. Lonsec regards Kessler's investment experience and overall investment capability highly, considering him to be a quality investment professional with suitable experience in absolute return style investing.
- The investment team of five is relatively small in the context of the Manager's broad investment universe. That said, Lonsec notes the targeted research approach and concentrated, low turnover investment style allows the Manager to operate with a lower headcount than many of its peers. Additionally, Lonsec notes that the Manager looks opportunistically for investments and does not try to cover the entire universe in the way that a core-styled benchmark aware fund manager would. Pleasingly, Lonsec notes the recent addition of an Investment Analyst from the Fund's intern program and will continue to monitor the resourcing of the investment team.
- Kessler is chiefly supported by Deputy CIO and Portfolio Manager du Preez, who joined Kessler at Pengana in February 2009. du Preez has extensive portfolio management experience, having managed Australian, South African and Global Equity strategies in a value and market neutral style prior to joining Pengana and has a career spanning over

30 years. Lonsec considers du Preez to be a highly capable and experienced investment professional who has formed an extensive and successful track record working alongside Kessler.

- Lonsec notes that team's head-count has reduced year-on-year to five with the recently announced resignation of Chris Tan. Tan was an experienced Investment Analyst who has not been replaced as yet. However, Lonsec acknowledges the Manager's imminent hiring intentions to replace this role. While noting that team turnover has historically been low at the Manager, Lonsec considers the loss of such an experienced analyst invariably impacts the breadth of coverage of the team until a suitable replacement has both been found and integrated into the team. Somewhat mitigating this concern is Lonsec's conviction in Kessler and du Preez, noting the heavy involvement of both in the investment process.
- The team has one remaining experienced, high quality analysts in Mark Christensen and have recently added an additional investment analyst via the Fund's intern program. Collectively, Lonsec continues to view the investment team to be suitably experienced and skilled, albeit will continue to monitor the team's structure and experience levels as a replacement for Tan is found.
- Pengana and the Fund's management team (Kessler and du Preez) share in the profits generated by their business unit in a 45/55 proportion, which helps promote the alignment of interests between Pengana and the investment staff. The alignment with end investors is further supported by the performance fee structure and the material investment in the Fund by Kessler. Lonsec is pleased to note that this arrangement remains unchanged since the merger between Hunter Hall and Pengana. Additionally, Lonsec is pleased with the additional retention efforts undertaken under the merger with key investment staff (Kessler and du Preez) granted shares of Pengana under a loan share plan with a five-year escrow period. Going forward, it is also understood that equity participation in some form may be broadened to include Tan and Christensen contingent on certain milestones being reached.
- There is a high level of key person risk with Kessler due to the small team size, his decision making responsibilities within the investment team, and his central role in developing the investment process used by the Fund. This risk is lessened by Kessler's profit share agreement, share holding plan, his significant co-investment in the Fund, and the appointment of du Preez as his backup.

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Pengana Australian Equities Fund

ISSUE DATE 25-10-2022

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P 4-10

Research and portfolio construction

- The Manager has a conservative approach to investing and prefers companies with predictable after-tax cash flows with pricing power and resilient business models. The Manager will screen out stocks that are unable to generate an after-tax cash earnings yield of 6-8% p.a. with sustainable growth in the medium term. Stocks that have a short history, such as start-up companies, are typically filtered out. The Manager tends to avoid companies with overly complex corporate structures and financially engineered entities. Lonsec believes this approach to be prudent and aligned with the Manager's philosophy of conservatism and capital preservation.
- Investment ideas are generated mainly through internal research and also from broker contacts. The Manager forms a qualitative view on each stock, which involves an assessment of management competence, business model resilience and industry structure. Company visits and discussions with company management, suppliers, and competitors are an important part of this process. Access to external research is considered a valuable resource in supplementing idea generation and understanding industries. Lonsec notes the lower level of research expertise in the Metals and Mining sectors but does not consider this to be a significant disadvantage, given the portfolio has a bias away from these sectors. Lonsec also believes the Manager's qualitative research to be detailed but somewhat lacking in breadth.
- Quantitative assessment includes a valuation component using a combination of proprietary and broker-sourced models. Internal models integrate cash flow, balance sheet and earnings analysis with the primary focus of determining the quantum and certainty of cash flows and determining a stock's return to shareholders within operating and financial leverage parameters. Lonsec believes this to be logical and consistently applied.
- The research process has a clear focus on downside risk and market exposure via the Manager's tactical cash allocations and derivative positions. Specifically, the Fund can hold up to 100% in cash if no suitable investment opportunities can be found that meet the Fund's investment criteria. Over the last two years, cash levels have ranged between 4-15% and averaging 10%. Lonsec notes that the Manager's cash allocation decision is driven by its bottom-up research, with plentiful opportunities reflected by low cash holdings. The Fund's derivative positions are typically put options over the ASX200 Index and are used as a downside protection strategy.
- Whilst this strategy is aligned with the capital preservation philosophy of the Fund, Lonsec notes that in January 2022, the Manager allowed this protection to expire as a result of the premium required to purchase this protection being considered expensive. Lonsec appreciates the Manager's valuation focus, however, at the time the protection was allowed to lapse the Fund was 95% invested and as such, Lonsec considers the forgoing of protection at such high exposure levels to equity beta to be contradictory to the Fund's capital preservation focus. Disappointingly, the broader market experienced risk-off sentiment over this period, with the ASX200 Index returning -6.4% for the month of January 2022 for which the Fund held no protection.
- Although experiencing this recent misstep in downside protection, Lonsec highlights the Fund's long term defensive and capital preservation characteristics. This is evidenced by the Fund's volatility, as measured by standard deviation, typically being 10-20% less than that of the Index since inception. Furthermore, the Fund's beta characteristics have also typically been lower than the broader market. Additionally, the Fund has outperformed in 77% of down markets since the Fund's inception. In contrast, the Fund has only outperformed in 31% of up markets over the corresponding period, typical of the Fund's conservatism. Nevertheless, Lonsec will continue to monitor the Manager's cash allocations and protection levels for greater adherence to the investment philosophy in future reviews in order to maintain its conviction.
- Lonsec considers the Fund's portfolio construction process to be relatively subjective and unconstrained in comparison to peers, allowing the Manager significant autonomy. Instead of price targets or stock rankings, position sizes are determined according to level of conviction, relative risk/reward profiles and market liquidity. As such, there is more art than science involved. However, Lonsec notes that the Manager has historically demonstrated a conservative approach to portfolio construction and has used its wide investment mandate predominantly to hedge or reduce portfolio risk. Having said that, the Fund has a reasonable allocation to mid/small cap stocks and concentrated sectors, which can increase overall risk levels. Over the longer term, Lonsec is reassured by the Manager's general adherence to its investment philosophy and Kessler's common sense approach to investing.
- While Lonsec considers the investment approach to be well-defined, the Fund's recent positions in cyclical industries, such as car fleet operators and consumer financing companies, is considered by Lonsec to be a deviation from the Fund's quality, defensive positioning. Additionally in Lonsec's view, position sizing in some cases appears to be discordant with the associated risks and the Fund's focus on capital preservation. Disappointingly, these positions were among the biggest detractors to the Fund's performance over the 12 months to March 2022. Lonsec will continue to monitor the Manager's propensity to own lower quality stocks and will observe for greater adherence to the long-held investment philosophy in future reviews in order to maintain its conviction.

ESG integration

- Lonsec's ESG integration assessment considers how rigorous, robust and structured the ESG process for the Fund is as well as how well it integrates into the overall investment process and the Manager's overall policy and reporting framework. The assessment is not intended to assess the underlying holdings of the Fund's portfolio or the Manager's adherence to any form of impact, green / sustainable or ethical standards.
- At the overall corporate level Lonsec views Pengana's overall ESG framework as below peers. The Manager

Pengana Australian Equities Fund

ISSUE DATE 25-10-2022

has an articulated commitment to their integration of ESG within their investment process with evidence of a policy framework and public positioning. The ESG policy is publicly available and has recently been updated with details on the Manager's engagement approach. While the engagement framework and policy lightly touch on engagement objectives, no reporting on engagement outcomes is publicly available. The Manager does not provide any details on their proxy voting policy or voting outcomes.

- Overall ESG integration at the Fund level is seen by Lonsec as being relatively light. While the manager is sourcing data from an external ESG data provider it is incorporated in a less thorough manner than some peers. ESG analysis is visible within the research processes with ESG forming part of the Managers research note for each company. The process by which ESG research is reflected in position sizing is a little less transparent than in some leading managers. Portfolio monitoring for aggregated ESG risks is evident but light.
- Note that the Managers "risk/value" approach to ESG may mean that poor ESG companies may be included if the return potential is sufficient and this may conflict with some clients perception of what a strong ESG process would deliver.
- The Manager has indicated that their Responsible Investment style is "ESG Integration" and as such that they take Environmental, Social and Governance factors into consideration when assessing investment opportunities. Note that such an approach does not automatically ensure that the resulting portfolio will adhere to any particular structure or provide any particular level of ethicalness, greenness or sustainability.

Risk management

- The Fund is run in a 'benchmark unaware' fashion and does not have any formal tracking error constraints in keeping with the Fund's absolute return style. The Fund is also able to invest up to 100% in cash with the asset allocation decision intrinsically tied to stock valuations.
- Lonsec considers much of the Fund's risk management process to be within its bottom-up stock research process. In particular, the Manager seeks to invest in companies with defensive characteristics. The identification of such companies is largely the result of the detailed bottom-up assessment of quality and value. The Fund holds ASX 200 Index puts as a downside protection strategy, additionally, the Manager may also buy further put protection around events it deems as a potential catalyst for a drawdown event.
- The Fund's risk objective is to experience lower volatility than the broader equity market. Lonsec notes that the Fund has been true to label in this respect with volatility 10-20% lower than that of the ASX200 Index. Furthermore, the beta characteristics of the Fund have also typically been lower than the broader market, however, Lonsec has observed a steady rise in this measure over the past four years from 0.6 in 2018 to upwards of 0.9 at the time of the most recent review. That said, Lonsec acknowledges increased risk metrics can partially be explained by broader market volatility. Nevertheless, Lonsec will

continue to monitor risk traits of the Fund in future reviews to assess the Managers adherence to the Fund's quality and capital preservation philosophy.

- Portfolio positions are monitored daily to ensure the Fund adheres to portfolio constraints as well as monitoring liquidity and counterparty risk. Lonsec notes that the Manager's risk management process and systems are not as sophisticated as some of its peers. The risk management framework is broadly based on qualitative judgement and can be subjective in nature. Thematic exposures can be material given the Fund's low turnover, concentrated style. That said, risk is almost entirely managed in an absolute sense and Lonsec believes the systems used are adequate for monitoring portfolio risk.

Capacity management

- As of 31 August 2022, the strategy was approximately \$789m in size. Pengana have stated that the strategy's theoretical maximum capacity is 0.5% of the free float adjusted market capitalisation of the small and mid-cap market. However, Kessler has indicated that he would be more comfortable managing around \$1bn, which is more conservative than the Fund's stated estimate capacity.
- Whilst there are positives and negatives to low or high levels of FUM, on balance (and all other factors being equal) Lonsec believes managers with smaller FUM are better placed to add value. As such, Lonsec believes that the Manager has the potential to confront liquidity issues and is less nimble in the market (as it takes a longer period of time for a position to be established or sold down) than peers with smaller FUM. This is particularly pertinent in times of market volatility as experienced in the recent calendar year.
- That said, Lonsec has a level of comfort that the Manager can effectively manage the strategy at current lower levels of FUM due to the flexibility of the mandate (ability to hold 100% cash, invest 20% offshore, all-cap nature of the portfolio), relatively conservative initial capacity estimate compared to peers and strong alignment/co-investment of interests with investors. The portfolio turnover of the strategy is also typically fairly low at below 30% p.a. Notwithstanding, Pengana will need to carefully manage the firmness of their capacity stance going forward given the proximity to the \$1bn target. The strategy's capacity will continue to be a key focus in future reviews to ensure that liquidity constraints are not detrimental to performance.

Performance

- The investment objective of the Fund is to achieve over the medium to long term an investment return in excess of the RBA Cash rate plus a margin to compensate investors for the extra risk associated with investing in Australian Equities. The Manager believes an appropriate equity risk premium is 6-7% p.a., which currently translates to an internal absolute return target of 8-9% p.a. over five years. The Manager also seeks a volatility of return less than that of the Australian Equity market.
- Over the three- and five-year periods to August 2022, the Fund has not achieved its internal performance target, RBA Cash Rate plus 6% p.a., delivering net underperformance of 2.9% p.a. and 1.9% p.a.

ANALYST: MATTHEW FREEMAN | APPROVED BY: PETER GREEN

P. 5-10

Pengana Australian Equities Fund

ISSUE DATE 25-10-2022

respectively. Lonsec notes that this performance outcome is largely skewed by the return achieved over the past 12 months. Over the 12 months to August 2022, the Fund returned -9.4%, equating to 15.8% underperformance relative to the Fund's performance objective, however largely reflective of broader equity market returns.

- Relative to the market returns, as measured by the S&P/ASX 300 Index ('the Index'), the Fund underperformed by 5.7% over the 12 month period to August 2022 with the Index returning -3.7%. In an absolute sense, the Fund was impacted in January 2022, a month where net exposure was 95% and the option protection strategy not present, to return -6.7% compared to the Index return of -6.3% to underperform in a relative sense by 0.4% for the month. Most notable however, is the Fund's relative performance in the month of March 2022. Broader equity markets underwent a material rally with the Index returning 6.9% for the month compared to the Fund's monthly return of 1.9% resulting in relative underperformance to the Index of 5.0%.
- Historically, the Fund's conservatism has resulted in lower volatility and drawdowns than the broader market. This is evidenced by the Fund's volatility, as measured by standard deviation, typically being 10-20% less than that of the Index. Furthermore, the Fund's beta characteristics have also typically been lower than the broader market, however, Lonsec has observed a steady rise in this measure over the past four years from 0.6 in 2018 to upwards of 0.9 at the time of the most recent review. Additionally, the Fund has outperformed in 77% of down markets since the Fund's inception. In contrast, the Fund has only outperformed in 31% of up markets over the corresponding period.
- Finally, Lonsec has noted that in recent market drawdown events the Fund had provided lower than expected capital preservation and higher than expected correlation to equity markets. That being said, the Fund has offered downside protection and displayed capital preservation characteristics over the longer term as evidenced by the Fund's down market outperformance and typically lower risk traits. Nevertheless, Lonsec will continue to test the Fund's capital preservation focus in future reviews.

Overall

- Lonsec has maintained the Fund's rating as '**Recommended**'. Lonsec's rating is based on its high regard for Rhett Kessler as Portfolio Manager and the intuitive investment philosophy and process behind the strategy, which has historically produced sound absolute return outcomes for investors.
- That said, the Fund has suffered from weaker performance more recently while Lonsec has observed increasingly elevated risk characteristics, albeit acknowledging broader market volatility as a contributor. Additionally, the Manager has experienced recent missteps in its downside protection strategy. Lonsec considers these factors to be inconsistent with a capital preservation focus and will continue to monitor performance outcomes and risk behaviour to maintain its current level of conviction in the Fund.

People and Resources

Corporate overview

The Fund was formerly managed by Pengana Holdings Pty. Ltd., the owner of Pengana Capital Limited which was jointly owned by Pengana Staff, Directors and other minority interests (50.1%) and nabInvest (a wholly owned subsidiary of National Australia Bank, 49.9%). On 1st June 2017, Pengana merged its business with Hunter Hall International Limited and on completion of the merger was renamed Pengana Capital Group Limited.

As a combined funds management business, Pengana manages approximately \$3.4bn in FUM, as at July 2022, across global and Australian equity strategies. Pengana employs over 50 staff including approximately 17 investment professionals across offices in Sydney and Melbourne. The directors and staff currently own circa 41% of the business. The investment team responsible for this Fund is based in Sydney.

All of Pengana's underlying managers are boutique in nature with profit sharing arrangements in place with the responsible portfolio management teams and Pengana. Additionally, key members of the team are aligned to the headline business via the allotment of shares under a loan share plan which have a five year escrow period from the date of the merger.

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
RHETT KESSLER	CIO/SENIOR PORTFOLIO MANAGER	27 / 14
ANTON DU PREEZ	DEPUTY CIO/PORTFOLIO MANAGER	30 / 13
MARK CHRISTENSEN	INVESTMENT ANALYST	22 / 8
DAVID GLASSER	INVESTMENT ANALYST	1 / 1
STEPHANIE DORAN	TRADER	7 / 7

Rhett Kessler (Chief Investment Officer & Senior Portfolio Manager) joined Pengana in October 2007. He was previously at IAG Asset Management ('IAGAM') for eight years. In addition to his role as Head of Research at IAGAM, he played an active role as a Joint Portfolio Manager for various wholesale funds totalling \$3.3bn. In 2005, he successfully launched and ran the IAGAM Absolute Return Fund. Prior to this he was a rated media analyst for UBS Australia for two years. Before emigrating from South Africa in 1996, Kessler successfully managed wholesale and retail equity portfolios as Deputy General Manager of Investment for Liberty Asset Management. Kessler holds bachelors degrees in Commerce and Accounting from the University of Witwatersrand, is a Chartered Accountant (SA) and a Chartered Financial Analyst.

Anton du Preez (Deputy CIO and Portfolio Manager) joined Pengana Capital in February 2009. Prior to this Du Preez was with Rand Merchant Bank ('RMB') for five years. In this role he managed a value proprietary fund in Australia for two years, and before that a similar RMB fund in South Africa. Before joining RMB, Du Preez was a Co-Principal of a market neutral hedge fund based in Cape Town, South Africa. Previously, he was a Director and Fund Manager at PSG Asset Management responsible for managing a global equity fund, which

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Pengana Australian Equities Fund

ISSUE DATE 25-10-2022

achieved top quartile performance on a consistent basis. Du Preez was a rated sell-side analyst with ABN Amro covering industrial and consumer sectors. Du Preez holds bachelors and honours degrees in Commerce and Accounting from the University of Stellenbosch and Pretoria, is a Chartered Accountant (South African and Canadian) and a Chartered Financial Analyst. Du Preez is also qualified as a Chartered Management Accountant (UK).

Mark Christensen (Investment Analyst) joined Pengana in October 2013 as an Investment Analyst within the Australian Equity team. Previously, Christensen was a research analyst at Morgan Stanley with experience covering Australian Consumer and Gaming equity out of Sydney and European Consumer Staples out of London across seven years. Prior to Morgan Stanley, Christensen was a chartered accountant at PricewaterhouseCoopers for five years.

David Glasser (Investment Analyst) joined Pengana in 2021 after successfully graduating from the company's graduate internship program.

Remuneration / Alignment of interests

Analysts receive a mixture of fixed and variable remuneration, which includes a competitive base salary and discretionary bonus. The variable component is based on a combination of qualitative and quantitative factors. The qualitative component involves an assessment of idea generation, research capability, and overall contribution to the business. The quantitative assessment focuses on the ability of analysts to identify stocks with sustainable earnings yield in the medium term. A profit sharing arrangement is in place between the investment team (Kessler and du Preez) and Pengana Capital Group in relation to the earnings of the Australian Equity business unit. Additionally, Kessler and du Preez are the only members of the team that were granted shares of the headline Pengana Capital Group as part of the merger.

Research Approach

Overview

RESEARCH PHILOSOPHY	BOTTOM-UP SEEKING QUALITY COMPANIES AT REASONABLE PRICES WITH A FOCUS ON CAPITAL PRESERVATION
NO. STOCKS IN UNIVERSE	GREATER THAN 300
NO. STOCKS FULLY MODELED / RESEARCHED	80-180
KEY SCREENS	AFTER-TAX CASH EARNINGS YIELD OF 6-8% P.A.
BROKER RESEARCH	FOR IDEA GENERATION
VALUATION OVERVIEW	AFTER TAX CASH EARNINGS YIELD, DCF, PRICE MULTIPLES, DIVIDEND YIELDS

The key inputs into the research process include company management, suppliers, customers, competitors (both listed and unlisted), broker research, investment banks and industry specialists. Broker research is an important input with regards to idea generation, understanding industries and facilitating meetings with company management.

The key areas of focus and the aims of the research process include:

- Management Competence: With a clear preference for companies with strong management and a track record of integrity.

- Business Model Resilience: Is business model transparent and predictable?
- Industry Structure: How much market power does company wield?
- After-tax Earnings Yield: Quantum and predictability of future earnings.

Valuation

The primary valuation approach is after-tax cash earnings yield targets. A company's after tax cash earnings yield is calculated by taking the profit (EBITDA) and subtracting the working capital, maintenance capital expenditure, interest and tax to determine an earnings figure, which is divided by the size of the company. The after tax cash earnings yield is required to be at least 6% p.a. with reasonable certainty to grow to 10% plus yield within five years. This measurement of value tends to look for companies for which earnings are predictable and therefore are akin to an increasing annuity. Intrinsic value is also inferred from a number of other financial metrics such as price-to-earnings, return on equity and profit margins.

Portfolio Construction

Overview

FUND BENCHMARK	RBA CASH RATE PLUS 6% P.A.
INTERNAL RETURN OBJECTIVE	SAME AS ABOVE
INTERNAL RISK OBJECTIVE	VOLATILITY OF RETURN LESS THAN THE AUSTRALIAN EQUITY MARKET
PORTFOLIO MANAGEMENT APPROACH	BENCHMARK UNAWARE
INVESTMENT STYLE	CORE / NEUTRAL
PORTFOLIO DECISION MAKING	ULTIMATE RESPONSIBILITY WITH CIO
STOCK SELECTION	BOTTOM-UP
TOP-DOWN INFLUENCE	5%
MARKET CAPITALISATION BIAS	ALL-CAP
TYPICAL NUMBER OF HOLDINGS	20-50
EXPECTED PORTFOLIO TURNOVER	APPROXIMATELY 30% P.A.
PORTFOLIO EXPOSURE IN 'TOP 10' HOLDINGS	52.2% (JULY 2022)

As the portfolio manager, Kessler is ultimately responsible for management of the Fund. Rather than strict valuation targets, position sizing is subjective and discretionary in nature. The portfolio is constructed in a 'benchmark unaware' fashion where absolute positions are determined by the conviction, relative attractiveness, and market liquidity of the security. The Manager will tend to avoid being overly exposed to single factor risks, however sector concentration and market-capitalisation biases may result from the bottom-up process.

Buy decisions are based on the Manager's assessment of fundamental quality first, then its valuation. Other factors considered in the buy decision include non-fundamental factors such as appetite for risk, M&A, behavioural investing, and technical factors. A risk/reward assessment is undertaken no matter how compelling the valuation. Stocks may be sold if the Manager believes company fundamentals have changed or its potential for achieving cash earnings yield is compromised. Portfolio turnover has been low-moderate historically at circa 20-30% p.a.

The cash allocation decision is primarily driven by bottom-up valuation and the Fund will generally be more heavily invested in cash when few opportunities are presented. Nonetheless, the Fund has held an

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Pengana Australian Equities Fund

ISSUE DATE 25-10-2022

average cash buffer of approximately 20-25% since inception.

Risk Management

Risk limits

SEPARATE INVESTMENT RISK MONITORING	YES
STOCK LIMIT	MAXIMUM 15% OF NAV (10% OF NAV AT ACQUISITION)
SECTOR LIMIT	UNCONSTRAINED
TRACKING ERROR	8-12% P.A. (NOT TARGETED)
CASH LIMIT	0-100% (TYPICALLY 20%)
GLOBAL EQUITIES LIMIT	0-20%

The Manager views risk from an absolute return standpoint, rather than viewing risk as differences in performance against a market benchmark. As a 'benchmark unaware' Manager, the Fund can take sizeable positions away from the benchmark, including material allocations into cash. The Fund may also use a number of derivative strategies in gaining and adjusting stock-specific positions or market exposure and as a means of managing the Fund's overall risk profile.

Risk monitoring

Risk is primarily managed at the security level through the adherence to the investment process. The Portfolio's risk positions are monitored daily by Pengana's risk officer and Chief Investment Officer Nick Griffiths using a combination of Bloomberg and in-house risk management systems.

Currency hedging

The Fund is permitted to invest up to 20% of the portfolio in global equities. Pengana will actively manage any currency hedging overlay based on its fundamental views around the Australian dollar.

Risks

An investment in the Fund carries a number of standard investment risks associated with investment markets. These include performance, liquidity, counterparty, market and tax risks. These and other risks are outlined in the PDS and should be read in full and understood by potential investors. Lonsec considers the following to be the major risks:

Equity market risk

Investments in equity markets are subject to numerous factors, which may have an impact on the performance of an investment (both positive and negative). Unexpected changes in economic, technological, structural, regulatory or political conditions can have an impact on the returns of all investments within a particular market.

Derivatives risk

The Manager has scope to implement various derivative strategies with the objective of mitigating equity market or currency risks or gaining exposure to an investment. Lonsec does not expect this to be a widely adopted strategy. The Fund's net portfolio exposure will never be short overall and derivatives cannot be used to leverage the Fund.

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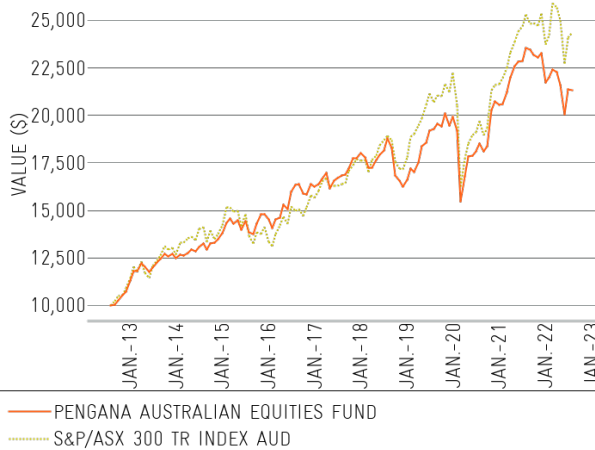
Quantitative Performance Analysis - annualised after-fee % returns (at 31-8-2022)

Performance metrics

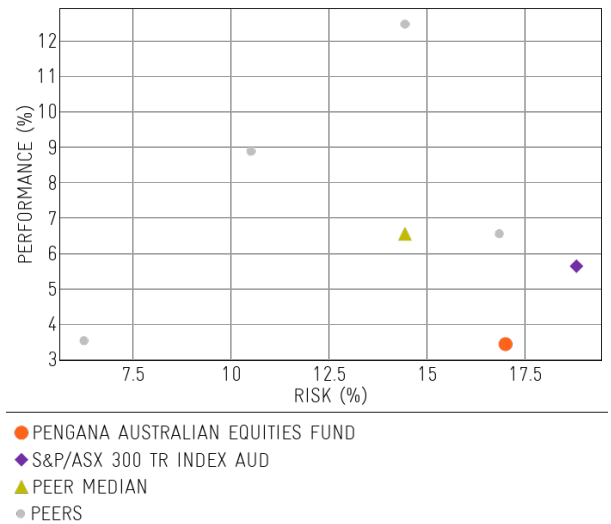
	1 YR		3 YR		5 YR		10 YR	
	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN
PERFORMANCE (% PA)	-9.40	0.94	3.44	6.56	4.84	6.12	7.87	7.87
STANDARD DEVIATION (% PA)	12.64	12.64	17.01	14.44	14.43	13.06	11.71	10.63
EXCESS RETURN (% PA)	-5.73	-4.47	-2.20	3.18	-3.40	1.08	-1.44	4.31
OUTPERFORMANCE RATIO (% PA)	33.33	58.33	38.89	63.89	41.67	55.83	42.50	61.67
WORST DRAWDOWN (%)	-14.75	-5.94	-23.12	-16.96	-23.12	-19.34	-23.12	-16.96
TIME TO RECOVERY (MTHS)	NR	NR	8	12	8	10	8	12
SHARPE RATIO	-0.77	0.07	0.18	0.51	0.27	0.50	0.53	0.86
INFORMATION RATIO	-0.93	-0.51	-0.41	0.34	-0.58	0.19	-0.23	0.88
TRACKING ERROR (% PA)	6.16	6.16	5.38	6.26	5.81	5.53	6.21	6.21

PRODUCT: PENGANA AUSTRALIAN EQUITIES FUND
 LONSEC PEER GROUP: AUSTRALIAN EQUITIES - AUSTRALIAN LARGE CAP - ABSOLUTE RETURN
 PRODUCT BENCHMARK: S&P/ASX 300 TR INDEX AUD
 CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD
 TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

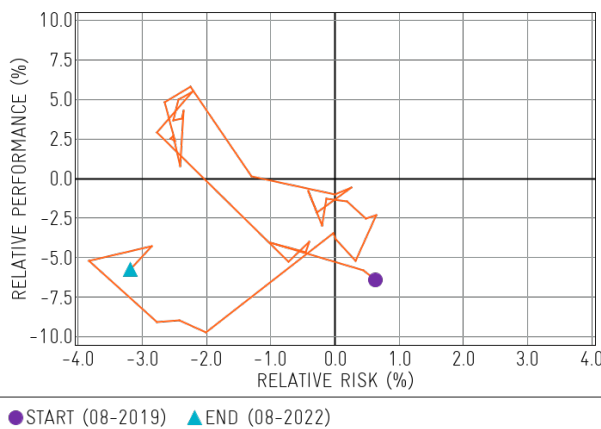
Growth of \$10,000 over 10 years



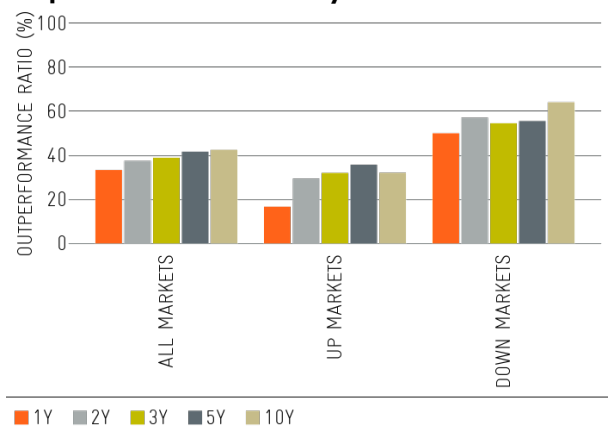
Risk-return chart over three years



Snail trail



Outperformance consistency



Pengana Australian Equities Fund

Glossary

Total return ‘Top line’ actual return, after fees
Excess return Return in excess of the benchmark return
Standard deviation Volatility of monthly Absolute Returns
Tracking error Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)
Sharpe ratio Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)
Information ratio Relative reward for relative risk taken (Excess Returns / Tracking Error)
Worst drawdown The worst cumulative loss (‘peak to trough’) experienced over the period assessed
Time to recovery The number of months taken to recover the Worst Drawdown
Snail Trail A trailing 12-month relative performance and relative risk measurement over the benchmark. The trail is generated using a 12-month rolling window over the specified period

About Lonsec

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Analyst Disclosure and Certification

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