



**SQM**  
RESEARCH

# Pengana High Conviction Property Securities Fund

This report has been prepared for financial advisers only



**Favourable**

November 2020

# INTRODUCTION

## Key Principles

SQM Research considers (but is not restricted to) the following key review elements within its assessment:

1. Business profile - product strategies and future direction
2. Marketing strategies and capabilities, market access
3. Executive Management / Oversight of the investment management firm
4. Corporate Governance / fund compliance / risk management
5. Investment team and investment process
6. Fund performance, investment style, market conditions, investment market outlook
7. Recent material portfolio changes
8. Investment liquidity
9. Investment risks
10. Fund/Trust fees and expenses

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**Report Date: 17 November 2020**

Star Rating *	Description	Definition	Investment Grading
4½ stars and above	Outstanding	<b>Highly suitable for inclusion on APLs</b> <i>SQM Research believes the Fund has considerable potential to outperform over the medium-to-long term. Past returns have typically been quite strong. Product disclosure statement (PDS) compliance processes are of a high-calibre. There are no corporate governance concerns. Management is extremely experienced, highly skilled and has access to significant resources.</i>	High Investment grade
4¼ stars	Superior	<b>Suitable for inclusion on most APLs</b> <i>SQM Research considers the Fund has substantial potential to outperform over the medium-to-long term. Past returns have tended to be strong. PDS compliance processes are high-quality. There are no material corporate governance concerns. Management is of a very high calibre.</i>	High Investment grade
4 stars	Superior	<b>Suitable for inclusion on most APLs</b> <i>In SQM Research's view, the Fund has an appreciable potential to outperform over the medium-to-long term. Historical performance has tended to be meaningful. PDS compliance processes are strong. There are very little to no corporate governance concerns. Management is of a high calibre.</i>	High Investment grade
3¾ stars	Favourable	<b>Consider for APL inclusion</b> <i>SQM Research concludes the Fund has a moderate potential to outperform over the medium-to-long term. Past performance has tended to be reasonable. Management is experienced and displays investment-grade quality. There are no corporate governance concerns, or they are of a minor nature.</i>	Approved
3½ stars	Acceptable	<b>Consider for APL inclusion</b> <i>In SQM Research's view, the potential for future outperformance in the medium-to-long term is somewhat uncertain. Historical performance has tended to be modest or patchy. Management is generally experienced and capable. SQM Research has identified weaknesses which need addressing in order to improve confidence in the Manager.</i>	Low Investment grade
3¼ stars	Caution Required	<b>Not suitable for most APLs</b> <i>In SQM Research's opinion, the potential for future outperformance in the medium-to-long term is very uncertain. Historical returns have tended to be disappointing or materially below expectations. PDS compliance processes are potential substandard. There are possible corporate governance concerns. Management quality is not of investment-grade standard.</i>	Unapproved
3 stars	Strong Caution Required	<b>Not suitable for most APLs</b> <i>In SQM Research's opinion, the potential for future outperformance in the medium-to-long term is unlikely. Historical performance has tended to be unacceptable. There may be some material corporate governance concerns. SQM Research has a number of concerns regarding management.</i>	Unapproved
Below 3 stars	Avoid or redeem	<b>Not suitable for most APL inclusion</b>	Unapproved
Event-driven Rating	Definition		
<b>Hold</b>	<i>Rating is suspended until SQM Research receives further information. A rating is typically put on hold for a period of two days to four weeks.</i>		
<b>Withdrawn</b>	<i>Rating no longer applies. Significant issues have arisen since the last report date. Investors should consider avoiding or redeeming units in the fund.</i>		

\* The definitions in the table above are not all encompassing and not all individual items mentioned will necessarily be relevant to the rated Fund. Users should read the current rating report for a comprehensive assessment.

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**SQM Rating** 
*Favourable. Consider for APL inclusion.*

<b>Fund Description</b>	
Fund Name	Pengana High Conviction Property Securities Fund
APIR code	PCL8246AU
Asset Class	AREITs
<b>Management and Service Providers</b>	
Fund Manager	Pengana Capital Limited
Responsible Entity	Pengana Capital Limited
Custodian	BNP Paribas
<b>Fund Information</b>	
Fund Inception Date	11 March 2020
Fund Size	\$3.5 million
Return Objective (as per PDS)	To obtain returns greater than the S&P/ASX 300 A-REIT (AUD) TR Index ('Index') over rolling 3 year periods (after fees).
Internal Return Objective	Not Applicable
Risk Level (as per PDS)	Medium
Internal Risk Objective	Not Applicable
Benchmark	S&P/ASX 300 A-REIT TR Index
Number of stocks/positions	10-20
Fund Leverage	None
Turnover	Expected to be Low/Medium
Top 10 Holdings Weight	Approximately 75%
<b>Investment Information</b>	
Minimum Application	\$20,000
Redemption Policy	Daily
Distribution Frequency	Quarterly
Investment Horizon (as per PDS)	Three or more years
Currency Hedging Policy	Not Applicable
Management Fee	0.70%
ICR - latest	0.95% (Estimate, since inception)
Buy Spread	0.25%
Sell Spread	0.25%
Performance Fee Rate	15%

## SUMMARY

### Fund Summary

#### Description

The **Pengana High Conviction Property Securities Fund (the "Fund")** is an actively managed listed property securities portfolio that invests principally in Australian Real Estate Investment Trusts (AREITs). The Fund may also invest up to 10% of its assets in listed (or soon to be listed) International property securities (or GREITs). It may also invest in the shares of property developers and other companies associated with the property sector.

The Fund aims to provide capital security, income yield and sustainable growth. It seeks to achieve this by identifying mispriced securities via a strategy built on two pillars – through a high conviction and ESG focused approach – and by diversifying into new growth sectors.

The Fund employs an active and **fundamental** approach to research. The process is predominantly bottom-up, with a top-down sectoral/thematic overlay as a starting point. The Fund is **benchmark unaware, concentrated** and has a **small/mid-cap bias** (relative to the index). The Fund's investment objective is to obtain returns greater than the S&P/ASX 300 A-REIT Accumulation TR Index ('Index') over a rolling 3-year period after fees.

The Fund is structured as an open-ended unlisted registered managed investment scheme.

#### Fund Rating

The Fund has achieved the following rating:

Star Rating	Description	Definition	Investment Grading
3.75 stars	Favourable	Consider for APL inclusion	Approved

### SQM Research's Review & Key Observations

#### 1. People and Resources

##### About the Manager

Pengana Capital Limited ("PCL"; AFSL 226 566 granted 7 May 2003) is a wholly-owned subsidiary of Pengana Capital Group Limited (PCG). Pengana Capital Group ('Pengana') is a diversified Funds Management group. Founded in 2003 and headquartered in Sydney, with offices in Melbourne and Brisbane, Pengana currently manages over AUD\$3 billion across a range of International and Australian strategies.

Pengana's investment products employ active strategies with non-benchmark mandates, giving their investment teams the freedom to invest in their best

ideas. Their business model also delivers centralised support from their corporate team, so that their fund managers can focus on managing portfolios. Pengana strives to give investors access to global funds management strategies: strategies that will create an impact on portfolio returns. They aim to do this through their in-house investment teams, and by partnering with investment managers around the world.

Pengana is a profitable company and employs 50 staff members, out of which 17 are investment professionals.

#### Investment Team

The investment team comprises of two experienced AREIT managers, responsible for stock selection, portfolio construction and portfolio management – Ms **Amy Pham** (Portfolio Manager and Analyst) and Ms **Jade Ong** (Investment Specialist, Part-time). The team is based in the Sydney office and employs a flat structure, with both team members involved in idea generation, company analysis and portfolio management. Ms Pham has final responsibility for portfolio management decisions and performance including analysis, research and fund reporting. Ms Ong assists Ms Pham in strategy, analysis and provides back-up to her. They worked together previously at IAG for 3 years so there is tenure in their working relationship, which is important for a small team, in terms of interaction and collaboration.

The Investment Committee for the Fund is overseen by Mr **Nick Griffiths** (CIO of Pengana Capital), who is responsible for reviewing the investment process, adherence to the mandate and assessing the ESG framework. The Investment Committee meets monthly to review the strategy, portfolio positioning and adherence to mandate.

Amy Pham has a direct profit share in the Property Securities business unit. The direct ownership interest in the separate business entities and the profit share component of the remuneration is a positive for retention & alignment of interests. Capacity limits and performance fees further focus the monetary incentive on Fund performance. She also has a significant personal investment in the Fund.

*SQM Research notes that Jade Ong is a **contractor** (rather than a direct Pengana employee). Also, since she is working part-time only, from a workload/coverage point of view, SQM Research believes that as the Fund grows and builds a track record, it would be preferable if her role becomes full-time or the team is expanded. It is Pengana's intention to offer her a full-time role with profit share once the Fund reaches break-even (\$80 million to \$100 million) and to consider expanding the team further to include a junior analyst at that stage.*

Several PMs of the broader Pengana Equities team are also contractors (rather than direct Pengana employees), as they are employed by a separate business entity, in which they are an Equity holder along with Pengana. This is a relatively less common business model for Funds Management firms operating Managed Funds under their own brand name, although some boutique firms do use similar type of business models/employment arrangements. That said, the direct ownership interest in the separate business entities and the profit share component of the remuneration (for those Pengana PMs) is a positive for retention and alignment of interests.

Considering that this is a relatively new Fund, the investment process, the size of the AREITs universe and the size of the team, SQM Research believes that the **Key Person risk** (in Amy Pham) is **"medium"**.

## 2. Investment Process and Philosophy

### Investable Universe

Investments are selected from listed real estate securities, or about to be listed, on the Australian Stock Exchange, which includes A-REITs and real estate managers and developers. They screen out securities with a market capitalization of <\$50m and/or securities that have >30% of their income from 'unethical' sectors, as per the definition adopted by Pengana (namely gaming, tobacco, alcohol), or for poor corporate governance. The Fund is not confined to securities in the S&P/ASX 300 A-REIT Index. Pengana focuses on diversifying into new growth sectors driven by secular trends such as childcare, seniors living, healthcare, data centres, transport and agriculture, all of which provide defensive sustainable growth and diversification from core real estate sectors (i.e. office, retail and industrial).

The result is a universe of approximately **50** Australian securities. The Fund can also invest a small portion of the Fund (up to 10%) in global REITs and global listed real estate managers and developers. The Fund can invest in cash and cash equivalents (up to 20%).

### Process / Philosophy / Style

The Fund employs an active and **fundamental** approach to research. The process is predominantly bottom-up, with a top-down sectoral/thematic overlay as a starting point. The Fund is **benchmark unaware, concentrated** and has a **small/mid-cap bias** (relative to the index).

Ideas are generated and assessed through the following means:

- Pengana's broader research team/equities specialists provide a forum for understanding macro movements and sharing research ideas, whilst allowing fund managers the flexibility to make investments decisions appropriate for their strategy.
- Amy Pham and Jade Ong attend all company management meetings and property tours within their universe, as an integral part of the idea generation, company valuation and portfolio maintenance processes.
- Access to external research is considered a valuable resource in supplementing idea generation, understanding industries and facilitating access to company management. Long term relationships with the major banks and the boutique investment banks assist in this regard.

In addition to the above, the inputs to their research include:

- Financial modelling including the analysis of income statements, balance sheets and cash flow statements.
- Discussions with all market participants: asset owners, operators, developers, investors and leaseholders.
- An ESG questionnaire.

Both qualitative and quantitative factors are incorporated into the **valuation ranking model**. The model calculates the forecast **Total Return (TR)** based on the 1-year forecast yield and 3-year forecast EPS growth and weights this with respect to 9 factors to generate a relative valuation rank. The primary focus of the valuation process relates to the company's ability to generate sustainable free cashflow and a strong balance sheet to support future growth. The TR is weighted based on Quantitative & Qualitative factors in a 55:45 ratio. Price/5 Yr NPV is used for rent collectors, and an average of Price/5 Yr NPV and SOTP is used for Real Estate Fund Managers and Developers.

In the team's opinion, **ESG** issues can have a measurable effect on a company's value, as well as its reputation. By incorporating ESG factors as part of their risk analysis process, they invest in quality companies that generate sustainable returns.

The decision to Buy would be based on:

- Fundamental quality first, then the valuation
- Non-fundamental factors (appetite for risk, M&A, behavioural investing, technical, indexation, register)

- Risk/reward assessment, no matter how compelling

Allocations (weights in the portfolio) to the individual stocks are based on the level of conviction and sector diversification. For index stocks, individual stocks weights are between **0%-20%**. For non-index stocks, they are between **2%-5%**. In addition, the Fund can also allocate up to **10%** of the portfolio in GREITS and real estate related companies. It is the objective to be near fully invested at all times. The cash allocation is a function of the bottom-up investment process, with cash increasing when suitable equity investment opportunities cannot be identified. The maximum cash holding is **20%** (and the long term expected cash level, on average, is expected to be around 0%-5%).

### Risk Management

The Risk Management process (and constraints) include the following:

- Risk, including volatility, is managed at the individual stock level and the overall portfolio level.
- Monitoring of risk limits is performed daily by a Risk Analyst independent from the portfolio management team. The Analyst generates risk reports which are reviewed daily by the CIO or Performance and Risk Manager and monthly by a Risk Committee which includes the CIO, COO and Head of Operations.

Other details are discussed later in the report.

### 3. Portfolio Characteristics

#### Portfolio Turnover

Portfolio turnover is not applicable/relevant yet, as this is a relatively new Fund. Considering the Fund's strategy/style, Pengana expects the turnover to be low/medium (average around 40%-50% per annum).

#### Liquidity

Liquidity of the securities is a consideration in the investment process. Portfolio liquidity is monitored daily.

#### Length of Track Record

This Fund does **not** employ direct leverage (through borrowing by the Fund) **or** economic leverage (through the use of derivatives).

### 4. Performance & Risk

#### Return Objective & Performance

The investment/return objective stated in the PDS is: "The Fund aims to "obtain returns greater than the S&P/ASX 300 A-REIT (AUD) TR Index ('Index') over rolling 3 year periods after fees".

The Fund's benchmark, as stated in the PDS, is the "**S&P/ASX 300 A-REIT (AUD) TR Index**".

#### Length of Track Record

The **Pengana High Conviction Property Securities Fund** has a very short history of **6 months** (inception **11 March 2020**). Any observations and analysis of returns will have virtually no statistical meaning. SQM Research notes that returns, volatility and other risk measures can be "noisy" and less reliable when quantified using a small sample size of observations.

*In view of the above, SQM Research has not provided an analysis of the Fund's risk and return profiles in this report.*

#### Risk Objective

The Fund's PDS states that the risk level of the Fund is "**Medium**".

### 5. Other Features

Fees and Costs	Fund	Peer Avg
Management Fee (% p.a.)	0.70%	0.82%
Other Costs (% p.a.)	Nil	-
Performance Fee (%)	15.00%	0.00%
Indirect Cost Ratio ICR (% p.a.)	0.95%	0.86%
Buy Spread (%)	0.25%	0.24%
Sell Spread (%)	0.25%	0.24%

#### Management Fee

- Expressed as a percentage rate per annum of the Fund's Net Asset Value ("NAV")
- Calculated daily and paid to the Manager half-yearly
- Including GST and impact of RITC (Reduced Input Tax Credit)

**Performance Fee**

There is a performance fee charged as follows:

- **15%** of the amount by which the Fund's investment returns (after base management fees have been deducted) exceed the returns of the Benchmark (S&P/ASX 300 AREIT Accumulation Index).
- including GST and impact of RITC (Reduced Input Tax Credit).
- Fee is accrued daily and (if applicable) paid to the Manager half-yearly.
- The fee is adjusted for any prior accumulated negative performance fee. Underperformance in a previous performance period is required to be made-up for before a performance fee is payable. This creates a permanent high-water mark.

**Governance**

**Pengana Capital Limited (PCL) is the Responsible Entity (RE) and the Fund Manager of the Fund.**

The **Board of Directors of the Responsible Entity (Pengana Capital Limited)** consists of **3** directors, **none** of whom are independent. SQM Research prefers the inclusion of independent members on the Board of Directors – it is a meaningful way to enhance governance and oversight. Board members have an average of **29** years of industry experience.

The Responsible Entity's **Compliance Committee** is composed of **3** members, **2** of whom are independent. The Chair **is** independent. The minutes of Compliance Committee meetings are reported in full to the Pengana Capital Group Board. SQM Research views independence in a RE oversight body such as the Compliance Committee as a strong and favourable factor in Fund governance. Compliance Committee members have an average of **34** years of industry experience.

**FUM (Funds Under Management) / Capacity**

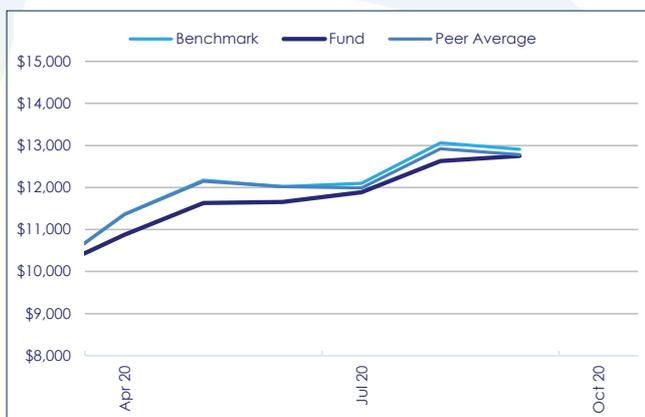
The Fund is approximately \$3.5 million in size, as at **Oct-2020**.

Fund Performance to 30 September 2020 (% p.a.)							
Total Return	1-Month	3-Month	6-Month	1-Year	3-Year	5-Year	Inception
Fund <sup>1</sup>	0.97	9.39	27.51	n/a	n/a	n/a	27.51
Benchmark <sup>2</sup>	-1.15	7.38	29.10	n/a	n/a	n/a	29.10
Peer Average	-1.05	6.37	27.80	n/a	n/a	n/a	27.80
Alpha	2.12	2.01	-1.59	n/a	n/a	n/a	-1.59

1. With dividends reinvested. Returns beyond one year are annualised. Return history starts Apr-2020  
 2. Benchmark: S&P/ASX 300 A-REIT TR

**SQM Research notes that whilst the Fund's inception date was 11 March 2020, it was not fully invested until the end of March and therefore the performance tables in this report will use returns starting April 2020.**

**Growth of \$10,000**



### Strengths of the Fund

- Pengana has built up a long track record (17 years) of managing money across various Funds, specialising in Australian & International Equities. Pengana currently manages about \$3 billion in FUM and has over 50 employees.
- The Fund's investment team is experienced and knowledgeable. Ms Amy Pham and Ms Jade Ong have 25 years & 17 years of industry experience, and the CIO Nick Griffiths has 27 years of industry experience. Additionally, the broader Pengana investment team is large and experienced.
- The investment/research process is robust and has been consistently applied by the Portfolio Manager Amy Pham to build high conviction portfolios for many years.
- The Fund has a high Active Share and a significantly high allocation to non-index stocks. This provides it with the additional ability to generate alpha and also improves the diversification of the portfolio, by avoiding the high concentration risk of the index and investing in alternative property sectors driven by secular trends.

### Weaknesses of the Fund

- Compared to some of the other Funds Management firms, Pengana does not have any prior experience in managing an AREITs Fund, although it has managed property funds in the past. That said, this is largely mitigated by the AREITs experience of this new Portfolio Management team (as noted above) and also the AREITs experience of the broader Australian Equities team.
- The Fund's Portfolio Management team is smaller than peer group Funds. Jade Ong (Investment Specialist) is working part-time only and therefore from a workload/coverage point of view, SQM Research believes that as the Fund grows and builds a track record, it would be preferable if her role becomes full-time or the team is expanded.

### Other Considerations

- The Fund has a very short track record (6 months), reducing the ability to conduct meaningful quantitative analysis.

- Whilst the Fund is very new, SQM Research has met Ms Amy Pham (PM of the Fund) a few times over the years, as she was one of the PMs of the Charter Hall (ex Folkestone) A-REITs Fund, which has been rated by SQM Research for several years.
- The Fund has a capital preservation focus and a higher Cash holding (on an average). Therefore, in bullish/strong market conditions, the Fund may slightly underperform (on a relative basis). Conversely, the Fund is more likely to outperform in negative or mildly positive market conditions.
- The Fund is a high conviction, benchmark unaware Fund and displays a small/mid-cap bias relative to the index.
- The ESG component of the investment process is a key differentiator. In addition to the fundamental bottom-up research, the screening process uses an 'ethical' filter, by which securities that have >30% of their income from 'unethical' sectors (gaming, tobacco & alcohol), as per the definition adopted by Pengana, or for poor corporate governance. The PM has advised that this filter has led to only 3 stocks being screened out (including 1 stock for 'governance' related factors). *SQM Research will review the value add/attribution of the ESG/Ethical filters in the next year's review.*
- Some of the Key Metrics of the Fund include (whilst noting the short track record): The Fund's Active Share is about 65-70%, Dividend Yield of the portfolio holdings is 4.2%, and allocation to non-index stocks is significantly high at about 40%. Other metrics including asset allocation are listed at the end of the report.

### Key Changes since the Last Review

- This report is an inaugural review.

Investment Process Diagram



Process Description

**Universe**

**Investable Universe** Investments are selected from listed real estate securities, or about to be listed, on the Australian Stock Exchange, which includes A-REITs and real estate managers and developers. The Fund is not confined to securities in the S&P/ASX 300 A-REIT Index. Pengana focuses on diversifying into new growth sectors driven by secular trends such as childcare, seniors living, healthcare, data centres, transport and agriculture, all of which provide defensive sustainable growth and diversification from core real estate sectors (i.e. office, retail and industrial).

The result is a universe of approximately 50 Australian securities. The Fund can also invest a small portion of the Fund (up to 10%) in global REITs and global listed real estate managers and developers, although the target allocation is currently zero.

The Fund can invest in cash and cash equivalents (up to **20%**).

**Investment Process**

**Top-down or bottom-up** The Fund is predominantly bottom-up, with a top-down sectoral/thematic overlay as a starting point.

**Top-down**

- The top-down part of the process aims to pick the best core sub-sectors with a 2-3 year growth horizon and identify new growth sectors driven by secular trends. It combines macro-economic factors with real estate sub-sector analysis in order to identify different points in the property cycle.

**Bottom-up**

- The bottom-up research uses a range of quantitative and qualitative factors to identify the A-REITs that are best of breed and likely to outperform over the next one to three years.

### Investment Process

#### Top-down or bottom-up ...continued

- The proprietary Valuation Ranking Model proportionally increases or decreases the total return (TR) based on a variety of quantitative (5) and qualitative (4) factors. This forms a starting point for discussion amongst team members for stock selection, portfolio weights and portfolio monitoring.
- A key differentiator is the incorporation of ESG into the valuation process. The approach is qualitative in that the team engage with companies to rank them in terms of "E", "S" and "G", similar to how they rank quality of management, using an in-house questionnaire.
- The team formally models key financial metrics for smaller capitalization or non-benchmark stocks which are not as widely covered. For larger more widely covered stocks, the team utilizes the models of the best external research analyst for the particular stock (not consensus).

#### Research and Portfolio Construction Process

##### Idea Generation and Screening

Ideas are generated and assessed through the following means:

- Pengana's broader research team/equities specialists provide a forum for understanding macro movements and sharing research ideas, whilst allowing fund managers the flexibility to make investments decisions appropriate for their strategy.
- Amy Pham and Jade Ong attend all company management meetings and property tours within their universe, as an integral part of the idea generation, company valuation and portfolio maintenance processes.
- Access to external research is considered a valuable resource in supplementing idea generation, understanding industries and facilitating access to company management. Long term relationships with the major banks and the boutique investment banks assist in this regard.

They screen out securities with a market capitalization of <\$50m and/or securities that have >30% of their income from 'unethical' sectors, as per the definition adopted by Pengana (namely gaming, tobacco, alcohol), or for poor corporate governance.

##### Research and Stock Selection

In addition to the above, the inputs to their research include:

- Financial modelling including the analysis of income statements, balance sheets and cash flow statements.
- Discussions with all market participants: asset owners, operators, developers, investors and leaseholders.
- An ESG questionnaire.

Both qualitative and quantitative factors are incorporated into the **valuation ranking model**. The model calculates the forecast Total Return(TR) for each security based on the 1-year forecast yield and 3-year forecast eps growth, and weighs this with respect to 9 factors to generate a relative valuation rank. The primary focus of the valuation process relates to the company's ability to generate sustainable free cashflow and a strong balance sheet to support future growth.

## Investment Process

### Research and Portfolio Construction Process ...continued

#### Special Focus:

- Research interpretation; risk vs. reward
- Changes in industry and company dynamics
- Asset quality and the security of income
- Weighted Average Lease Expiry (WALE)
- Cash-flow and financial flexibility
- High quality stocks out of favour with the market, potential mispricing

In the team's opinion, **ESG** issues can have a measurable effect on a company's value, as well as its reputation. By incorporating ESG factors as part of their risk analysis process, they invest in quality companies that generate sustainable returns. Their approach is qualitative in that they engage with companies to rank them in terms of "E", "S" and "G". For example, under "E" (Environment), they track how a company is progressing in achieving its sustainability and energy efficiency targets. This is important as it lowers operating costs for tenants and in return leads to lower vacancy rates, longer leases (WALEs) and higher rents. The team has compiled its own ESG questionnaire, to rank each company, similar to the way they rank the quality of management.

*The PM has advised that this filter has led to only 3 stocks being screened out (including 1 stock for 'governance' related factors). That suggests that the filter is not overly restrictive and therefore does not materially reduce the opportunity set (whilst also noting that Pengana has a bigger AREITs opportunity set/investable universe compared to most AREIT Funds). SQM Research will review the value add/attribution of the ESG/Ethical filters in the next year's review.*

#### Portfolio Construction

Following the screening process outlined above, an understanding of the fundamentals and outlooks for those opportunities (stocks) is developed using financial statements, journals, transcripts, company meetings and external research. In the normal course of events, trades that require allocating (eg allocations from a broker, including IPOs) will be allocated proportionally. Mandates with different risk limits, mandate rules or exposures are taken into account.

Buy decisions would be based on:

- Fundamental quality first, then the valuation
- Non-fundamental factors (appetite for risk, M&A, behavioural investing, technical, indexation, register)
- Risk/reward assessment, no matter how compelling

Portfolio construction incorporates both the results from "bottom-up" security analysis and "top-down" research. This is combined with the judgment and experience from the investment team particularly with regards to assessment of management quality and ESG factors.

Allocations (weights in the portfolio) to the stocks are based on the level of conviction and sector diversification. For index stocks, holdings/weights are between **0%-20%**. For non-index stocks, holdings are between **2%-5%**. In addition, the Fund can also allocate up to **10%** of the portfolio in GREITS and real estate related companies.

It is the objective to be near fully invested at all times. The cash allocation is a function of the bottom-up investment process, with cash increasing when suitable equity investment opportunities cannot be identified. The maximum cash holding is **20%** (the long term expected cash, on an average, is expected to be around 0 to 5%).

## Investment Process

### Research and Portfolio Construction Process ...continued

#### Portfolio Turnover

Portfolio turnover is not applicable/relevant yet, as this is a relatively new Fund. Considering the Fund's strategy/style, Pengana expects the turnover to be low/medium (average around 40%-50% per annum).

#### Liquidity

Liquidity of the securities is a consideration in the investment process. Portfolio liquidity is monitored daily.

#### Sell Discipline

The decision to Sell would consider factors like:

- If either qualitative or valuation criteria have been compromised or misjudged,
- Fully valued with better risk-return reward elsewhere in the universe,
- Change in view on thematic or fundamental change of the security's characteristics – change in strategy, management or ownership.

#### Risk Management

The Risk Management process (and constraints) include the following:

- Risk, including volatility, is managed at the individual stock level and the overall portfolio level.
- Monitoring of risk limits is performed daily by a Risk Analyst independent from the portfolio management team. The Analyst generates risk reports which are reviewed daily by the CIO or Performance and Risk Manager and monthly by a Risk Committee which includes the CIO, COO and Head of Operations.
- Tracking error is not targeted due to the benchmark unaware nature of the Fund. More relevant are volatility and drawdown. However, a numerical risk target is not targeted.
- Stop-losses and trade review triggers are not used.
- The Firm has an internal breach reporting and escalation process.
- Currency risk: Does not hold GREITs yet. Any holdings in GREITs would **not** be hedged.
- Leverage: not utilised.
- Derivatives: not utilised, however, may be used for risk management purposes.
- Short Positions: not allowed.
- Operational Risk: monitored independently by the operations team. Counterparty risks are monitored by the independent risk management team.
- The team uses the risk modules in Bloomberg Portfolio and Risk Analytics (PORT) for performance and risk analysis.

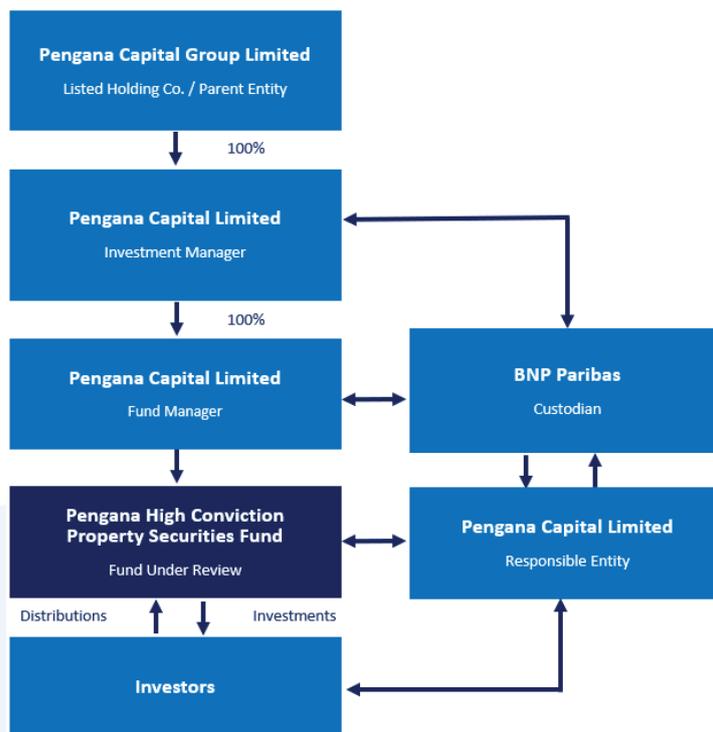
*Portfolio risk constraints/details are listed at the end of the report.*

## Trading/Implementation

### Trading Resources & Procedure

The Fund does not have a dedicated trader. The trading responsibility is mainly performed by Amy Pham and is backed up by Jade Ong. Trading is done in 2 ways: through DMA and placing orders with brokers. Orders are placed on a 'best care over the day' basis to minimise execution costs. The average brokerage cost (rate) is 0.20%.

## Key Counterparties



## Parent Company

Pengana Capital Group ('Pengana') is a diversified Funds Management group, with investment strategies that aim to deliver superior long-term risk-adjusted returns to investors, with a focus on capital preservation. Founded in 2003 and headquartered in Sydney, with offices in Melbourne and Brisbane, Pengana currently manages over AUD\$3 billion across a range of International and Australian strategies.

Pengana's premium investment products employ active strategies with non-benchmark mandates, giving their investment teams the freedom to invest in their best ideas. Their business model also delivers centralised support from their corporate team, so that their fund managers can focus on managing portfolios. Pengana strives to give investors access to superior global funds management strategies: strategies that will create an impact on portfolio returns. They aim to do this through their in-house investment teams, and by partnering with investment managers around the world.

Pengana is a profitable company and employs **50** staff members, out of which **17** are investment professionals.

## Investment Manager / Fund Manager

Pengana Capital Limited ("PCL"; AFSL 226 566 granted 7 May 2003) is a wholly-owned subsidiary of Pengana Capital Group Limited ('PCG').

## Responsible Entity

**Pengana Capital Limited (PCL) is also the Responsible Entity (RE) of the Fund.**

The **Board of Directors of the Responsible Entity (Pengana Capital Limited)** consists of **3** directors, **none** of whom are independent. SQM Research prefers the inclusion of independent members on the Board of Directors – it is a meaningful way to enhance governance and oversight. Board members have an average of **29** years of industry experience.

The Responsible Entity's **Compliance Committee** is composed of **3** members, **2** of whom are independent. The Chair **is** independent. The minutes of Compliance Committee meetings are reported in full to the Pengana Capital Group Board. SQM Research views independence in a RE oversight body such as the Compliance Committee as a strong and favourable factor in Fund governance. Compliance Committee members have an average of **34** years of industry experience.

## Management Risk

Funds management businesses rely on the operational capabilities of key counterparties. A critical element is the ability of the Responsible Entity to monitor operational performance and to meet the regulatory and statutory responsibilities required. For any investment fund, there is a risk that a weak financial

position or management performance deterioration of key counterparties could temporarily or permanently compromise their performance and competency. This can adversely affect financial or regulatory outcomes for the Fund or associated entities.

*Based on the materials reviewed, SQM Research believes that Pengana Capital Limited and the associated key counterparties are appropriately qualified to carry out their assigned responsibilities. Management risk is rated as low/modest.*

### Funds under Management (FUM)

The Fund is approximately \$3.5 million in size, as at **Oct-2020**.

### Distributions

The Fund aims to pay distributions on a **quarterly** basis, subject to the availability of distributable income. In a scenario where the Fund's realised losses and expenses exceed income in a distribution period, the Fund may elect not to make a distribution during that time. The distributions may contain a capital return component.

Being a relatively new Fund (launched in **March 2020**), its first distribution payment was in June 2020.

#### A General Note on Distributions for Managed Funds

The Responsible Entity of a Managed Fund will provide for a regular schedule of distributions, such as monthly/quarterly/semi-annual or annual. This is subject to the Fund having sufficient distributable income. The official total distributable income available to pay to investors is determined over the period of that Fund's financial year. By distributing the net taxable income of the Fund to investors each year, a Fund itself should not be liable for tax on its net earnings.

If a Fund makes distributions more frequently than once over the financial year, those distributions will be based on estimates of the distributable income for that distribution period. The final total amount of distributable income available for passing on to investors can only be calculated after the close of the financial year, based on the Fund's taxable income for that year.

If the total distributions a Fund pays out exceeds total taxable income for that particular financial year, the excess amount may be treated as a return of capital rather than income. This will possibly have tax implications for the investor.

Due to the considerations outlined above, there may be periods in which no distributions are made or a Fund may make additional distributions. A Fund's ability to distribute income is determined by the performance of the Fund and general market conditions. Accordingly, there is no guarantee a Fund will make a distribution in any distribution period.

Key Investment Staff				
Name	Responsibility/Position	Location	Years at Firm	Years in Industry
Nick Griffiths	CIO/Executive Director/Investment Committee	Sydney	16.0	27.0
Amy Pham	Portfolio Manager & Investment Analyst	Sydney	0.5	25.0
Jade Ong	Investment Specialist (Contracting, Part-time)	Sydney	0.5	17.0
<b>Average</b>			<b>5.7</b>	<b>23.0</b>

### Investment Team

The investment team comprises of two experienced AREIT managers, responsible for stock selection, portfolio construction and portfolio management – Ms **Amy Pham** (Portfolio Manager and Analyst) and Ms **Jade Ong** (Investment Specialist, Part-time).

The team is based in the Sydney office and employs a flat structure, with both team members involved in idea generation, company analysis and portfolio management. Ms Pham has final responsibility for portfolio management decisions and performance including analysis, research and fund reporting. Ms Ong assists Ms Pham in strategy, analysis and provides back-up to her. They worked together previously at IAG for 3 years so there is tenure in their working relationship, which is important for a small team, in terms of interaction and collaboration.

The Investment Committee for the Fund is overseen by Mr **Nick Griffiths** (CIO of Pengana Capital), who is responsible for reviewing the investment process, adherence to the mandate and assessing the ESG framework. The Investment Committee meets monthly to review the strategy, portfolio positioning and adherence to mandate.

Amy Pham has a direct profit share in the Property Securities business unit. The direct ownership interest in the separate business entities and the profit share

component of the remuneration is a positive for retention and alignment of interests. Capacity limits and performance fees further focus the monetary incentive on Fund performance. She also has a significant personal investment in the Fund.

*SQM Research notes that Jade Ong is a **contractor** (rather than a direct Pengana employee). Also, since she is working part-time only, from a workload/coverage point of view, SQM Research believes that as the Fund grows and builds a track record, it would be preferable if her role becomes full-time or the team is expanded. It is Pengana's intention to offer Jade a full-time role with profit share once the Fund reaches break-even (\$80 million to \$100 million) and to consider expanding the team further to include a junior analyst at that stage.*

*Several PMs of the broader Pengana Equities team are also contractors (rather than direct Pengana employees), as they are employed by a separate business entity, in which they are an Equity holder along with Pengana. This is a relatively less common business model for Funds Management firms operating Managed Funds under their own brand name, although some boutique firms do use similar type of business models/employment arrangements. That said, the direct ownership interest in the separate business entities and the profit share component of the remuneration (for those Pengana PMs) is a positive for retention and alignment of interests.*

### Meeting Schedule

The table below shows regular meetings that form an essential part of the overall process.

Meeting	Purpose	Frequency	Participants
<b>Securities Research</b>	Where new opportunities/ ideas are in the markets, investment process, Q&A and research findings	Daily	Investment Team
<b>Portfolio Construction</b>	To monitor and discuss portfolio management and overall portfolio holdings & weights and any potential issues.	Weekly	Investment Team
<b>Investment Strategy</b>	To discuss investment process, mandate compliance, risk and ESG issues	Monthly	Risk & Investment Team

*SQM Research believes the practice of constant communication and the broad-based inclusion of team members in decision-making is a vital ingredient to the success of the process. Interactive peer review and collaboration across a tightly knit group of experienced investors will likely make the best use of their combined intellectual property and shared history.*

## Staffing Changes

Being a relatively new Fund, there has not been any staff turnover since the launch in March 2020.

## Key Investment Staff

### Nick Griffiths – CIO & Executive Director

Mr Griffiths is the Chief Investment Officer of Pengana Capital and has particular responsibility for performance monitoring and risk management. He joined Pengana in 2003 and has over 20 years' experience in actuarial and investment consulting, manager research and risk management. He has worked for institutional investment firms in the UK and Australia and prior to joining Pengana was Head of Investment Research within Aon's Investment Consulting Practice in Sydney. There he managed the Australian based research team which actively encouraged a focus on alternative assets and hedge funds, and was the regional representative within Aon's global investment group, the Global Research Unit.

Mr Griffiths graduated from the University of Durham, England, in 1992 with a Joint Honours degree in Law and Economics, qualified as an actuary in 1997 and completed the Chartered Financial Analyst Exams in 2002.

### Amy Pham - Portfolio Manager & Investment Analyst

Ms Pham has over 20 years of property funds management experience. Prior to joining Pengana, she worked at Charter Hall/Folkestone for 6 years, managing a high conviction AREIT strategy. This team won several industry awards including Financial Standards Property Fund Manager of the Year 2019, Money Management/Lonsec Australian Property Securities Fund Manager of the Year 2018, and Financial Standards Property Fund Manager of the Year 2017. Ms Pham has held several senior positions including head of property securities at IAG and portfolio manager at Deutsche Asset Management and Perpetual Funds Management. She began her career as a quantitative analyst at Legal & General in 1994.

Ms Pham holds a bachelors and honours degree in Economics from the University of New England and the University of California Davis.

### Jade Ong - Investment Specialist

Ms Ong has over 17 years of property funds management and corporate finance experience. Previously she was a senior member of Macquarie Capital's real estate corporate advisory team in London and Sydney for 9 years. During this time, she worked closely with AREIT clients, advising on mergers and acquisitions, direct asset sales and private capital transactions involving establishing and raising capital for wholesale real estate investment funds. Prior to Macquarie, she was an assistant portfolio manager of IAG's property securities fund, working alongside Amy.

Ms Ong holds a Bachelor of Law and a Bachelor of Commerce degree, graduating with honours from the University of Sydney.

## Remuneration and Incentives

Base salaries are based on industry comparators and reviewed annually. Senior investment professionals have (direct) profit shares in their business units and are rewarded for Fund performance and Assets under Management (AUM). Capacity limits and performance fees focus the monetary incentive more tightly on Fund performance.

The Portfolio Manager of the Fund also has a personal investment in the Fund.

*SQM Research believes remuneration in the form of firm equity and client-focused performance bonuses act as strong incentives for optimising staff engagement, retention and productivity. The intention (and SQM believes, the effect) is to align staff performance with client and shareholder objectives. It focuses on the customers' needs and medium to long-term results.*

Fees and Costs	Fund	Peer Avg
Management Fee (% p.a.)	0.70%	0.82%
Expense Recovery (% p.a.)	Nil	-
Performance Fee (%)	15.00%	0.00%
Indirect Cost Ratio ICR (% p.a.)	0.95%	0.86%
Buy Spread (%)	0.25%	0.24%
Sell Spread (%)	0.25%	0.24%
Other Features	Fund	Peer Avg
Redemptions	Daily	-
Distributions	Quarterly	-
Minimum Investment	-	-
1-year Investment: Round Trip Cost	1.20%	1.30%

### Buy/Sell Spread

This spread represents the difference between the application price and the withdrawal price of the Fund, a reflection of transaction costs relating to the underlying assets.

### Ongoing Fees

The management fee includes GST and is net of any applicable Reduced Input Tax Credits (RITC).

The management fee is calculated daily and paid to the Manager half-yearly.

### Performance Fees

There is a performance fee charged as follows:

- **15%** of the amount by which the Fund's investment returns (after base management fees have been deducted) exceed the returns of the Benchmark (S&P/ASX 300 AREIT Accumulation Index).
- Including GST and impact of RITC (Reduced Input Tax Credit).
- Fee is accrued daily and (if applicable) paid to the Manager half-yearly.
- The fee is adjusted for any prior accumulated negative performance fee. Underperformance in a previous performance period is required to be made-up for before a performance fee is payable. This creates a permanent high-water mark.

### Overall Fees

#### 1-year Investment: Round Trip Cost.

If held and redeemed within 12 months, total costs would amount to **1.20%** of investment in the Fund.

This figure includes the management fee, expense recovery (when disclosed) and the buy/sell spread. It does **not** consider rebates or negotiations or any potential **performance fee**.

#### SQM Research observes that:

- *The Fund management fee is 0.70% p.a., which is 12 basis points lower than the peer group average of 0.82% p.a. The ICR is 0.95% p.a. (estimate), which is 9 basis points higher than the peer group average of 0.86% p.a.*
- *The performance fee accrues at any return above the benchmark (subject to the returns being positive).*
- *The performance fee, at 15%, is similar to the average of peers that charge a performance fee. Most of the peers do not charge a performance fee.*
- *The performance fee includes a permanent high-water mark.*

Risk/Return Data to 30 September 2020 (% p.a.)							
Total Return	1-Month	3-Month	6-Month	1-Year	3-Year	5-Year	Inception
Fund <sup>1</sup>	0.97	9.39	27.51	n/a	n/a	n/a	27.51
Benchmark <sup>2</sup>	-1.15	7.38	29.10	n/a	n/a	n/a	29.10
Peer Average	-1.05	6.37	27.80	n/a	n/a	n/a	27.80
Alpha	2.12	2.01	-1.59	n/a	n/a	n/a	-1.59

Metrics	1-Year	3-Year	5-Year	Inception
Tracking Error (% p.a.) - Fund	n/a	n/a	n/a	9.17
Tracking Error (% p.a.) - Peer Average	n/a	n/a	n/a	4.99
Information Ratio - Fund	n/a	n/a	n/a	-0.44
Information Ratio - Peer Average	n/a	n/a	n/a	-0.42
Sharpe Ratio - Fund	n/a	n/a	n/a	5.05
Sharpe Ratio - Peer Average	n/a	n/a	n/a	3.07
Volatility - Fund (% p.a.)	n/a	n/a	n/a	12.35
Volatility - Peer Average (% p.a.)	n/a	n/a	n/a	21.26
Volatility - Benchmark (% p.a.)	n/a	n/a	n/a	20.92
Beta based on stated Benchmark	n/a	n/a	n/a	0.58

1. With dividends reinvested. Returns beyond one year are annualised. Return history starts Apr-2020
2. Benchmark: S&P/ASX 300 A-REIT TR

*SQM Research notes that whilst the Fund's inception date was 11 March 2020, it was not fully invested until the end of March and therefore the performance tables in this report will use returns starting April 2020.*

### Quantitative Insight<sup>1</sup>

**Note:** Unless stated, all return and risk data reported in this section are **after-fees** and for periods **ending Sep-2020**.

The **Pengana High Conviction Property Securities Fund** has a very short history of **6 months**. Any observations and analysis of returns will have virtually no statistical meaning. SQM Research notes that returns, volatility and other risk measures can be "noisy" and less reliable when quantified using a small sample size of observations.

*In view of the above, SQM Research has not provided an analysis of the Fund's risk and return profiles in this report. However, SQM Research does note that whilst the Fund has slightly underperformed the benchmark and the peer group for the 6-month period, the absolute returns have been very high (representing a strong market rebound after the COVID-19 related market crash in March 2020).*

<sup>1</sup> Note: Sharpe and Information Ratios are not reliable comparison tools in periods where both the Fund and its peers/benchmark record a negative result

## ASSET ALLOCATION & RISK PARAMETERS

The table below outlines the limits on the Fund's asset allocation and other risk parameters:

Fund Constraints and Risk Limits	Permitted Range or Limit
Maximum number of securities 20	20
Australian listed property securities	70-100%
International listed property securities	0-10%
Cash and cash equivalents	0-20%
Other Constraints	
Maximum position size in Index securities	20.00%
Maximum position size in non-Index securities	5.00%
Minimum market capitalisation	A\$50 million
Limit for Holdings Not in Benchmark	No limit

The Fund's history of asset allocation, sector and other portfolio metrics are detailed below:

### Fund Allocations

Mar-2020 to Aug-2020

Equity Sector	Average Weight	Max Weight	Min Weight	as at Aug-20
Office	8.5%	12.8%	5.7%	5.7%
Retail	15.0%	18.5%	12.0%	14.8%
Industrial	17.3%	18.9%	15.1%	18.7%
Diversified	21.0%	23.2%	19.6%	20.0%
Residential	7.4%	9.4%	6.1%	6.5%
Mortgage	0.0%	0.0%	0.0%	0.0%
Specialised	5.7%	9.2%	0.0%	6.4%
Development	4.7%	7.1%	2.8%	4.9%
Commercial	0.0%	0.0%	0.0%	0.0%
Cash	18.0%	22.1%	15.2%	16.3%
Health Care REITs	0.0%	0.0%	0.0%	0.0%
Internet Services & Infrastructure	2.2%	6.7%	0.0%	6.7%

Sector Profile	Current	Benchmark	Active
Office	5.72%	11.20%	-5.48%
Retail	14.78%	23.96%	-9.17%
Industrial	18.71%	27.84%	-9.13%
Diversified	20.00%	31.63%	-11.63%
Residential	6.52%	1.19%	+5.33%
Mortgage	0.00%	0.00%	+0.00%
Specialised	6.39%	3.49%	+2.90%
Development	4.89%	0.00%	+4.89%
Commercial	0.00%	0.00%	+0.00%
Cash	16.26%	0.00%	+16.26%
Health Care REITs	0.00%	0.69%	-0.69%
Internet Services & Infrastructure	6.71%	0.00%	+6.71%

Top 5 Holdings				
Name	% of Fund	% of Index	GICS Sector	Country
GOODMAN GROUP	18.71%	26.39%	Industrial REITs	Australia
NEXTDC LTD	6.71%	0.00%	Internet Services & Infrastructure	Australia
INGENIA COMMUNITIES GROUP	6.52%	1.19%	Residential REITs	Australia
CHARTER HALL SOCIAL INFRASTR	6.39%	0.73%	Specialized REITs	Australia
BWP TRUST	6.38%	1.80%	Retail REITs	Australia

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