



PENGANA INTERNATIONAL EQUITIES LIMITED (ASX: PIA)

SEPT 2018
PERFORMANCE
UPDATE

DESCRIPTION AND FEATURES

Pengana International Equities Limited provides access to the benefits of an actively managed core portfolio of 30-50 ethically screened companies across developed and developing global markets via a listed investment company structure.

Investments are made predominantly in companies that deliver stable yet growing free cash flow throughout cycles (which we classify as 'Core' holdings) whilst also taking positions in more cyclical companies ('Cyclical') and those whose valuation has been materially misconstrued by the market ('Opportunistic').

Visit our website for more information on the Company.

Portfolio managers	Jordan Cvetanovski Steven Glass
ASX code shares	PIA
ASX code options	PIAO
Founded	19 March 2004
Mandate inception	1 July 2017
Asset class	International Equities
Fees	Management fee: 1.23% p.a. Performance fee: 15.38% of any return greater than the MSCI World ³
DRP	Yes
Share price¹	\$1.155
Option price¹	\$0.008
NTA (pre-tax)^{1,2}	\$1.2082
NTA (post-tax)^{1,2}	\$1.1930
Premium/discount to pre-tax NTA¹	(4.40%)
Ordinary shares on issue¹	252.95m
Bonus options on issue¹	237.83m
Benchmark	MSCI World ³

¹ At 30 September 2018.

² The figures are unaudited.

³ MSCI World refers to the MSCI World Total Return Index, Net Dividends Reinvested, in A\$.



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INFORMATION
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OUR WEBSITE:
PENGANA.COM/PIA

PERFORMANCE

Net performance for periods ending 30 September 2018⁴

	1 mth	3 mths	1 yr	FYTD	Since Inception p.a. ⁵
PIA	-1.9%	1.4%	10.9%	1.4%	7.9%
Benchmark	0.5%	7.2%	20.6%	7.2%	7.6%

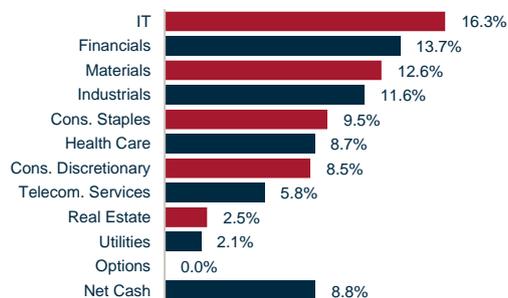
Pengana International Equities Limited has been managed under the new investment mandate by the Pengana investment team since 1 July 2017. The performance since inception in the table above refers to the movement in net assets per share since the inception of PIA in March 2004. See footnotes 4 and 5 below for further details.

PORTFOLIO INFORMATION

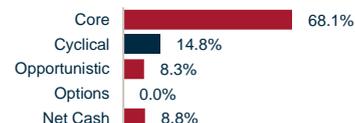
Top 10 stocks		
Name	Country	Sector
Alibaba	China	Information Technology
Bharti Infratel	India	Telecommunication Services
Cigna	United States	Health Care
CME Group	United States	Financials
Dollar General	United States	Consumer Discretionary
Heineken	Netherlands	Consumer Staples
KAR Auction Services	United States	Industrials
Newmont Mining Corp	United States	Materials
Reckitt Benckiser	United Kingdom	Consumer Staples
Tencent Holdings	China	Information Technology

Largest 3 contributors (for the quarter)		Largest 3 detractors (for the quarter)	
Cigna		Tencent Holdings	
Dollar General		Newmont Mining Corp	
Check Point Software		Bharti Infratel	

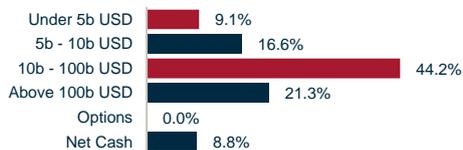
SECTOR BREAKDOWN



SEGMENT



CAPITALISATION



GEOGRAPHIC



4. Performance figures refer to the movement in net assets per share plus dividends per share paid in the period, reversing out the impact of option exercises, before tax paid or accrued on realised and unrealised gains. Past performance is not a reliable indicator of future performance, the value of investments can go up and down.

5. Inception date of PIA: 19 March 2004, new investment team with new mandate adopted: 1 July 2017

None of Pengana International Equities Limited ("PIA"), Pengana Investment Management Limited (ABN 69 063 081 612, AFSL 219462) nor any of their related entities guarantees the repayment of capital or any particular rate of return from PIA. Past performance is no guarantee of future performance. This document has been prepared by PIA and does not take into account a reader's investment objectives, particular needs or financial situation. It is general information only and should not be considered investment advice and should not be relied on as an investment recommendation.

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PERFORMANCE COMMENTARY

Aim

We aim to achieve superior AUD-denominated returns with low volatility. The superior returns aim can be disaggregated into (i) capital preservation; (ii) capital appreciation. While these aims make no mention of the benchmark, we believe that fulfilling our aims will result in superior returns to the benchmark over the medium-to-long term. Since inception, the portfolio has delivered compounded returns of 7.9% p.a., net of fees.

Quarterly Performance

The portfolio delivered 1.4% in 3Q18. As in 2Q18, during 3Q18 (and in the first few days of October) the portfolio held up on weaker days, but these weaker days were few and far between in an environment that is rewarding risk taking.

Key drivers of the performance include:

- Stocks with a positive contribution – Cigna (US health insurer), Check Point Software (cyber security) and Dollar General (US discount retailer).
- Stocks making a negative contribution – Wacker Chemie (German specialty chemical business), TomTom (Dutch map and telematics), and Tencent (Chinese internet conglomerate).
- Stocks we don't own – not owning the 'FAANGs' (Facebook, Amazon, Apple, Netflix, and Google) cost the portfolio in relative performance.
- Cash – 12% of the portfolio was held in cash and gold stocks during the quarter. This was a relative performance headwind as equity markets increased.
- Country exposure – the portfolio was underweight the US and Japan, which were relatively strong performing regions during 3Q18, and overweight China, Europe and India, which were relatively weaker performing regions during 3Q18.
- Portfolio insurance (put options) – the puts were a minor headwind to performance.

MARKET COMMENTARY

In 3Q18, the MSCI World was up 5.3% in local currency and up 7.2% in AUD terms as the AUD depreciated against the USD. This performance continued the trend over the past two years, with the market only delivering one negative quarter in local currency and no negative quarters in AUD since March 2016.

The best performing sectors were Health Care, Industrials, and Information Technology (IT). The extent of the outperformance of IT is best viewed over a longer time frame. IT has been amongst the top three performing sectors in eight of the nine past quarters. According to our calculations, over the past two years IT has been the best performing sector by a considerable margin, delivering almost twice as much as the second best performing sector over the same period, Financials.

The worst performing sectors over the quarter were Materials, Utilities and Consumer Staples. This, again, is a continuation of the trend with Consumer Staples and Utilities being among the worst performing sectors over the past two years.

The best performing (major) countries during the quarter were Russia, Brazil and the US. With the US accounting for >50% of the global index, the strength of the US market continues to drive up global markets.

The worst performing (major) countries were China/Hong Kong and many European markets.

PORTFOLIO

The portfolio is divided into three segments:

- (1) Core (60-80% of the portfolio) – Core is intended to provide a stable base for the portfolio. Companies in this segment are growing, reasonably priced, have low business cyclicality, strong cash generation, dominant presence in their industries, strong management teams and favourable structural tail-winds.
- (2) Cyclical (0-30% of the portfolio) – Cyclical contains companies we expect to benefit from shorter duration trends. As these cycles tend to be transitory, timing is more important in our investment decisions than in Core. Cyclical companies offer the potential for materially more substantial short-term gains than Core, however, they are also riskier. Financials, basic materials, and agriculture are examples of industries that may be represented in this segment.
- (3) Opportunistic (0-20% of the portfolio) – Opportunistic includes companies we believe are materially undervalued or whose growth has been under-appreciated. These companies offer potentially more attractive shorter-term gains than Core, however, they also tend to be riskier. Examples of Opportunistic investments include

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companies in the midst of a takeover, earlier stage internet/health/retail companies and companies whose share prices have markedly declined.

The portfolio's positioning at 30 September 2018 is summarised as:

- 91% of the portfolio is invested in equities, 3% of the equities exposure is in gold-linked shares, and 9% is held in cash.
- Segment exposure is 60-70% in "Core", 10-20% in "Cyclical" and 5-10% in "Opportunistic".
- Geographic exposure – the portfolio's key underweights (relative to the market) are the US and Japan. The key overweights are Europe and Emerging Markets. It is marginally overweight Asia-ex-Japan. The portfolio currently has no direct Latin America or Africa exposure.
- Sector exposure – the portfolio is notably overweight Materials and is somewhat overweight Consumer Staples. It is materially underweight IT, Energy and Financials.
- 26% of the portfolio is invested in small or mid-cap companies, 44% is in large-caps, and 21% is in mega-caps.

The major changes made to the portfolio during the quarter include exiting the European bank positions and increasing the China exposure.

STOCK FOCUS

Headquartered in Chicago, CME Group is the world's largest derivatives exchange. It is the (electronic) marketplace for trading financial derivatives on assets such as US interest rates, gold, oil (WTI), corn, and the S&P500 index. The company primarily makes money by charging market participants a fee on every contract traded on its (electronic) marketplace.

CME has sustainable competitive advantages, high incremental margins, is highly free cash flow generative, and has an attractive growth outlook.

The sustainable competitive advantages can be traced to its substantial network effects and other scale benefits. As the world's largest derivative exchange it is the most capital efficient and cheapest venue to trade derivatives. We believe it has an unassailable competitive position in many of the world's most important financial derivatives.

Derivative exchanges have high fixed costs but relatively low variable costs and ongoing capital investment requirements. This means the largest operators generate wide margins and healthy free cash flow. As the world's largest derivatives exchange, this is especially true for CME.

We also believe that CME's growth outlook has never been better. Over the past few years the company has aggressively invested in international expansion, the benefits of which are starting to be realised. In addition, CME is well positioned to benefit from a number of structural tailwinds.

Growing demand for interest rate derivatives will be underpinned by the dual influence of increased US Treasuries issuance and the Fed winding down its balance sheet. Thriving US oil production is driving demand for WTI derivatives. A change in hedge accounting rules will enable corporates to use exchange traded derivatives for hedging purposes.

Finally, CME is well positioned to benefit from increased volatility. Derivative volumes are positively correlated with volatility as market participants use derivatives to protect against uncertainty, which is synonymous with volatility. Due to global Quantitative Easing (QE) volatility has been subdued across most asset classes. We believe this calm is unlikely to persist and when volatility roars back, CME will be one of the major beneficiaries.

In summary, CME is a high quality business that is well positioned to grow and will be one of the few beneficiaries of the growing US budget deficit, winding down of QE and increasing volatility. It is the kind of company that we would want to hold forever.



PENGANA
CAPITAL

PENGANA INTERNATIONAL EQUITIES LIMITED
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