

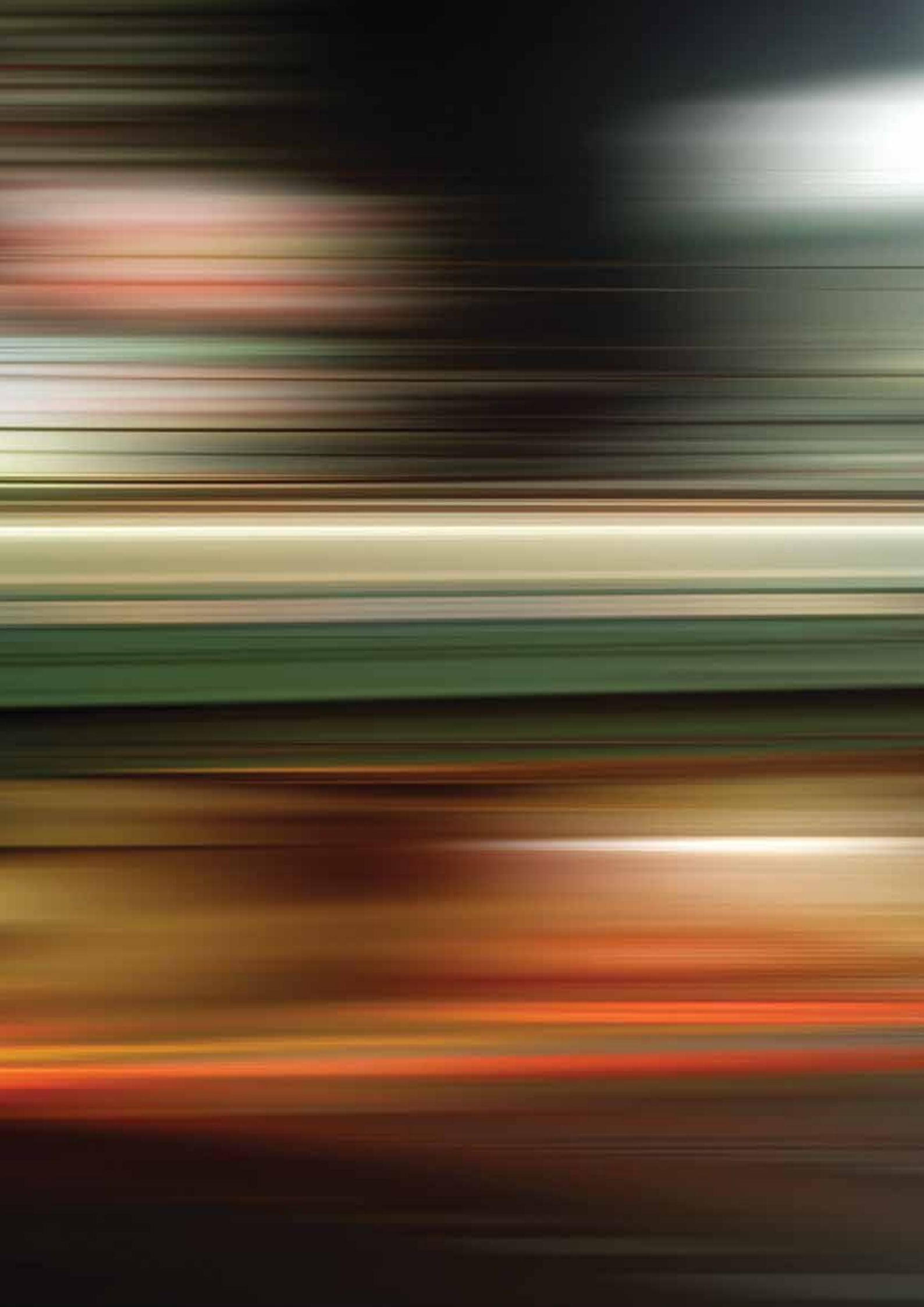


PENGANA
CAPITAL

GLOBAL RESOURCES

Looking beneath the surface





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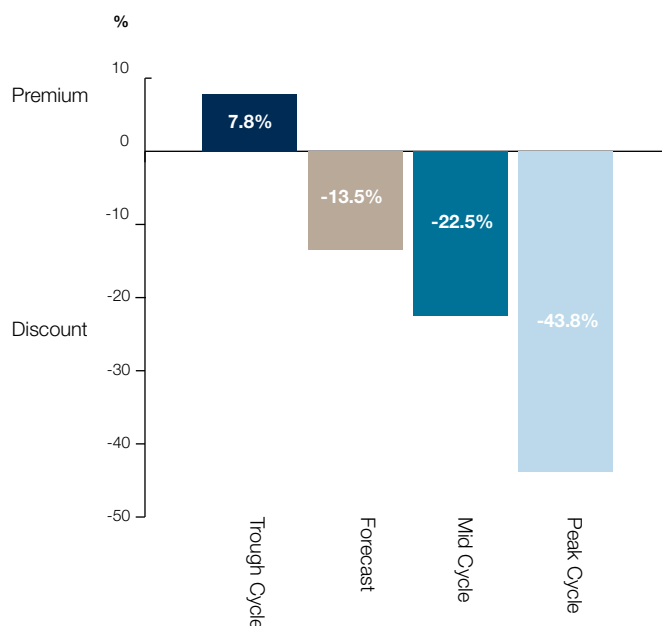
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EXECUTIVE SUMMARY

- In our view, the 'tide is turning' in terms of the outlook for global resources with improving global growth, albeit to still sub-trend levels.
- With key commodity prices unsustainable and trading below long term average levels we consider the resource sector is under-earning (or operating below long term potential) which affords an attractive entry point.
- We think that the resource sector is now good value with global resource stocks trading at over a 20% discount to mid cycle valuations (see graph below).
- The Resources industry is not homogenous and each industry /commodity has its own dynamics and outlook.
- Companies with good management, strong balance sheets and quality assets can withstand and even prosper during periods of commodity price declines.
- A multi-speed resources market is developing where select commodity industries, companies and assets will perform strongly while others will lag. This has become evident in our valuation work which shows a large dispersion in the mispricing of individual resource equities/companies.
- The outlook for resources favours active benchmark agnostic management that is not tied to investing in large companies operating in less favoured industries.
- Global resources stocks are a major component of world sharemarket indices (around 20%) and should be considered in the strategic asset allocation.
- The ASX only accounts for around 5% of the global resources market and is highly concentrated with the 5 largest stocks comprising 75% of the S&P ASX 300 Resources index.
- The dynamics of risk/reward and opportunity cost have changed for portfolios overweight income and underweight growth assets with the concepts of real return and store of value increasing the focus of investors on being properly diversified.
- The asset allocation skew of being overweight income and underweight growth is becoming arbitrated away. There is increased potential for an asset allocation shift to resources in the near term which may be a catalyst for share prices to appreciate whilst earnings remain near term in a downgrade cycle.

WEIGHTED GLOBAL RESOURCE SECTOR VALUATIONS UNDER VARIOUS COMMODITY PRICE SCENARIOS



Source: Pengana

Weighted (by market cap) Global Resource Sector Valuations Under Various Commodity Price Scenarios

SECTION 1: SETTING THE SCENE

A: OVERVIEW

With headlines such as 'Oil price plummets 60%' and 'Iron ore price hits new five year low' it is understandable some investors' initial reaction is to balk at the prospect of investing in global resources equities. With that said, it is critical for investors to realise that the resources sector is NOT a 'catch all', but rather a segregated number of discrete industries, each with their own industry dynamics and differentiated outlooks. Therefore, despite some industries and companies facing cyclical difficulties, others are able to prosper. For instance, year to date the S&P/ASX Gold Index has gained more than 25% in less than 2 months. To underscore this point further, one of our Fund's largest offshore oil and gas positions has been in US listed EOG Resources. Despite a fall of 60% in the oil price during 2014, EOG's share price increased by over 10%, highlighting that companies are able to differentiate themselves through good management, good balance sheets and quality assets to withstand and indeed prosper during periods of commodity price declines. On headline news value, the outlook continues to pose significant challenges for investment in resources companies. The combination of lower global economic growth expectations, lower commodity prices and falling bond yields is far from the ideal pre-conditions to push the share prices of commodity producers, as a whole, higher. However, with many major commodity prices retracing to unsustainably low levels and the resource sector representing good value based on long term earnings, the environment is conducive to M&A activity and a bottoming of the resources market. Further, the potential for small changes in asset allocation can lead to rapid changes in asset prices. We believe these conditions will see improved share price performance within the sector and that now is an opportune time to reallocate to resource.

B: THE OUTLOOK FOR RESOURCE EQUITIES IN 2015

While the preconditions of unsustainably low commodity prices and intrinsic value are in place for resources as a whole to rally, the outlook for global resources in 2015 is more akin to 'the tide is turning' rather than a king tide that will 'float all boats'. The combination of an improving, but still sub-trend global growth outlook and lower opportunity cost from overbought income assets will see a multi-speed resources market develop where select commodity industries, companies and assets will perform strongly while others will lag. This variable-rate emergence has become evident in our valuation work which shows a large dispersion in the mispricing of individual resource equities/companies. As a result, share price volatility is still expected to be a key feature for the resources sector in the near term with the outlook favouring active managers; particularly those active managers that are index agnostic and therefore not tied to investing in large companies operating in less favoured industries.

SECTION 1: SETTING THE SCENE

C: THE WORLD PRE AND POST GFC

The defining characteristics of the global landscape in the pre-Global Financial Crisis environment were an abundance of capital, leveraged returns, accelerating growth from emerging economies, capacity utilisation at high levels, growing employment and improving wealth effect. Today's macro-economic environment is different and any reversion back to a pre Global Financial Crisis environment appears long-dated.

Substantial wealth destruction occurred as a result of the Global Financial Crisis and not surprisingly investors were forced to re-assess their thresholds of risk and return. As a consequence, a re-balance occurred in asset allocation with investors sharpening their focus on risk. This led to a greater value being placed on reliability of income and potential capital growth appeared to be discounted at the same time. Simply put, income generating assets such as cash deposits and fixed income securities were valued more highly as investors sought certainty of return. At the same time, investors moved away from equity exposure given the capital losses experienced during the Global Financial Crisis. Subsequently, investors have selectively invested in equities and this has seen companies capable of growing profitability and paying dividends, against a backdrop of tepid growth, rewarded handsomely.

D: RISK/REWARD HAS CHANGED

Today, we are several years into a post Global Financial Crisis environment and the investment environment remains challenging. However, the dynamics of risk/reward and opportunity cost have changed. For instance, at the end of 2007 Australia's 10 year bond yielded 6.4%, today the yield is 2.62%. Similarly, Australia's official cash rate at the end of 2007 was 6.75% and today is just 2.25%. Over the same period the Euromoney Global Mining Total Return Index has fallen 46%. The overweighting to income producing assets and underweighting growth assets has been rewarding for those investors who adjusted their portfolios accordingly. Given the changing dynamics around asset pricing relative to risk it is not unreasonable to see changes in return expectations, risk assessment and ultimately asset allocation ensue.

E: IS THE 'RISK FREE' RATE REALLY RISK FREE?

A number of developed countries now have 10 year bond yields under 1% including Germany, France, Denmark and Japan. In the case of Switzerland, the yield on their 10 year bond is a remarkable -0.11%. Investors today have a very different risk/return dynamic playing out with little in the way of yield (even more pronounced if we take into account the concept of 'real yields'), supporting total returns from an investment in bonds. Given the duration of the bonds and lack of yield, the potential for capital loss is significant, undermining the perceived 'safe haven' status and effectively changing one of the underlying investment propositions for many investors – seeking to avoid loss of capital through investment in an income producing asset.

SECTION 1: SETTING THE SCENE

F: WHY ARE BOND YIELDS SO LOW?

The pricing of bonds does not imply robust economic fundamentals for these regions. To further compound the potential problem both Japan and Europe are in the midst of quantitative easing in an effort to bolster growth in both regions. The pricing of bonds appears to be implying these initiatives will prove unsuccessful which may lead to governments and central banks having to consider different forms of economic stimulus. Alternatively, there is a glut of money chasing perceived 'safe havens' causing a re-pricing event.

G: ARE INVESTORS ADEQUATELY DIVERSIFIED?

Arguably, the asset allocation skew in a post Global Financial Crisis environment of being overweight income and underweight growth is becoming arbitrated away. How much longer this dynamic prevails is difficult to ascertain. In an uncertain environment and taking into consideration current asset pricing skews the case for re-balancing portfolios is increasingly compelling, particularly when considering those asset classes which have high correlations to falling cash and bond yields. In such an environment, the concept of real returns and store of value are gaining increasing importance and we expect will gain further traction this year. As a result, there will be an increasing focus on investors being appropriately diversified. A small change in asset allocation with the ensuing fund flow can see asset pricing change quickly in a relatively short period of time. This is something we are monitoring closely and may well be a catalyst for share prices within the resources sector to appreciate whilst company earnings remain near term in a downgrade cycle.

H: THE SUPER CYCLE IS NOT RESUMING

Whilst not expecting the environment for resources investment to return to a 'rising tide that floats all boats', investment in the sector is becoming more compelling. Differentiation in terms of strategic direction, capital intensity, balance sheet strength and industry positioning are crucial. The environment lends itself to a wider disparity of returns and commercial Darwinism. Being exposed to the right stocks and sectors capable of adapting and prospering in today's environment is the key.

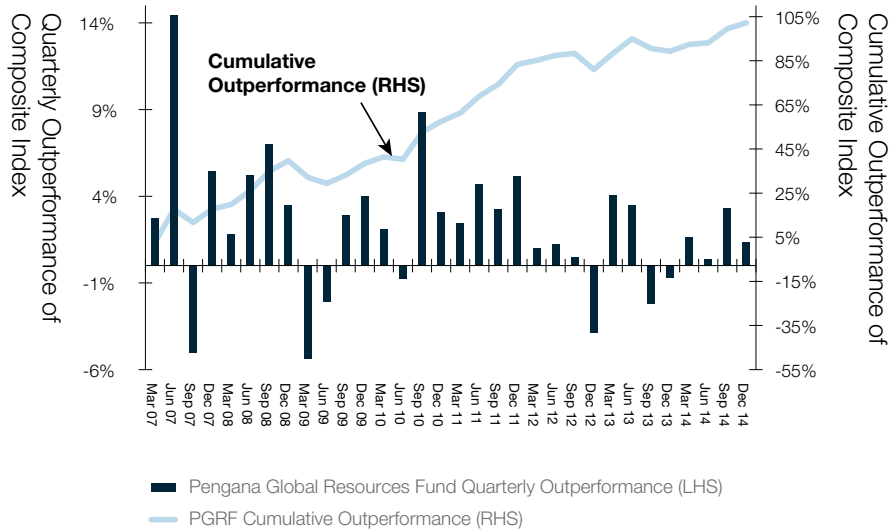
Negative commodity price momentum, earnings downgrades and high levels of share price volatility have been among the key factors making investment in the resources sector appear unattractive for investors. This has been compounded by poor investment decisions and risk management by many companies in the sector. On a positive note, unrealistic values attributed to exploration upside, over-zealous commodity price assumptions and overly optimistic M&A appeal have all disappeared from much of the sector. Perversely, we may be close to a juncture where consensus commodity price assumptions become too negative – migrating closer to spot prices which have retraced to very low levels at or below the marginal cost of production for some commodity industries. Investors are also failing to take into account the lack of investment in new supply growth over the medium term. Such an environment is increasingly conducive to M&A activity and a bottoming of the resources cycle. Further, with key commodity prices trading below long term average levels the resource sector is under-earning (or operating below long term potential) which does afford an attractive entry point. While the market is digesting lower near term earnings, we assess the global resource equity market is currently trading more than 20% below value based on long term earnings.

SECTION 2: PENGANA GLOBAL RESOURCES FUND

A: WHY WE BELIEVE THE PENGANA GLOBAL RESOURCES FUND IS POSITIONED WELL FOR 2015?

The Pengana Global Resources Fund (The Fund) is positioned well to perform strongly in this environment, being an active, benchmark agnostic offering, with active risk management focussed on delivering better absolute returns. The combination of the Teams' experience, especially in portfolio construction, an investment approach which affords a deeper understanding of both stock opportunities and the prevailing investment outlook as well as a flexible fund structure employing long-short investment strategies all work in concert with the aim of ensuring the Fund has the right level of market exposure at any juncture of an economic cycle. 'A Fund for all seasons'.

QUARTERLY AND CUMULATIVE OUTPERFORMANCE OF THE GLOBAL RESOURCE MARKET* SINCE INCEPTION**



1 Performance figures are shown after all fees and expenses and assume reinvestment of distributions. Investments can go up and down. Past performance is not a reliable indicator of future performance.

* 75% Euromoney Global Mining Total Returns Index, 25%MSCI AC World Energy Total Return Index.

** Fund inception 23 March 2007

SECTION 2: PENGANA GLOBAL RESOURCES FUND

B: PROVEN AND DURABLE PERFORMANCE IN CHALLENGING MARKETS: 'A FUND FOR ALL SEASONS'.

As with companies within the resources sector, there are fund managers who are able to better adapt to changing market circumstances than others. To this end, we believe the Pengana Global Resources Fund has proven its durability through volatile and challenging markets since being established in March 2007. Since inception the Fund has managed to achieve a positive return of 7.1% per annum (net) compared to its benchmark composite index* which has returned negative 2.8% per annum. It is this ability to adapt to prevailing conditions rather than rely on 'the cycle turning' or a 'set and forget' strategy that is an important differentiator in the way the Pengana Global Resources Fund is managed.

C: BIGGER UNIVERSE, BETTER OPPORTUNITIES

At Pengana, we are able to draw upon a global universe of companies from which to select. Diversification through industry, geographic location and market capitalisation are keys when constructing the portfolio. Simply put, Australia does not have the depth of resources market to provide adequate diversification. In some industries the Australian Stock Exchange provides access to world leading companies such as BHP Billiton and Rio Tinto. However, in other industries there are no alternatives

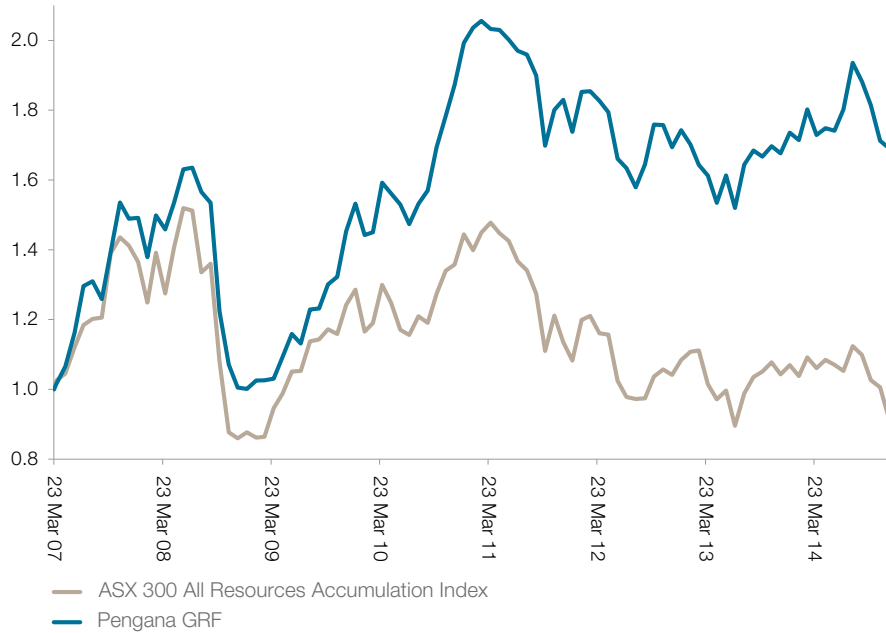
As an example, we have liked the outlook for zinc for some time. As Australian market exposure to zinc production is very limited, the Fund established a new long position in a Swedish listed zinc producer, Boliden AB in July 2014. The share price is now 30% higher and the company is executing its business plan well and it recently reported earnings 18% higher than consensus expectations for the December 2014 quarter. Being restricted to investing solely in Australian listed companies would have seen this opportunity foregone.

D: WHY ASX ONLY INVESTORS ARE MISSING OUT

The benefit to a domestic investor of the Funds' specialist approach employed over a deeper (global) opportunity set is clearly evident in the graph below. While Australian investors believe they have adequate exposure to resources on the ASX, the truth is that by total market capitalisation or number of equities with a market capitalisation over US\$1 billion, the ASX accounts for around 5% of the global resources market. Moreover, given that the ASX resource sector is highly concentrated with the 5 largest stocks comprising 75% of the S&P ASX 300 Resources index, generalist managers are not likely inclined to tilt holdings meaningfully from these large index weights, delivering their clients a quasi-passive exposure to resources. In comparison, the Fund has outperformed the S&P ASX 300 Resources index by over 80% net of all fees from inception in March 2007* to end January 2015.¹

SECTION 2: PENGANA GLOBAL RESOURCES FUND

COMPARATIVE RETURNS OF S&P ASX 300 RESOURCES ACCUMULATION INDEX AND PENGANA GLOBAL RESOURCES FUND BASED TO 100 FROM FUND INCEPTION



Source: Pengana, IRESS

- 1 Performance figures are shown after all fees and expenses and assume reinvestment of distributions. Investments can go up and down. Past performance is not a reliable indicator of future performance.

E: UNSAFE SAFE-HAVENS AND A MULTI-SPEED RESOURCE MARKET

With existing and new policy in place to see global growth grind to a higher albeit still sub-trend level, 2015 is not a year that we expect the resources market overall to create banner headlines. However, conditions are in place that the right approach, such as that of the Pengana Global Resources Fund can generate meaningful positive returns through selective investment and continuing focus on absolute risk. As it dawns on investors that existing portfolios are taking on risk due to a lack of diversification and exposure to over-bought income assets, a small change in asset allocation in favour of the resources market may prove to be a welcome driver to stronger gains for an under-owned sector with compelling fundamental value.

Pengana Capital Ltd (ABN 30 103 800 568, Australian financial services license number 226566) is the issuer of units in the Pengana Global Resources Fund (ARSN 142 322 361) (the 'Fund'). A product disclosure statement for the Fund is available and can be obtained from our distribution team. A person should obtain a copy of the product disclosure statement and should consider the product disclosure statement carefully before deciding whether to acquire, or to continue to hold, or making any other decision in respect of, the units in the Fund. This report was prepared by Pengana Capital Ltd and does not contain any investment recommendation or investment advice. This report has been prepared without taking account of any person's objectives, financial situation or needs. Therefore, before acting on any information contained within this report a person should consider the appropriateness of the information, having regard to their objectives, financial situation and needs. Neither Pengana Capital Ltd nor its related entities, directors or officers guarantees the performance of, or the repayment of capital or income invested in, the Fund.

