

# Montgomery Global Fund

## INVESTMENT REPORT & FACT SHEET

### FUND OVERVIEW

The Montgomery Global Fund employs a highly disciplined, bottom-up, value style and typically invests in 15 to 30 high conviction stocks listed on major global stock exchanges. The focus of The Fund is on investing in what Montgomery Global regards as high quality businesses with attractive prospects trading at a discount to their estimated intrinsic value.

The Fund has the flexibility to retain a reasonable level of cash, with a "soft" 30 per cent limit. The Fund will generally be currency unhedged but we can put in place strategies aimed at protecting investor capital against currency fluctuations if we predict material upside to the Australian dollar.

The Fund aims to deliver superior positive returns when suitable investment opportunities are abundant, and to preserve capital through cash allocations when an insufficient number of company names are appealing.

### FUND FACTS

#### INVESTMENT MANAGER

MGIM Pty Ltd

#### OBJECTIVE

The Montgomery Global Fund aims to outperform the index over a rolling 5-year period.

#### BENCHMARK

MSCI World Net Total Return Index, in Australian dollars.

#### FUND CONSTRUCTION

The Fund will typically invest in a portfolio of 15-30 high-conviction stocks listed on the major global stock exchanges. Cash typically ranges from 0%-30%, but can be exceeded in certain situations.

#### APIR

FHT0036AU

#### RECOMMENDED INVESTMENT TIMEFRAME

5 years

#### MINIMUM INITIAL INVESTMENT

\$25,000

#### INCEPTION DATE

1 JULY 2015

#### FUND SIZE

\$226.2M

#### MANAGEMENT FEE

1.28% per annum, inclusive of GST/ITC.

#### PERFORMANCE FEES

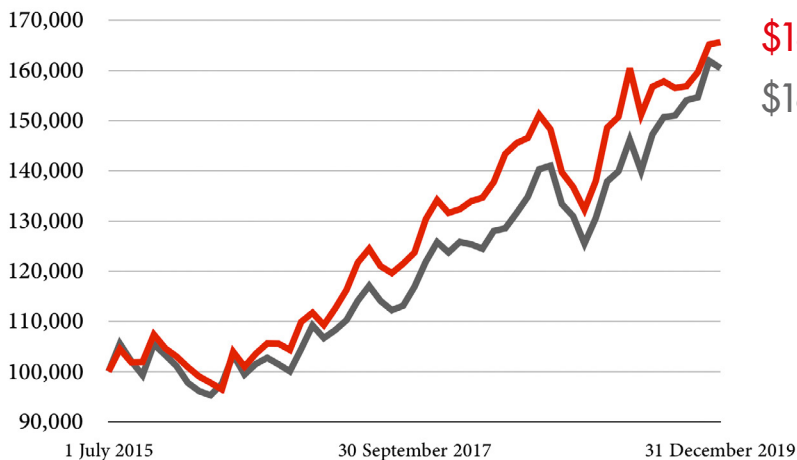
15.38% of the total return of The Fund that is in excess of its Benchmark. No performance fee is payable until any previous periods of underperformance has been made up. We currently estimate performance fees to be 0.57%.

#### APPLICATION & REDEMPTION PRICES

[montinvest.com/mgf](http://montinvest.com/mgf)

### PERFORMANCE GRAPH

■ Montgomery Global Fund ■ MSCI World Net Total Return Index



### CONTACT DETAILS

#### INVESTORS

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### PORTFOLIO PERFORMANCE

(to 31 December 2019, after all fees)

	INCOME	CAPITAL GROWTH	MONTGOMERY GLOBAL FUND	MSCI WORLD NET TOTAL RETURN INDEX <sup>1</sup>	OUT/UNDER PERFORMANCE
1 month	0.00%	0.31%	<b>0.31%</b>	-0.89%	1.20%
3 months	0.00%	5.62%	<b>5.62%</b>	4.16%	1.46%
6 months	0.00%	5.68%	<b>5.68%</b>	8.95%	-3.27%
12 months	13.87%	11.38%	<b>25.25%</b>	27.86%	-2.61%
3 years (p.a)	9.56%	4.48%	<b>14.04%</b>	13.69%	0.35%
Since inception <sup>2</sup>	35.18%	30.49%	<b>65.67%</b>	60.47%	5.20%
Compound annual return (since inception) <sup>2</sup>	6.93%	4.94%	<b>11.87%</b>	11.08%	0.79%

1) In Australian dollars 2) Inception: 1 July 2015

## FUND COMMENTARY

In the month of December, the Montgomery Global Fund (the Fund) returned 0.31 per cent, net of fees. This compared favourably to the MSCI World Total Return Index in Australian dollar terms (the Benchmark) which declined by 0.89 per cent. Since inception, the Fund has increased by 65.67 per cent, net of fees. Regular readers will know this return was delivered with an average cash holding of 17.5 per cent. Over the same period, the Benchmark – which naturally carries zero cash – delivered a return of 60.47 per cent.

In calendar year 2019, the Fund increased by 25.25 per cent, net of fees. This is a strong absolute return, though underperformed the Benchmark that has become the standard of our industry, which increased by 27.86 per cent. It is important to note, however, two characteristics of the Benchmark: (i) the Benchmark is disproportionately weighted towards the US; and (ii) disproportionately underweight Asia.

As can be observed by the chart on the next page, in 2019, North America (we represent by the S&P 500) performed relatively better; and Asia (we represent by the Hang Seng Index) performed relatively poorer than other regions. Readers will know that the Fund has meaningful exposure to Asia which acted as a headwind to our relative performance this year.

Interestingly, upon constructing a World Index that reflects the geographical mix of the Fund each month, and adjusting for the drag created by our cash holdings, the underperformance in 2019 completely disappears.

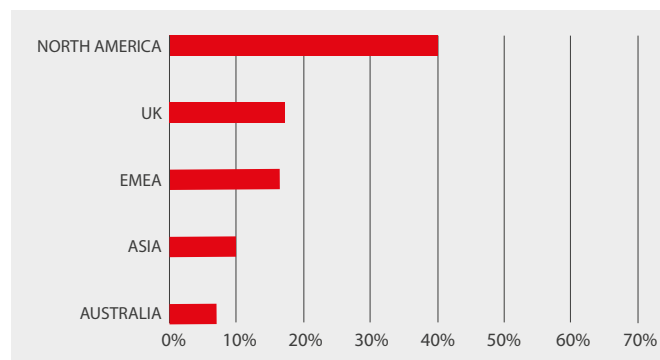
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## TOP COMPLETED HOLDINGS\* (TCH) (at 31 December 2019, out of 22 holdings)

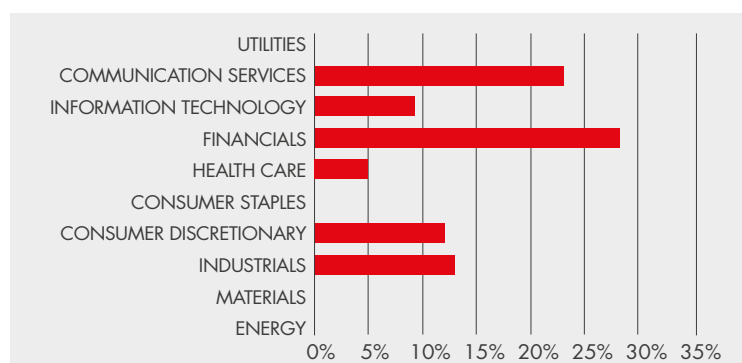
COMPANY NAME	COUNTRY OF DOMICILE	MARKET CAP (\$USDM)	WEIGHT (%)
Vivendi	FR	34,261	6.7
St James's Place	GB	8,163	5.8
Prudential	GB	49,433	5.7
Facebook	US	585,321	5.5
Airbus	FR	114,471	5.4
Floor & Decor	US	5,135	5.2
Microsoft	US	1,203,063	5.0
Unitedhealth	US	278,521	5.0
Alphabet	US	922,891	5.0
Alibaba	CN	569,006	5.0
<b>PORTFOLIO MEDIAN</b>		<b>58,083</b>	<b>4.2</b>
<b>Total equity weighting</b>			<b>90.1</b>
<b>Total cash weighting</b>			<b>9.9</b>

\*Top Completed Holdings are businesses we own but are not actively buying or selling at the time of writing.

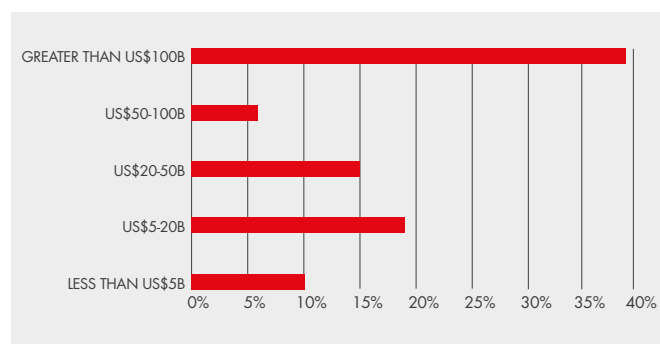
## GEOGRAPHIC - COUNTRY OF DOMICILE



## GICS SECTOR INDUSTRY EXPOSURE



## MARKET CAPITALISATION EXPOSURE

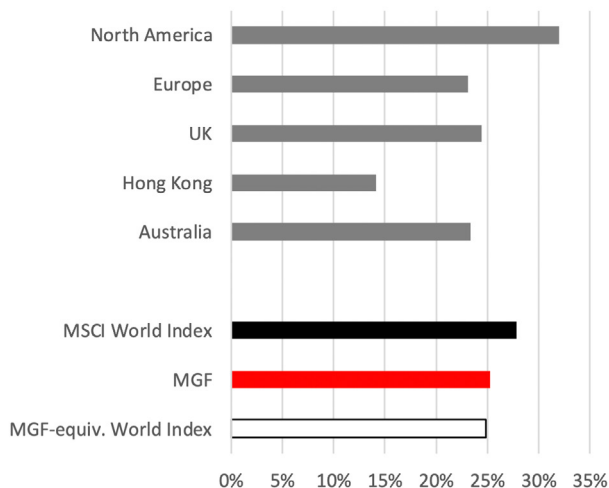


**PLATFORMS WE ARE ON:** Netwealth IDPS ⇌ Netwealth Super ⇌ BT Panorama ⇌ BT Wrap ⇌ Powerwrap ⇌ Macquarie Wrap ⇌ HUB24 ⇌ Asgard  
Colonial FirstWrap ⇌ Ausmaq ⇌ uXchange

#Portfolio Performance is calculated after fees and costs, including the investment management fee and performance fee, but excludes the buy/sell spread. All returns are on a pre-tax basis. This report was prepared by MGIM Pty Ltd, (ACN 604 878 533) AFSL 516 942 the investment manager of the Montgomery Global Fund (ARSN: 604 883 418). The responsible entity of the Fund is Fundhost Limited (ABN 69 092 517 087) (AFSL No: 233 045) (Fundhost). This document has been prepared for the purpose of providing general information, without taking account your particular objectives, financial circumstances or needs. You should obtain and consider a copy of the Product Disclosure Statement (PDS) relating to the Fund before making a decision to invest. Available here: <https://fundhost.com.au/fund/montgomery-global-fund/>. While the information in this document has been prepared with all reasonable care, neither Fundhost nor Montgomery makes any representation or warranty as to the accuracy or completeness of any statement in this document including any forecasts. Neither Fundhost nor Montgomery guarantees the performance of the Fund or the repayment of any investor's capital. To the extent permitted by law, neither Fundhost nor Montgomery, including their employees, consultants, advisers, officers or authorised representatives, are liable for any loss or damage arising as a result of reliance placed on the contents of this document. Past performance is not indicative of future performance.

## Relative performance analysis

Total return for calendar 2019



Source: MGI; Bloomberg

As we reflect on the calendar year of 2019, we must admit that we found the year to be quite challenging. This may sound surprising, given that equities performed well, and the net returns we delivered over the period were more than adequate. In our view, however, 2019 was a year characterised by a wide range of alternative histories. That is to say that, while equities did well over the period – thereby making equity investing look rather easy, there were some very different-looking scenarios that could have played out just as easily. Positioning the portfolio to protect against these scenarios, for those that did, likely resulted in some underperformance relative to peers that did not. We also had to risk manage a number of company-specific curve balls during the year as well. This comes with the territory of managing a high-conviction portfolio, though this year our portfolio management skills were tested more than usual.

Upon closing out 2019 and commencing 2020 we believe the state of the world, as it pertains to equity investors, can be summarised as follows. Global monetary policies generally recommenced easing during the year and the balance sheet of the Federal Reserve has started to expand again. Global disinflation persists and after the monetary-tightening-induced mini-meltdown of Q4 in 2018, there will be no rush to reduce monetary stimulus anytime soon by any major central bank.

As many readers know, we spent much of 2019 considering and analysing the drivers of long-term interest rates. Our analysis, which is available to read at [montaka.com](http://montaka.com) in our [two-part whitepaper](#), titled *Low Rates, Assets Inflate*, suggests that the drivers of long-term interest rates are more structural in nature, not cyclical; and more global in nature, not local. Through this lens, perhaps we should not be surprised that the US was unable to normalise its monetary policy settings over recent years. And it raises the genuine prospect for a lower-for-much-longer global interest rate scenario. For certain global businesses that can deliver sustained, structural growth over many years – such as those that we seek to own, such an environment will be very kind to the value of their equity over time.

The heat has come out of President Trump's trade dispute with China, for now. The protectionist measures that were put in place over the course of the last two years have impaired economic growth in both China and the US – the world's two largest economies. It is likely that, as President Trump is now just 10 months out from a general election, he will do everything in his power to strengthen the economy (and US equity markets) to boost his chance of re-election. (We believe it is unlikely he will be removed from office by the Senate following his recent impeachment).

The relationship between the Chinese governments and those governments in much of the western world is becoming increasingly adversarial and abrasive. This dynamic represents a significant and ongoing long-term risk for all global investors. In the US, for example, while Trump might favour a truce with China over the coming months, the Congress is reportedly working on veto-proof legislation that would punish China over its treatment of ethnic Uighur Muslims. This would come just months after it approved the Hong Kong Human Rights and Democracy Act, a move that shows definitive US government support for the freedoms of the people of Hong Kong. Meanwhile, US national security officials have recommenced lobbying the UK to refuse access for China's Huawei Technologies to its 5G telecommunications networks.

Not surprisingly to readers, the Chinese government does not appreciate the pressure building from around the western world. Perhaps this helps explain why Russia, China and Iran launched their first ever joint naval exercise in the Gulf of Oman in late December. It really does appear that the Chinese government is seeking to build a genuine counterforce against the US-led western alliances. And God forbid this leads to a clash of forces one day.

The above paragraph was written the day before the US military assassinated Iranian General Qassem Soleimani. Days later, as readers will know, Iran fired ballistic missiles at two US military bases in Iraq. Such an extraordinary escalation within days shows us just how quickly the world is changing.

On a more positive note, after more than three years of political uncertainty, an overwhelming victory in the UK general election by Boris Johnson's Conservative Party lays a path forward for Brexit. And it does a lot more than that. It also gives the new Prime Minister a mandate to reform and fiscally stimulate the UK economy – marking one of the most exciting global investment opportunities in 2020, in our view, and one for which we are well prepared.

\* \* \*

We recently spoke at the Sohn Hearts and Minds conference at the Opera House in Sydney. For those who are interested, we have [posted a video](#) of the presentation on our website. The idea we presented from our long portfolio was Floor & Decor. This was a name that we discovered at a conference in California in 2018 and, upon completing our investment process, added the business to our portfolio three months thereafter. George Hadjia provides a more detailed case study of our investment thesis.

**CASE STUDY: FLOOR & DECOR (NYSE: FND)**

One of the all-time great retail success stories is The Home Depot (NYSE: HD). Its success highlights the extraordinary value that can be generated when a retail store concept gains consumer traction and underpins an ambitious store rollout strategy. HD expanded from around 100 stores in 1988, to approximately 2,300 stores today and, over the same period, its share price went from a little over \$1 to around \$230 today.

**The Home Depot — A multi-year compounder**

Stock price, US\$/share



Source: The Home Depot; Bloomberg

We believe there is a similar retailer out there today, also starting with around 100 stores that has a promising store rollout journey ahead of it. That company is called Floor & Decor (NYSE: FND).

**An advantaged model**

Founded in 2000 and run by CEO Tom Taylor (who, incidentally, was instrumental in the success of The Home Depot for more than 20 years), FND sells hard surface flooring such as tiles, wood, luxury vinyl plank, and related accessories. While this sounds dull, the company's financial performance has been anything but, with FND chalking up double-digit same store sales growth in eight of the past 10 years. It is the way in which FND sells its mostly private label flooring products which is unique and represents the crux of the company's advantage vis-a-vis its competitors.

Sam Walton, the founder of Walmart, once opined: "Ignore the conventional wisdom. If everybody else is doing it one way, there's a good chance you can find your niche by going in exactly the opposite direction". FND is the embodiment of Walton's counsel, boasting enormous 75,000 square foot stores that dwarf the roughly 3,000 to 5,000 square feet of space dedicated to hard surface flooring within big-box home improvement chains such as The Home Depot and Lowe's.

Having larger stores allows FND to display more flooring SKUs than peers (~1,800+ flooring SKUs), but more importantly the company has

job-ready quantities of those SKUs in-stock: FND has ~1,500 flooring SKUs in-stock, an estimated 4x the in-stock SKUs of the big-box chains, and in some cases 75x the in-stock SKUs of other specialty flooring retailers. This has positioned FND as the supply house for the Pro customer (i.e. professional installers and commercial businesses), with high in-stocks obviating the sometimes one to two-week order wait times if a product is out-of-stock.

This is critical for Pros who are managing their own project timelines in which delays are costly. By having inventory in-stock, FND de-risks the job materials purchase for the Pro. And these Pro customers comprise around 60 per cent of FND's sales, a relatively higher exposure than for peers. This is positive given the purchase frequency of Pro customers is many multiples of that of a do-it-yourself customer. Furthermore, FND's Pro Premier Rewards loyalty program drives further stickiness in purchasing behaviour for the Pros.

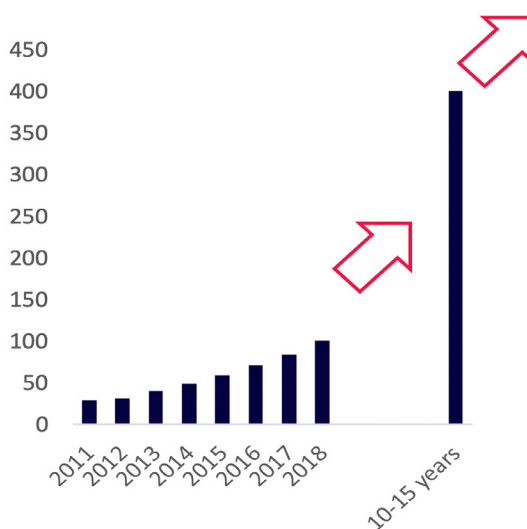
FND operates as the industry price leader, successfully effecting an everyday-low-price (EDLP) strategy. It can lead the industry due to its low-cost procurement model: FND directly sources product from the manufacturer, cutting out middlemen such as brokers and distributors. By combining the lowest prices with a superior retail experience, FND has been gaining market share in the hard surface flooring category. Furthermore, we believe that, with just an 8 per cent market share currently, FND has ample opportunity for further market share gains – particularly from the roughly one-third of the hard surface flooring market represented by small independent retailers. These independent flooring retailers lack the same scale and sourcing sophistication as FND and are therefore unable to match FND's prices. Consider that FND's products retail at a price point 30-50 per cent lower than that of an independent.

**Enormous store expansion opportunity**

FND's business model is impressive and the potential for significant shareholder value creation is amplified by the store rollout runway. FND currently has 113 warehouse-format stores, but there is a credible path to more than 400 stores over the next 10 to 15 years.

**Floor & Decor — store roll out trajectory**

Number of stores



Source: Floor & Decor

FND is opening new stores equivalent to circa 20 per cent of its existing store base each year. Ironically, this enormous store unit growth also happens to be contributing to the market’s misunderstanding of FND’s earnings power.

**The market is underestimating FND’s earnings power**

New stores naturally take time to reach maturity and ramp up their profit margins. Said another way, new stores are initially dilutive for FND’s profitability and have a depressing effect on consolidated margins. Mature stores, on the other hand, operate at 15-20 per cent EBITDA margins, compared to an 11 per cent EBITDA margin for FND overall. This difference is driven by the fact that more than half the existing store base today is less than three years old. While these are lowly profitable stores today, they will be highly profitable stores in the future.

FND is a well-run company in the hard surface flooring space with a “category killer” business model. In a digitally-disrupted world in which many retailers are shuttering stores and filing for bankruptcy, FND represents a rare opportunity to participate in a compelling retail store rollout story. Unlike other retail goods, the bulky nature of flooring products, combined with regulations around moving these materials, makes it unlikely that Amazon or other internet upstarts will encroach on FND’s growth. FND has been a standout performer for Montaka investors in 2019, and we believe the company has the potential to continue to compound in value for many years to come.

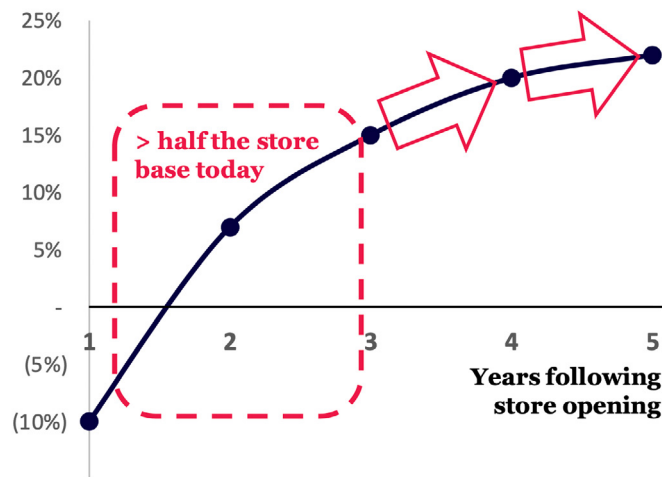
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One of the key differentiating attributes of this Fund is its ability and willingness to invest across the size spectrum. Said another way, we own businesses worth just north of a billion dollars, all the way up to businesses that are worth just north of a trillion dollars. We are able to do this because we are a relatively smaller, boutique global investment firm. And we choose to do this on our belief that, logically, investment opportunities will present themselves, from time to time, in businesses small, medium and large. So why should we limit ourselves by investing only in one pocket of the market? After all, the key principals of our business only invest in our own global equity funds.

The chart below illustrates this concept quite well. Every dot in the chart represents a business owned in our long portfolio at year end. On the vertical axis is the market capitalisation of the business (shown on a logarithmic scale); and on the horizontal axis is the size of the position in the portfolio. Dots across the page demonstrates our flexibility and willingness to invest across the size spectrum. So while many of our larger names, such as Microsoft, Apple or Alibaba might be owned by many fund managers, it is the smaller and mid-sized names that bring genuine complementarity to your existing portfolio.

**Floor & Decor — Store Profit Margin**

Percent of revenue



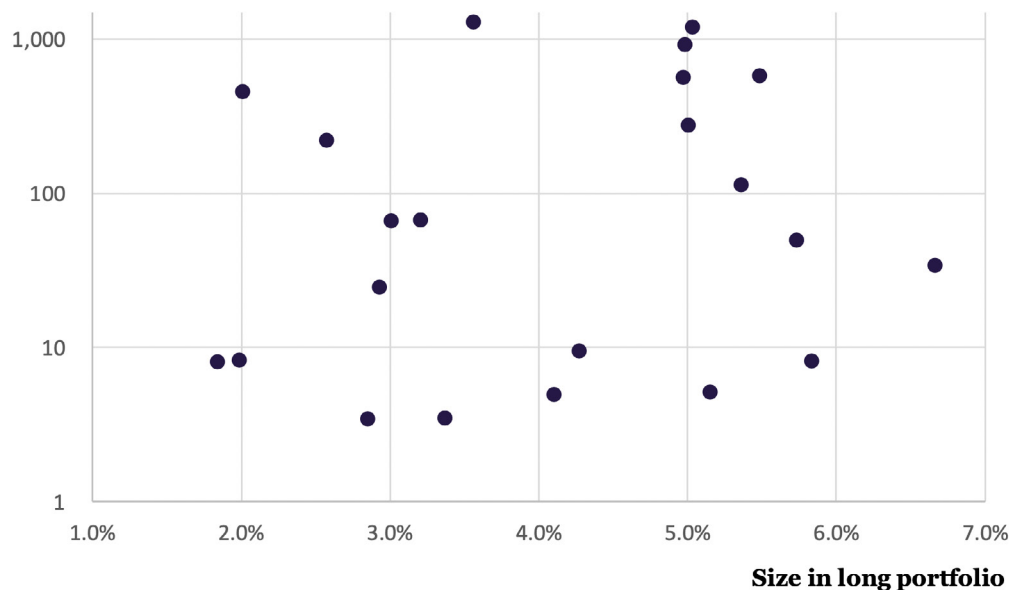
Source: Floor & Decor; MGI estimates



**Size of businesses we own**

Market cap, US\$ Billion (log scale)

● = Portfolio position



Source: MGI

\* \* \*

On a cool Saturday morning in Vienna in October, a 35-year-old by the name of Eliud Kipchoge became the first person in history to run a full marathon in less than two hours. Runners out there will know just how extraordinary this is, averaging 2:51 min/km (or 4:34 min/mile). It's a source of great inspiration for the rest of us mere mortals who are seeking continual self-improvement.

That same month, the team at Montaka Global Investments undertook a 360-degree anonymous feedback program to enable ongoing personal and professional development; and enhance team communication and effectiveness. While far less impressive than running a sub-two-hour marathon, this initiative reflects our ongoing commitment to the continual improvement of both the self and the collective. And anyone who has worked in our industry will surely appreciate just how unusual such a 360-degree feedback program is, given the discomfort that is sometimes associated with receiving external feedback.

We would once again like to take this opportunity to thank each and every one of our investors for the ongoing trust you place in us to preserve and compound your wealth, alongside our own wealth. As we have said in the past, it is a responsibility and a privilege we treasure. We are committed to working with complete discipline and integrity to implement our investment process day in and day out.

One final point in closing. This letter is unfortunately being written at a time during which many parts of Australia are literally on fire. Many have lost their homes, their livestock and for some, even their lives. We are thinking of those affected by the fires and have donated in their support. We wish any readers who have been affected all the best and hope that all can stay safe over this intense fire season.

Sincerely,



Andrew Macken  
Chief Investment Officer