THE MONTGOMERY FUND

Annual Letter to Investors

July 2021

MONTGOMERY

IMPORTANT INFORMATION

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To our Investors:

July 2020

Dear Investors,

The S&P/ASX300 Accumulation Index recorded a gain of 28.5 per cent for the 2021 financial year, the greatest return recorded in its twenty-year history.

Pleasingly The Montgomery Fund (The Fund) outperformed the benchmark for the second fiscal year in a row, delivering a return of 30.5 per cent after all fees and expenses.

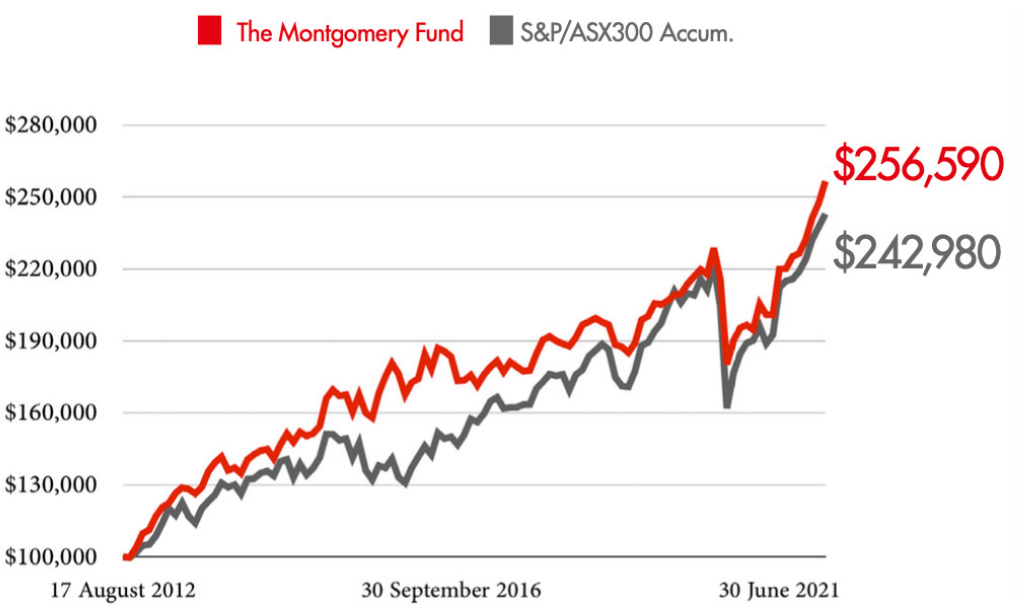
Before we provide our review on the financial year just past, we set out The Fund's performance chart and data since inception that we present at the start of every annual letter.

Given the strength in equity markets over the past financial year, it comes as no real surprise that there were no major drawdown events in the index relative to recent history.

This is despite the fact markets still faced an extremely uncertain outlook at the commencement of FY21, as markets were still grappling with the longer-term implications of COVID-19 without any indication of success on the vaccine front.

We are generally happy with our total return given the drivers of the broader market performance which we will discuss in more detail later.

Figure 1: The Montgomery Fund Performance Since Inception



Source: Fundhost/ Montgomery

Table 1: Annual Performance Information

Period	Returns: The Montgomery Fund	Returns: S&P/ASX 300 Accum. Index	Returns: Relative Performance	Maximum Drawdown: The Montgomery Fund	Maximum Drawdown: S&P/ASX 300 Accum. Index	Annualised Volatility: The Montgomery Fund	Annualised Volatility: S&P/ASX 300 Accum. Index
2013*	+26.3%	+14.1%	+12.2%	+6.8%	+10.6%	+10.2%	+11.5%
2014	+11.6%	+17.3%	-5.7%	+8.9%	+6.4%	+9.7%	+11.1%
2015	+13.7%	+5.6%	+8.1%	+8.1%	+8.6%	+10.6%	+13.0%
2016	+11.2%	+0.9%	+10.3%	+9.9%	+14.1%	+13.6%	+18.5%
2017	+1.7%	+13.8%	-12.1%	+10.1%	+6.5%	+8.9%	+10.9%
2018	+9.3%	+13.2%	-3.9%	+4.4%	+5.1%	+7.4%	+8.9%
2019	+4.4%	+11.4%	-7.0%	+10.3%	+13.0%	+9.7%	+11.2%
2020	-4.9%	-7.6%	+2.7%	+30.2%	+36.2%	+21.3%	+28.2%
2021	+30.5	+28.5	+2.0%	+5.8%	+5.4%	+12.9%	+14.1%
Since Inception	**+11.2%***	**+10.5%***	**+0.7%***	**+30.2%****	**+36.2%**	**+12.2%**	**+15.2%**

*2013 is the period 17 August 2012 to 30 June 2013

**Compound Annual Returns

*** Annual drawdown figures show the maximum decline with the relevant year

Distribution

At the conclusion of the financial year, The Fund paid a distribution of 5.0329 cents per unit. The Fund paid a distribution of 0.4601 cents per unit for the December 2020 half-year, so the total distribution was 5.4930 cents per unit.

The size of the distribution for The Fund tends to be driven by realised gains and losses more than by dividend or interest income. Therefore, full year distributions can vary considerably from year to year, depending on which holdings have been sold and whether a net gain or loss was realised.

You should note that our approach in managing The Fund is not to aim for a particular level of distribution, but to aim for the best possible risk-adjusted return.

Table 2: Distribution History for The Montgomery Fund to 30 June 2021

Year to June	Distribution (cents per unit)
2013*	7.2834
2014	4.0489
2015	13.0725
2016	7.7190
2017	2.1137
2018	12.8559
2019	8.5643
2020	1.6831
2021	5.4930
Total	62.8338

*17 August 2012 to June 2013

Since inception, distributions have totalled 62.8338 cents per unit, which equates to an annual average 7.0 cents per unit or a yield of 7.0 per cent per annum on the $1.00 unit price at inception on 17 August 2012.

The distribution at 30 June 2020 was 5.0329 cents per unit, and so after ending FY 2021 with a unit price of $1.6891, we commence FY 2022 with a unit price of $1.6388.

Looking back at the 2021 Financial Year

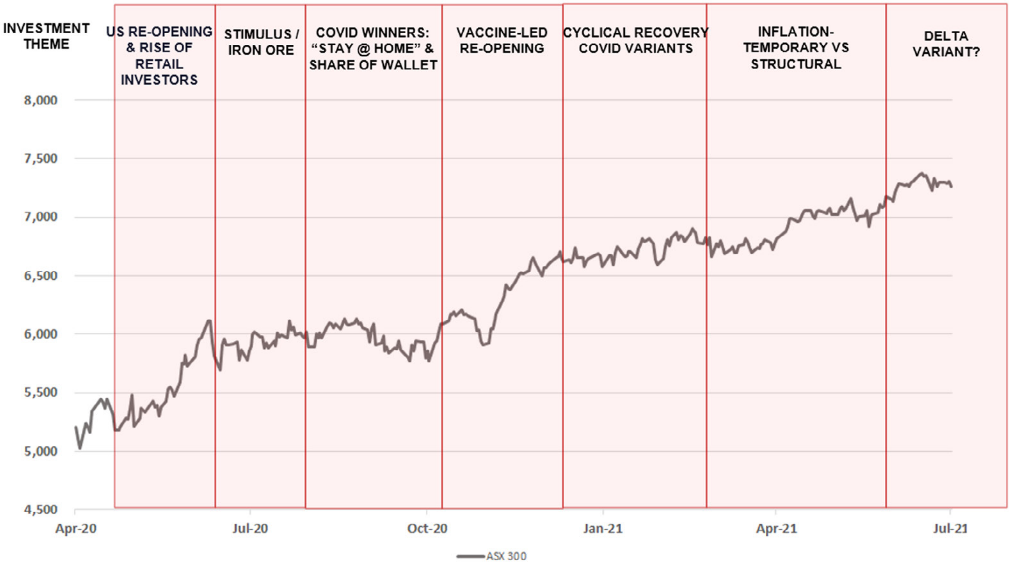
Much like the prior year, financial year 2021 was unprecedented in many ways. In many respects, the year has seemed like an extension of the initial March to June 2020 fall-out from COVID-19. Despite falling from the extremes of 2020, volatility for much of FY2021 remained elevated as the market reacted to the rapid pace of developments in a suddenly "less predictable" world.

Financial year 2021 – the year of short-term thematics

One of the hallmarks of FY2021 has been significant rotational moves driven by thematic investing, resulting in an extremely condensed investment horizon for many businesses and stocks. Share price moves were magnified by the surge of new retail investors driven to markets as a result of lockdown orders and readily accessible trading, partly funded by generous stimulus checks.

The below chart highlights some key themes that dominated headlines over the past year. What is notable is just how quickly the dominant narratives shifted over the year, which had a profound impact on relative share price performance depending on the "flavour du jour."

FY21 Investment Journey – dominant investment themes over the past 12-15 months



Source: Montgomery

The Montgomery Fund felt first-hand the significant volatility in many of its positions. This was most pronounced in the month of November 2020, when "Re-opening" trades surged on positive news on the Pfizer vaccine front, while "COVID-19 winners" were sold down heavily. For example, on 10 November 2020 – the day of the vaccine announcement – The Fund benefited from large gains in "Re-openers" such as Scentre Group, Sydney Airport and IDP Education, while seeing its positions in "COVID-19 winners" such as Redbubble, Codan and Reliance record significant falls.

Navigating this dynamic has been challenging as share prices reacted immediately and violently to changes in the news cycle. To highlight the point – Redbubble, one of the top contributors to fund performance in FY21 – fell over 20 per cent on 10 November 2020 to below $4 per share, only to peak again at over $7 per share in January 2021, just 3 months later.

In this regard, our focus on quality, valuation and earnings sustainability helped to maintain our resolve as we looked to take advantage of prevailing narratives in both a cyclical and counter-cyclical manner.

Review of The Fund's performance

As previously noted, The Fund delivered a total return of 30.5 per cent, outperforming the broader benchmark return of 28.5 per cent by 2.0 per cent. We are pleased the outperformance has been achieved despite the challenging set of market conditions:

- The S&P/ASX300 Accumulation Index recording the greatest return in its 20-year history – The Fund has generally underperformed buoyant market conditions, in large part due to its historically conservative cash weighting; and

- The two largest sectors in the market – Banks (+51 per cent) and Materials (+36 per cent) – being two of the strongest performing sectors in FY21. The Fund, by virtue of its index unaware construction and quality focus, is generally “underweight” these sectors, which will hurt relative performance should these two sectors do well.

Drivers of performance in the 2021 financial year

Our stock selection delivered overall performance. Reviewing The Fund’s positive contributors, it is notable to see the number of newer positions featuring prominently. These include Redbubble, REA Group, Wesfarmers, Tabcorp, Uniti Group, Woolworths Group and Megaport, and all contributed solidly to Fund performance.

On the other hand, the two biggest non-bank contributors over FY21 have been The Fund stalwarts Codan and Reliance Worldwide.

We were rewarded in maintaining a sizeable position in both names despite significant share price volatility associated with “COVID-19 winners.”

- In the case of Codan, the company has experienced an acceleration in earnings growth in its key metal detector division, while also utilising its strong balance sheet to acquire two complimentary businesses in its communications division. These acquisitions help bolster the company’s earnings growth profile over the next 2-3 years.
- Reliance Worldwide benefited from a spike in Renovation and Remodelling activity in its key US market, with the company also receiving a boost from structurally higher demand given increased product awareness.

The Fund’s major bank positions – Commonwealth Bank and Westpac – feature prominently in the top contributors by virtue of their strong share price performance and The Fund’s significant weighting in both names.

From September 2020 onwards, The Fund's weighting towards the major banks has been at its highest in the history of The Fund as we viewed them as primary beneficiaries of a rebound in the domestic economic recovery. We continue to hold almost 15 per cent of The Fund in our preferred banks exposures given a finely balanced outlook on inflation expectations in the next 12 months.

In terms of negative contributors, the only name that detracted significantly to The Fund's performance is Avita Medical. As you would be aware, Avita Medical had a meteoric rise in the first 12 months after it first entered the portfolio in March 2019. However, the post COVID-19 era has been particularly brutal for the company's share price, as COVID-19 related lockdowns impacted all facets of its operations from reduced burn incidents, limited access to hospitals delaying product ramp-up and sales penetration, as well as patient enrolment for key pivotal trials. These delays culminated in a momentum killing capital raising in early 2021.

Price declines were also exacerbated by indiscriminate index selling and negative perceptions around CEO share selling for tax purposes.

Despite the disappointing share price performance, we continue to hold a significant investment in the company. We have reviewed our investment thesis numerous times over the past financial year. This has included numerous conversations with burn surgeons and dermatologists to re-test our view around the longer-term opportunity arising from RECELL relative to the current standard of care (burns / wounds) as well as addressing unmet needs (vitiligo) for these patient groups. We anticipate further progress in burns market penetration, regulatory clearance (reimbursement approvals, Japan market entry) and clinical studies over the coming year and note recent developments with FDA paediatric label extension and a recent uplift in sales as positive signposts along this journey.

Cash positioning

A special mention must be made of our cash weighting, which has been one of the larger detractors to relative performance given its drag on overall returns since the inception (August 2012) of The Fund.

In the early days of the COVID-19 fallout in March 2020, we identified the prior "pre-COVID-19" valuation paradigm driven by Central Bank largesse was unlikely to change given the policy response of even greater levels of debt monetisation. However, The Fund maintained its conversative positioning during the June 2020 quarter given our concern over the medium-term risks that may arise from the ubiquitous spread of COVID-19 around the world. With the benefit of hindsight, this proved to be too cautious as the flood of new money jolted financial markets and the development of an effective vaccine provided welcome certainty to underpin the optimistic outcome scenario.

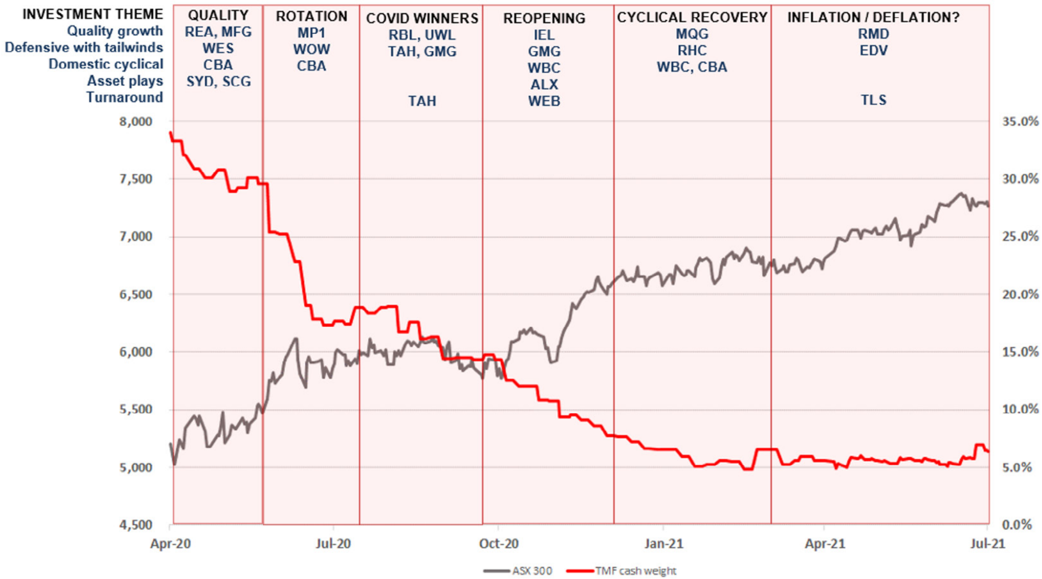
Throughout the financial year however, we steadily invested our sizeable cash position in companies with:

1. bright prospects that have added value through an uncertain period;
2. have been a "COVID-19 winner" and / or potential beneficiaries of structural change; and
3. where longer-term valuations remained relatively attractive in a more "normal" world.

This investment focus helped identify many of the newer positions which we previously outlined as meaningful contributors to the total return of The Fund.

The following chart shows The Fund's focus over various points of the past financial year. We noted earlier the prevalence of thematic investing, and this chart highlights how we have tried to be opportunistic in taking advantage of narratives in both a stock selection and a divestment sense. The ASX company codes represent the opportunities identified in each period as well as the main contributors to Fund performance during the particular investment theme.

The Montgomery Fund's investment journey through FY21



Source: Montgomery

Despite a still-meaningful relative drag on performance given the overall strength of the market, we invested much of our cash holding prior to the November 2020 rally. As a result, The Fund not only managed to participate in much of the overall market rally, but The Fund's well-diversified exposure meant it was not heavily overweight any one thematic which may have detracted from overall investment returns.

We anticipate The Fund to remain much more fully invested in the future as we continue to identify opportunities with favourable risk-return profiles in honour of our capital preservation focus, whilst acknowledging the nil return on cash.

Fund positioning and outlook

The Fund's current positioning may be best described as a well-diversified portfolio of quality companies at valuations which we deem relatively attractive. We classify our exposures into 5 broad categories of investments:

- Quality growth companies – exposed to structural, multi-year dynamics. These include companies such as REA Group, Codan, Avita, Resmed and IDP Education. In many cases, these companies are pursuing an opportunity set that is defined in global terms, providing a much larger available footprint for business value accretion.
- Quality defensive companies exposed to positive tailwinds – these companies have lower forecast earnings growth but are less exposed to economic cycles while still being exposed to positive structural tailwinds. These holdings include Goodman Group, Wesfarmers, Ramsay Health Care, Steadfast and Uniti Wireless.

- Quality asset plays – companies that own assets that are in our view undervalued by the market. They offer attractive risk-return characteristics given the valuation buffer and the long-term asset dynamics. Many of our re-opening investments fall under this category including Sydney Airport, Atlas Arteria and Scentre Group.
- Quality cyclicals – portfolio holdings that necessitate a view on both relative value and broader macro considerations in the industry as they are more economic sensitive. Our significant weighting to the Banks falls under this category.
- Tactical opportunities – this category includes turnaround opportunities in companies where we see potential change in the company from a self-help or industry perspective, thereby improving the quality of the business. We also include tactical positions where have identified shorter-term investment ideas with significant above-market return potential.

In terms of our broader outlook – we remain optimistic that an eventual path out of COVID-19 will occur sooner rather than later, albeit we remain cognisant of the risk surrounding potential variants.

There are also many known, and countless more unknown risk factors for investment markets ahead, none of which relate to COVID-19 and the global pandemic. Inflation expectations and bond market ructions affect short-term narratives, fuelling intra-day, intra-week and intra-month volatility. Geopolitical tensions remain elevated. And Cybersecurity risks represent a significant unquantifiable risk given the world's dependence on computer systems for simple day-to-day operations.

These concerns must be balanced with a view that society and companies will continue to evolve and progress, adapting to the challenges as the past twelve months have demonstrated.

Our investment focus remains on quality companies with bright prospects. Value is a consideration we make in all our investments. And finally, we remain wary of pockets of speculative activity given The Fund’s commitment to capital preservation. We believe these three traits will continue to hold us in good stead as we navigate an uncertain future.

Thank you for your continued support of The Montgomery Fund. We appreciate the opportunity to work for you.

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