PENGANA INTERNATIONAL EQUITIES LIMITED

MONTHLY REPORT
SEPTEMBER 2021

PENGANA INTERNATIONAL EQUITIES LIMITED (ASX: PIA)

DESCRIPTION

Pengana International Equities Limited (trading on the ASX as **PIA**) is the largest international ethical Listed Investment Company ("LIC") on the ASX, that exists to provide shareholders with capital growth as well as regular, reliable, and fully franked dividends.

The strategy aims to generate superior risk-adjusted returns, through investing in an actively managed portfolio of global companies that meet the team's high quality and durable growth criteria at reasonable prices. A robust ethical framework provides an added layer of risk mitigation.

These companies are identified through the conduct of fundamental research, with a long-term, global perspective, and must exhibit the following four key investment criteria: competitive advantages, quality management, financial strength, and sustainable growth potential.

STATISTICAL DATA

VOLATILITY[3]	NUMBER OF STOCKS	BETA (USING DAILY RETURNS)[4]
8.8%	71	0.68

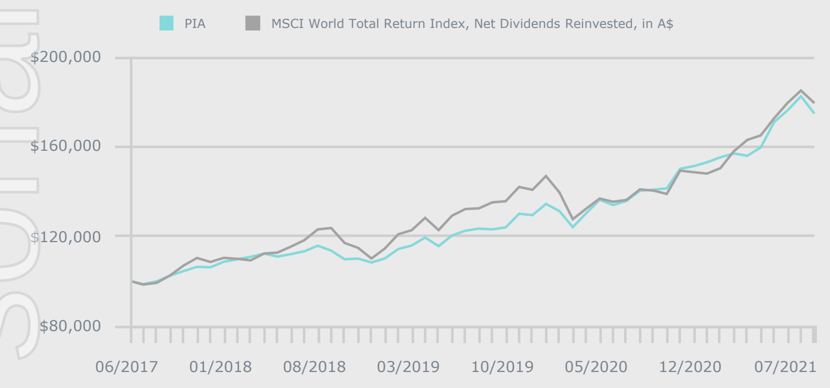
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 30 Sep 2021[1]

	1M	1Y	3Y	Pengana SI July 2017[1]
(ASX: PIA)	-4.2%	24.1%	15.4%	14%
Index[2]	-3%	27.8%	13.2%	14.7%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

Alphabet Inc	Communication Services
Amazon	Consumer Discretionary
Deere & Co	Industrials
Facebook Inc	Communication Services
First Republic Bank	Financials
Illumina	Health Care
Microsoft	Information Technology
PayPal	Information Technology
SVB Financial Group	Financials
Wuxi Biologics Cayman Inc	Health Care

SECTOR BREAKDOWN

Consumer Discretionary	7.8%
Consumer Staples	1%
Financials	13.3%
Health Care	22.8%
Industrials	12.9%
Information Technology	22.9%
Real Estate	1.9%
Communication Services	12.8%
Utilities	0.5%
Cash	4.1%

CAPITALISATION BREAKDOWN

Under 5bn USD	2.2%
In between 5bn - 10bn USD	0.8%
In between 10bn - 50bn USD	31.8%
In between 50bn - 150bn USD	25.6%
In between 150bn - 500bn USD	20.4%
Above 500bn USD	15.1%
Cash	4.1%

REGION BREAKDOWN

Australia/New Zealand	0.5%
North America	63.1%
Europe ex-UK	12.2%
Emerging Markets	13.6%
Japan	2.7%
UK	1.9%
Asia Pacific ex-Japan	2%
Cash	4.1%

THE LONG-TERM HEALTH OF CHINA'S SOCIETY AND ECONOMY

COMMENTARY

In September 2021, the Portfolio retracted -4.2%, compared to a market decline of -3.0% for the same period.

The Global Equity Portfolio lagged the benchmark, the MSCI All Country World Index, primarily due to weak holdings in Information Technology (IT) and Consumer Discretionary. Strong stock selection in Health Care proved helpful during the month.

Our commentary for the month is below, and we are also pleased to include a video update on the portfolio, as well as market outlook, since Harding Loevner took over the investment management.

In IT, Dutch payment-processing business **Adyen** declined to absent any specific news, apparently caught in a shift from more expensive, long-duration growth companies in response to expectations of higher interest rates. Another case was US software developer **Adobe**, whose shares declined after recently reporting another quarter of strong earnings growth that nevertheless did not satisfy investors' elevated expectations. In Discretionary, US sportswear manufacturer **Nike** cut its sales guidance due to supply-chain challenges, specifically the closure of factories in Vietnam due to COVID-19 outbreaks.

In Health Care, Chinese pharmaceutical contract development and manufacturing company **Wuxi Biologics** reported strong results for the first half of the year, with revenues up 127% and net profits up 163%, both year-over-year. The company is running at full capacity with a strong backlog of projects. Japan's **Sysmex**, a manufacturer of blood-testing instruments has also recently reported good results, with rising revenues and margins.

By region, stock selection in the US weighed on relative returns. Key detractors included Adobe and Nike, as well as life science products and services company **Illumina**. The company's shares continued to decline after it announced last month it had completed its acquisition of GRAIL (leader in the new field of liquid biopsies) without EU regulatory approval. This action may subject Illumina to future regulatory action. The portfolio's underweight in Japan also hurt performance versus the benchmark.

In the spring of 2020 – in the early stages of the global pandemic – we marvelled at the resiliency of the Chinese stock market, which we ascribed to the country's success in containing the domestic spread of the coronavirus through draconian lockdowns, whose efficacy was made possible by its authoritarian political system. Eighteen months later, a similarly authoritarian intervention has this time left investors reeling. While government intervention is not uncommon in China, the scale and pace of this latest crop of reforms are unprecedented. Is Xi, China's most powerful leader since Chairman Mao, revealing his allegiance to a collectivist ideology long thought to be discredited? Or is he boldly grasping the nettle of reform to redress economic imbalances and social ills before they become more entrenched and undermine the Chinese Communist Party's legitimacy?

Despite hyperventilating headlines conjuring memories of the CCP's gruesome past, we accept that on balance the policy changes are intended to benefit the long-term health of Chinese society and economy, especially its middle class. The message the Party is sending to business leaders across China is clear: compete on a level playing field and pay a fair wage. For instance, much of the coverage of Ant Group's cancelled IPO focused on the ostensible desire of the CCP to clip the wings of its tech oligarchs. More persuasive in our view is that having observed and learned from the West's subprime debacle a decade prior, Chinese financial regulators are not keen to allow loan origination to be divorced from the underlying credit risks of the loans—a source of moral hazard that would potentially destabilize a financial system still dominated by lumbering state-owned banks with weak credit cultures and poor management systems. Antitrust interventions targeting the largest e-commerce platforms echo the statements (if not yet the achievements) of many Western policymakers to improve competition by increasing the bargaining power of smaller businesses versus the giants.

Meanwhile, although the gutting of the private educational tutoring sector may seem disproportionate, it has with the stroke of a pen stigmatized one of the educational advantages of affluence while inhibiting the exam preparation arms race that many middle-class families feel has spiralled out of control. Actions taken to strengthen the data privacy protections of social media companies, tighten local ownership of Macau casinos, and rein in speculation in the high-end liquor market would not be out of place in Europe or the US. Not to minimize the serious consequences of these abrupt and radical reforms for private businesses; as investors, we are viewing these actions mainly as problems requiring further analysis rather than as an indication that China has become too unpredictable to be investable.

More troubling for China's long-term prospects, although less of an immediate danger to our portfolio, is the looming default of Evergrande. For years, the Chinese government has promised to wean the economy from fixed asset investments in favour of consumption, with little to show for the rhetoric. Regional governments have continued to rely on a red-hot property sector to provide their funding and achieve their mandated growth targets. Alarmed by the outsized role of property development in the economy, and the associated risks to the financial system of too much property speculation, the central government pushed through a series of policies last year to force the property sector to deleverage. Evergrande's plight looks like the direct consequence of those blunt top-down mandates as the heavily indebted company started to find itself cut off from its usual credit lines. While the CCP may be happy to make an example of the company, the probable spill-over effects to the rest of the economy will be hard to contain and likely to require yet more interventions.

Equally disturbing to us are the rolling power outages afflicting as many as 20 provinces. Duelling top-down mandates with competing objectives seems to be playing a role here. Earlier in the year, the central government renewed its commitment to "dual control," a mandate to curb carbon emissions by limiting both energy usage and intensity (i.e., the amount of energy used per unit of GDP). That directive was issued, however, without anticipating this year's spike in industrial output, whose emissions far exceed those from less energy-intensive sectors. Now that they have met their local growth targets, regional administrators are rushing to institute power shutdowns to avoid breaching stipulated emission ceilings. Woe be to the regional leaders who fail to shrink their carbon footprint before President Xi goes before the UN Climate Change Conference in early November determined to show that China is no climate backslider. To be sure, there are other factors contributing to the power crisis—not least, skyrocketing coal prices resulting in part from both extreme weather as well as China's boycott of Australian coal imports in retaliation for that country's insistence on reopening the inquiry into the origins of the COVID-19 virus.

Nobel Prize-winning economist Friedrich Hayek would have predicted that the Chinese government would ultimately fail to manage its economy by mandate because officials can't foresee and prevent every unintended consequence of their own actions. If China's growth slows further, more such shortcomings are likely to surface. The Chinese authorities exhibited competence at virus management but, even when their intentions are good, leaders inevitably miscalculate. When the views of authoritarians are subjected to little debate and their mandates are implemented without checks and balances, miscalculations can have outsized consequences. It's unclear to us when a greater trust in the spontaneous order spawned by private actors and market forces, however, well-mitigated by regulation and taxation, will take hold in China. Likely not as soon as we had hoped.

Annual General Meeting

The company's Annual General Meeting was held on 21 October and we have made a recording available online.

For any shareholder who wishes to watch a recording please CLICK HERE

We are also pleased to advise that the two resolutions put forward in the meeting were approved with the required majority votes.

Dividend Announcement

This week, the board declared the interim dividend for the first quarter of the current financial year.

In line with the annual target announced in August 2021, a 1.35 cents per share quarterly dividend, fully franked at a tax rate of 30%, will be paid on 15 December 2021 to shareholders on the register on 1 December 2021.

FEATURES

ASX CODE	PIA
FEES	Management Fee: 1.23% p.a. Performance Fee: 15.38% of any return greater than the MSCI World***
INCEPTION DATE	19 March 2004
MANDATED	1 July 2017
BENCHMARK	MSCI World Total Return Index, Net Dividend Reinvested, in A$
NTA POST TAX **	A$ 1.427
NTA PRE TAX **	A$ 1.481
PRICE CLOSE **	A$ 1.420
SHARES ON ISSUE **	255.28m
DRP **	Yes

FUND MANAGERS

Peter Baughan
Portfolio Manager

Jingyi Li
Portfolio Manager

1. As at the last day of last month prior to publishing of this report. Performance figures refer to the movement in net assets per share, reversing out the impact of option exercises and payments of dividends, 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.
2. Inception date of PIA: 19 March 2004, new investment team with new mandate adopted: 1 July 2017. Pengana International Equities Limited has been managed under the new investment mandate by the Pengana investment team since 1 July 2017. The performance since mandated in the table above refers to the movement in net assets per share since the new mandate adopted on 1 July 2017. The index is the MSCI World Total Return Index, Net Dividends Reinvested, in A$.3. Annualised Standard Deviation since mandated
4. Relative to MSCI World
**. As at the last day of last month prior to publishing of this report. The figures are unaudited.
***. MSCI World refers to the MSCI World Total Return Index, Net Dividends Reinvested, in A$.

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ACN 107 462 966
MANAGED BY PENGANA INVESTMENT MANAGEMENT LIMITED
PART OF THE PENGANA CAPITAL GROUP
AFSL 219462

CLIENT SERVICE

T: +61 2 8524 9900
F: +61 2 8524 9901
E: clientservice@pengana.com

PENGANA.COM/PIA

Authorised by: Paula Ferrao, Company Secretary.