MONTAKA GLOBAL ACCESS FUND
QUARTERLY LETTER

MONTAKA

MARCH 2017

UNIT PRICE# $0.9526

FUND COMMENTARY

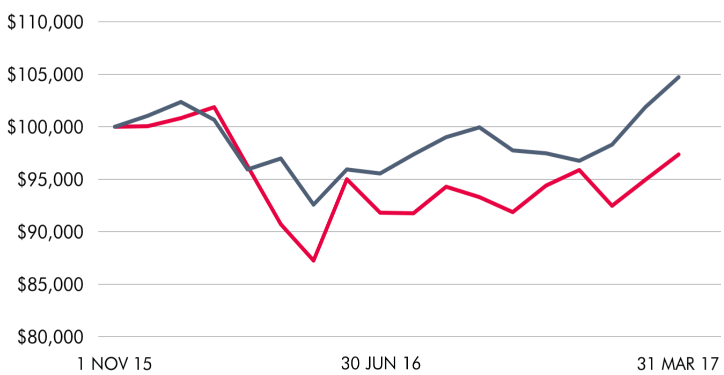
In the month of March, the Montaka Global Access Fund increased by 2.57%, net of fees. Over the same period, the global market increased by 1.86%. Over the March quarter, the Fund increased by 1.58%, net of fees; while the global market increased by 0.97%. Since inception, the Fund has decreased by 2.62%, net of fees versus the global market which was up by 4.56%. Of course, when comparing Montaka's returns to market returns, one must keep in mind that Montaka has delivered its returns being only approximately 50% exposed to the market.

The quarter was dominated by some truly historical moments in global politics - many of which relate to the new Trump Administration in the US. Following Trump's inauguration on January 20, we are now living in a period of "alternative facts", "fake news" and governance-by-Twitter. Prior to this Administration, it would have seemed inconceivable that CNN and the New York Times could be blocked from attending a White House press briefing; and yet, somehow, this was not the most surprising development this quarter.

For investors in global markets, it remains important to understand and monitor developments in the US political system. Policies effected in the world's largest economy can have knock-on effects to just about every corner of the world.

We begin by making a preliminary evaluation of President Trump. We believe that for any job - whether it be an investment professional, a doctor, an Uber driver, or President of the United States - there are two broad dimensions upon which a candidate can be evaluated: (i) aptitude; and (ii) attitude. With respect to President Trump, we have no ability to evaluate his aptitude. Only those who know him well and have worked with him directly could make such an evaluation.

FUND PERFORMANCE AUD VS USD[1]



 # The fund is forward priced; you will receive the price struck subsequent to the receipt of your application/ redemption request.

** all exposures, metrics & positions are derived from the underlying investment fund*

PERFORMANCE ATTRIBUTION* (%)

	March 2017
Long portfolio contribution	3.01
Short portfolio contribution	-0.80
Net return (USD)	2.21
Change in AUD/USD	0.36
Net return (AUD)	2.57
Since inception[1] (AUD)	-2.62
Since inception of the underlying fund (AUD)[2]	11.61

EXPOSURES* (as at 31 March 2017)

	% of NAV
Long exposure	86.4
Less: short exposure	(39.1)
Net market exposure	47.4

POSITION METRICS* (as at 31 March 2017)

	Long Portfolio	Short Portfolio
Number of positions	21	32
Largest position size	6.7	2.7
Smallest position size	1.6	0.6
Average position size	4.1	1.2

Note: sizes shown as % of NAV

TOP 10 LONG POSITIONS* (as at 31 March 2017)

		% of NAV
1	Playtech	6.7
2	REA Group	5.7
3	Insperity	5.5
4	China Life	5.4
5	Facebook	5.3
6	Oracle	5.1
7	Gentex	5.1
8	Tencent	5.0
9	Alibaba	5.0
10	Aetna	4.3
Total top 10 long positions		53.1

FUND SIZE (NAV) ($M) (as at 31 March 2017)

Montaka Global Fund	149
of which: Montaka Global Access Fund	64

1) 1 November 2015 2) 1 July 2015
3) Based on Montaka Global Master Fund USD performance

MARCH 2017

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With respect to Trump's attitude, we are now convinced it is completely inconsistent with the intentions implied by the oath of office of the President of the United States. For those seeking evidence of this claim, look no further than the transcript of Trump's speech in front of the CIA Memorial Wall on his first full day in office. Perhaps China observer, Bill Bishop, summed it up best with the following musing:

"[Trump] must have posed some interesting translation and analytical challenges for American experts in the PRC. How do they explain Trump to Xi Jinping? What is Chinese for 'cray cray'?"

From an investment perspective, the above evaluation implies a relatively higher degree of uncertainty with respect to US policy. And more uncertainty makes investing more difficult: investors need to ensure that their portfolios will perform well under a wider range of possible scenarios.

We have seen tangible instances of this already. Take the proposed repeal-and-replace of the Affordable Care Act, or "Obamacare" by which it has become more commonly known, for example. Most political observers would have placed a high probability on a repeal passing in the Republican-controlled Congress fairly promptly. After all, members of the Republican party have been campaigning on this promise for at least the last six years. And yet, internal divisions within the Republican party resulted in the vote being abandoned at the eleventh hour. Republican party members simply could not agree on the terms of the repeal.

Should investors care about any of this? Well, since the result of the US election in November, the MSCI World Total Return Index has increased by more than 10 percent. This gain was driven, in large part, by expectations of fiscal stimulus by the Trump Administration. A substantial reduction in the US corporate tax rate is a major part of these expectations.

Having now effectively "banked" these tax cuts, how will the market react in a world in which such tax reform cannot be agreed upon by members of the Republican Party? And this very scenario is not just a hypothetical proposition. It turns out the proposed cuts to corporate taxation are substantially funded by proceeds raised from a Border Adjustment Tax (BAT). This BAT essentially taxes imports and subsidises exports and has the potential to create an enormous set of winners and losers in the US corporate landscape. Naturally this is highly controversial and is far from assured. But without this source of funding, the proposed corporate tax cuts become far less likely.

The above gives a flavour for how we think about possible economic scenarios in the US. We do not try to predict what will happen; instead, we think through the scenarios that could happen and ensure our portfolio can perform in all possible scenarios.

As we enter the June quarter, it will not just be developments in the US that may be market-moving. In the UK, developments relating to its negotiations with the EU to effect its exit from the Union will likely be significant for the next 24 months.

In France, the outcome of its Presidential Election later this month could also have ramifications for the future of the EU.

As always, we remain focused on buying high-quality global businesses which remain undervalued. We believe owning high-quality businesses provides the portfolio with a level of resilience that other businesses do not offer. And we believe the value of resilience to an investor only increases with uncertainty in the world.

This idea of resilience transcends the portfolio of businesses we own. Whether it be Playtech (LSE: PTEC) which is driven by online betting; Essilor (Euronext: EI) which is driven by aging populations globally; China Life Insurance (HKEx: 2628) which is driven by a growing Chinese middle-class; or Take-Two Interactive (NASDAQ: TTWO) which is driven by the consumption of video game content. The underlying demand drivers of the businesses we own are resilient in the face of uncertainty. So while stock prices may move around from day to day, the intrinsic values of the businesses we own are resilient and will continue to compound.

We were fortunate to spend time touring parts of Australia in recent weeks, meeting with current and prospective investors. These were some of the ideas and messages we were sharing in our discussions. In addition, we shared with investors our thesis on Hennes & Mauritz – or "H&M" by which it is more commonly known, Montaka's largest short position. We share this thesis below – compiled by our highly-gifted research analyst, Daniel Wu, as part of our ongoing commitment to investor education.

CASE STUDY: Hennes & Mauritz (Nasdaq Stockholm: HMB)

Hennes & Mauritz, better known as H&M, is a global fast fashion retailer headquartered in Sweden that has historically generated high single digits to low teens annual growth through a rapid store expansion strategy. Since 2010, H&M has faced structural headwinds that have pressured margins, and the company has started to hit or exceed saturation in many markets, with sales and profit densities that have been deteriorating for years.

At Montaka, we follow a rigorous process and strict framework when analysing short candidates. Potential shorts must exhibit at least one characteristic of our four-point framework: i) thematic/structural declines; ii) divergent expectations; iii) asymmetries; and iv) misperceptions. As we discuss, H&M is a short that satisfies all four characteristics.

Thematics / Structural Declines

- ***Fast fashion retailing is increasingly more competitive.*** H&M is the second-largest apparel retail brand globally and competes with not only other fast fashion retailers including Zara (largest, owned by Inditex), Uniqlo (owned by Fast Retailing), Gap Inc and Primark (owned by ABF), but also online pureplays such as ASOS, Zalandoo and Amazon Fashion.

MARCH 2017

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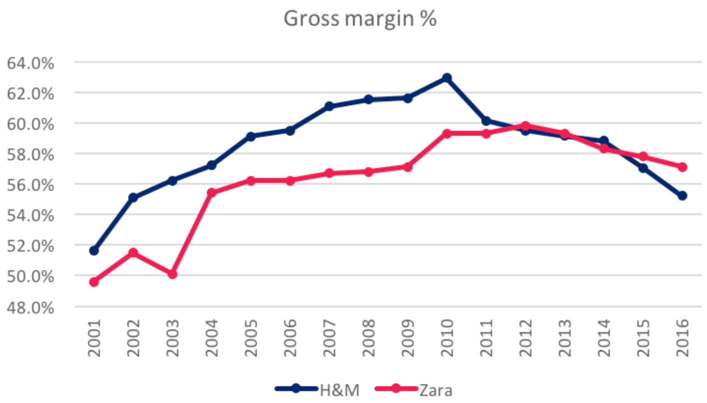
While all the retailers have taken share from Gap Inc over the past decade, H&M is positioned awkwardly towards the value end of the spectrum and is being squeezed from both ends by the premium Zara brand and the discounter Primark (while Amazon Fashion is yet to make an impact in the European markets). Broker price and quality comparisons have shown H&M to be 2x to 3x more expensive than Primark but of similar quality (or lack thereof), while Zara commands a substantial quality and price premium over H&M.

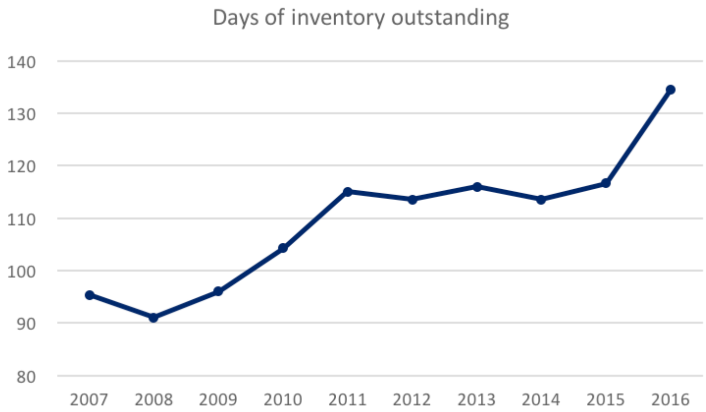
This competitive top line pressure, in addition to supplier wage inflation, has crushed H&M's gross margin since 2010.



• ***H&M has reached or exceeded saturation point in many markets.*** The company has for decades pursued an aggressive growth strategy underpinned by 10% to 15% net new store openings every year. Consider that in H&M's top 10 markets, it has almost five times as many stores as Zara; in Zara's top 10 markets, H&M still has more than twice as many stores. This aggressive store rollout strategy has driven a deterioration of H&M's store economics, as new stores cannibalise existing stores, and e-commerce sales cannibalise brick-and-mortar sales. We will explore this further under "Misperceptions".

On its Q4 2016 conference call, management threw in the towel on the annual store growth target, and rephrased it to an annual 10% to 15% sales growth target.

• ***H&M's business model has not adapted to the evolving fast fashion landscape.*** H&M runs a decentralised business model, which results in a higher fixed cost base and makes e-commerce fulfilment harder to scale. Additionally, H&M is not true "fast fashion"—80% of inventory is sourced from Asia, which has a six to nine-month lead time from design to manufacturing. This means H&M must bet on fashion trends seasons in advance and has little flexibility to adjust inventory for changing fashion preferences. Given H&M must plan inventory in anticipation of positive like-for-like (LFL) sales, its inventory position has blown out in recent years, which increases future markdown risk. For example, management expects -50 bps margin impact from markdowns in Q1 2017, on top of the -140 bps markdown already taken in Q1 2016.



Inditex, by comparison, sources 65% of its inventory from Europe with design to rack times as short as four weeks, which keeps inventory fresh while creating a sense of scarcity and excitement that drives an incredible 17x annual visit frequency compared to the industry average of 4x to 6x.

Divergent expectations

• ***The market and sell-side analysts have overreacted to H&M's new sales target.*** On the Q4 2016 conference call, H&M announced that it was abandoning its long-standing 10% to 15% net new store target, and replacing it with a new 10% to 15% sales growth target. On the surface this sounded like a positive development, as management is no longer hamstrung into opening at least 400 to 500 new stores every year, and growing sales at 10% to 15% annually is fantastic (if achieved). The market reacted positively to the news, sending the stock up 6% on the day. We believe this is an overreaction for two reasons: i) H&M only averaged 10% annual sales growth over the last decade—the low end of management's future target—and that was off a much smaller revenue base and in a more favourable retail environment; and ii) investors now expect a minimum 10% growth per year. If LFL sales growth doesn't return to low single digit positive territory, management may be forced to open even more stores to meet the sales target. New stores typically take time to ramp up (especially in oversaturated markets) so a 10% increase in store count will most likely drive less than a 10% increase in sales.

• ***Consensus expectations are for margins to stabilise.*** While margin expectations have been revised slightly lower since the Q4 2016 result, brokers are still expecting operating margins to remain more or less flat into the future. Scrapping the annual new store target may help alleviate some of the pressure on profit densities, but that in itself is not enough to drive operating margin improvement.

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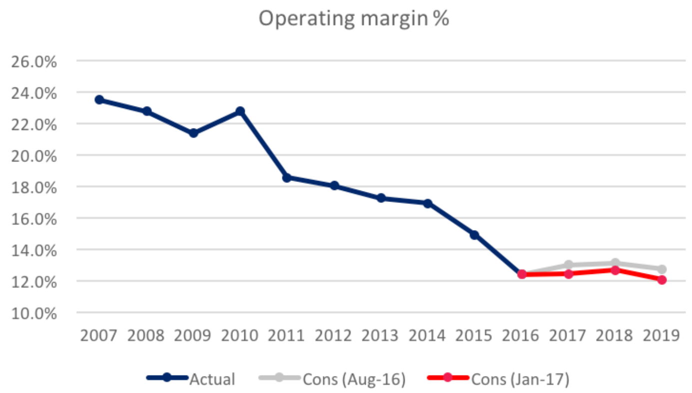
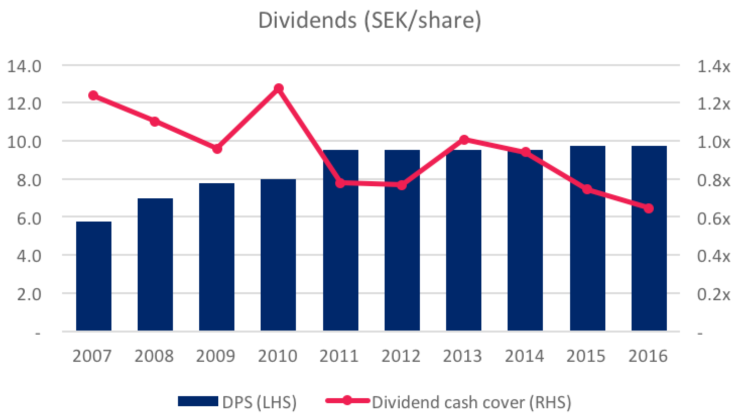
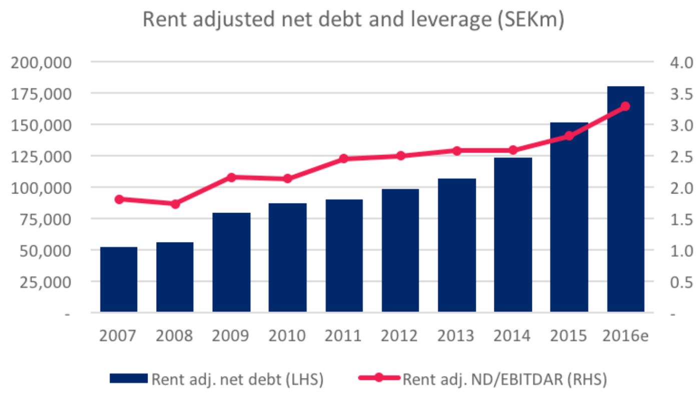


- ***H&M is paying out more than 100% of free cash flow as dividends.*** As the chart below shows, H&M's dividend cash coverage has fallen below 1x in four of the last six years, even as dividend per share remained flat. The dividend payout ratio has averaged over 80% since 2007, while the Board explicitly targets a 50% payout ratio. Management reaffirmed its commitment to the level of dividends on the Q4 2016 conference call, and expects the company to grow back into a 50% payout ratio. The market (and many brokers) appear sufficiently convinced, but we believe this is unlikely, and the pressure on H&M's cash balance will force the company to either cut the dividend or draw debt to maintain the dividend. Neither will be positive for the share price.



Asymmetries

- ***Rent adjusted leverage has been growing since 2008.*** H&M appears to have a clean balance sheet with minimal debt and a net cash position. However, as a retailer that only leases stores, we must adjust reported net debt for these lease obligations by capitalising the reported rent expense. Using the 8x rent expense "rule of thumb", we can see below that rent adjusted net debt has grown to SEK180 billion and rent adjusted leverage is north of 3x. If we use a more realistic cap rate reflecting a rental yield of, say, 6%, rent adjusted net debt would more than double to SEK380 billion!



Misperceptions

- ***Aggressive new store rollout masks deteriorating LFL sales development.*** Over the last decade, H&M's constant currency sales growth has averaged just under 11%. This looks rather impressive until one considers that of the 11% growth, an estimated 10% came from the increase in store space while only 1% came from LFL sales growth. The retailing holy grail is driving slightly more sales from the same stores at slightly less cost. H&M has struggled to achieve this. In fact, management stopped reporting LFL sales altogether after 2013, which is equivalent to banks not reporting their net interest margin or miners not reporting run-of-mine volumes. Zara, on the other hand, has averaged over 4% LFL sales over the same period and has significantly outperformed H&M since 2014.

- ***Aggressive new store rollout also masks declining profit densities.*** In addition to juicing sales, the rollout of new stores has also masked declining sales and profit densities. H&M conveniently does not report selling space either, so we have had to estimate total selling space over time. Looking at densities on a per-store basis paints a rosier picture than reality because average store size has increased over time, which means selling space has increased faster than store count.

Profit density per square metre has declined by over 60% from SEK11,000 in 2007 to SEK4,000 in 2016, while total selling space has more than tripled. This is extremely strong evidence of oversaturation and the cannibalistic effect of H&M's store rollout strategy. Aside from 2011, total operating profit has increased every year because the percentage increase in selling space was higher than the percentage decrease in profit per square metre. In 2016, total operating profit finally declined as the growth in selling space could no longer keep up with the decline in profit density.

MARCH 2017

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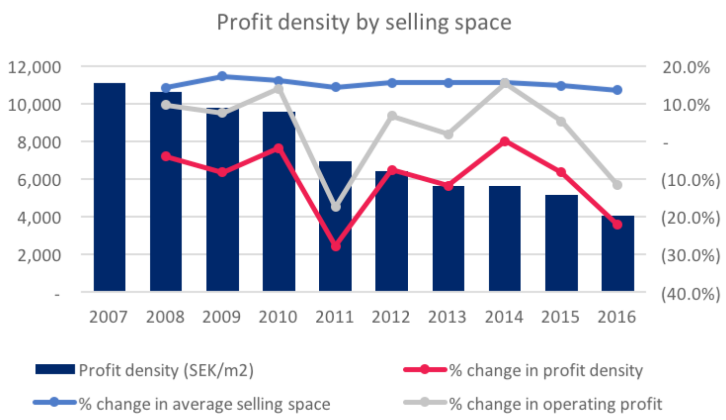

Profit density has declined on average almost SEK800 per annum since 2007. If this dollar-rate of decline continues, operating profit will be entirely wiped out within the next five years. If, instead, profit density continues to decline at the average historical percentage-rate, H&M's operating margin will fall from 12% in 2016 to low single digits by the end of the next decade. The company's recent decision to abandon its 10% to 15% annual new store target may alleviate some of the pressure on profit densities. However, we believe that this alone is not enough to return H&M to profit density growth, especially if maintaining the new 10% to 15% sales growth target requires opening a similar or even higher number of stores.

- It is not clear that H&M's online sales are profitable. H&M does not separately report online sales, but management has said that online sales are "profitable". While this may be technically true, it is disingenuous, as online sales can be either additive or cannibalistic. Using Amazon as best in class, we estimate that fulfilment and delivery costs would represent ~17% of online sales (brokers arrive at similar percentages), while H&M would then save on rent and labour. Given a consolidated operating margin of 12%, H&M's online sales must be additive to in-store sales in order to positively contribute to total operating profit. If online sales are cannibalistic, H&M would lose in-store sales but still incur store rent and labour costs (operating deleverage), plus an additional 17% cost margin for fulfilment and delivery, resulting in a very negative incremental operating margin.

Ultimately, H&M is a lumbering giant that is facing intense competition in many markets where it is already oversaturated, using a sourcing and distribution model that is ill-suited to competing in today's rapidly evolving fast fashion retail industry. The company has maintained a façade of growth by stubbornly pursuing an aggressive expansion strategy and sacrificing store economics, and that façade finally appears to be cracking.

* * *

As we round out the March quarter, we take the opportunity to review our returns and provide some additional insight around how these might be interpreted. Long-short strategies are different to long-only strategies because the short portfolio can act a bit like an insurance policy: it can help preserve capital when markets turn down, but can act as a drag on performance when markets rally.

The following analysis is intended only for those readers who enjoy rolling up the sleeves and analysing performance attribution. It is certainly not mandatory reading.

In the March quarter, the MSCI Total Return Index increased by 6.4% in US dollar terms. In these conditions, we can make the following statements:

- A strategy with approximately 50% net market exposure would be expected to rise by approximately 6.4 x 50% = 3.2% before the addition or subtraction of any value through stock picking by the manager.

- Assuming a long portfolio of 90% and a short portfolio of 40% (given the net market exposure of 50%); and in a world in which the manager neither adds or subtracts any value through stock picking, the total return of 3.2%would have the following attributions between its long portfolio and short portfolio:

o Long portfolio 6.4 x 90% = 5.8%.

o Short portfolio -6.4 x 40% = -2.6%.

o As a check, we confirm that the sum of the long and short portfolios result in the total return: 5.8 – 2.6 = 3.2%.

- A corollary to the above is as follows:

o Should a long-short strategy with the above characteristics deliver long performance above 5.8%, then this long portfolio has "added value".

o And if the short portfolio delivers a return of more than -2.6% - even if that return is still negative - then this short portfolio has also "added value". It may seem counterintuitive to some investors that a negative absolute contribution can still be classified as "value add". The reason is that "value add" is defined as a measure relative to what one could achieve simply by going short the market-index in the same quantity.

MARCH 2017

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Now, in the March quarter Montaka delivered a net return of 1.58%. in US dollar terms[5] (putting aside for the moment the effect of currency losses) the fund returned 7.7%. It has achieved this with a long portfolio of approximately 90%, a short portfolio of approximately 40%, resulting in a net market exposure of approximately 50%.

• Given the analysis above, any quarterly return above 3.2% would indicate value-add by the manager – so we are proud to have delivered this with Montaka's return of 7.7%.

• Furthermore, over the quarter, Montaka's long portfolio contributed approximately 11%. Since this is above the 5.8% from the analysis above, we conclude that Montaka's long portfolio added significant value over this period.

• Finally, over the quarter, Montaka's short portfolio delivered approximately -3.5%. This is slightly below the -2.6% from above indicating that we subtracted value in the short portfolio through stock picking to the tune of around -0.9%. Again, "value-add" is measured relative to a short-market-index portfolio of equivalent size, not in absolute terms.

The above analysis seeks to clarify how investors can analyse the results and attribution of long-short equity strategies, including Montaka. At the risk of providing unnecessary complexity, we are committed to education and being transparent with investors as much as possible.

The analysis we have provided for the March quarterly return is not intended to suggest that investors should focus so intently on short-term returns. It is for illustrative purposes only. We continue to encourage investors to take a longer-term view of at least 3-5 years when investing in Montaka. And we recommend against drawing strong conclusions from any one month's, or one quarter's, return – whether it be strong or weak.

As we enter the final quarter before our two-year anniversary of the Montaka strategy, we once again would like to acknowledge and thank all of our investors for the trust you have placed in us to protect and grow your wealth. It is a privilege we never take for granted.

Sincerely,

Andrew Macken

[5] Based on the returns of the Montaka Global Master Fund. The Montaka Global Access Fund delivered 1.58%, net of fees, in Australian dollar terms over the same period. The difference is substantially driven by currency movements, as illustrated on the Fund Performance chart on page 1.

MONTAKA GLOBAL ACCESS FUND
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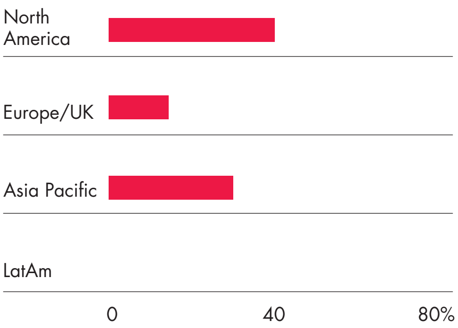
MONTAKA

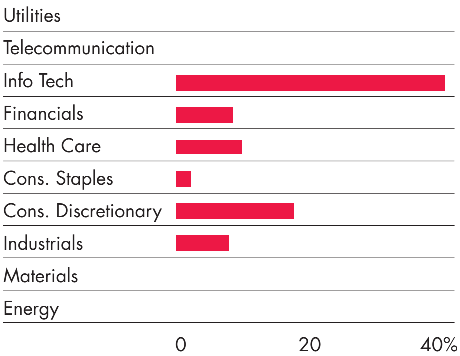
MARCH 2017

LONG PORTFOLIO*

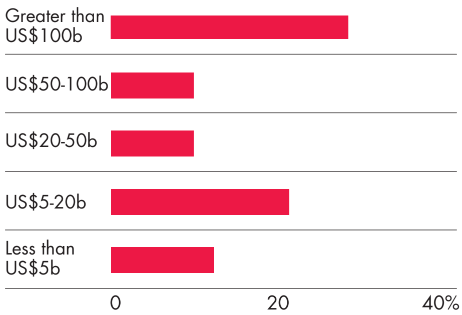
GEOGRAPHIC EXPOSURE (Country of domicile)



INDUSTRY EXPOSURE

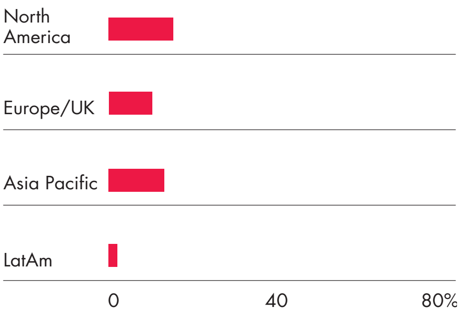


MARKET CAP EXPOSURE

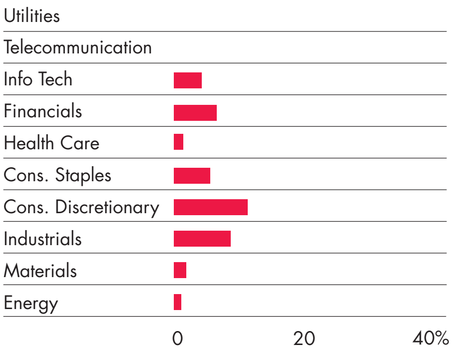


SHORT PORTFOLIO*

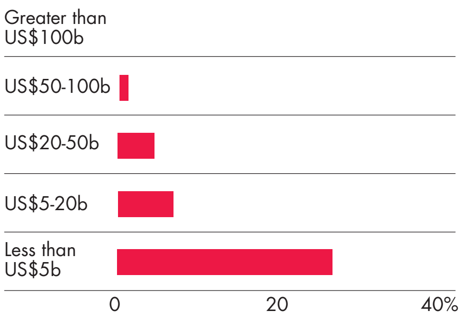
GEOGRAPHIC EXPOSURE (Country of domicile)



INDUSTRY EXPOSURE



MARKET CAP EXPOSURE



Note: exposures shown as % of NAV

** all exposures, metrics & positions are derived from the underlying investment fund*

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DISCLAIMER

#Fund performance is calculated after fees and costs, including the investment management fee and performance fee. All returns are on a pre-tax basis.

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