The Montgomery Fund employs a bottom-up, value style to invest and manage the equity portfolio. The Fund has the ability to retain a cash weighting, with a ‘soft’ 30 per cent limit, while seeking to identify companies that satisfy three main points of criteria. For inclusion in The Montgomery Fund, a business must be of premium quality, display bright prospects for earnings and growth in intrinsic value, and be available to purchase at a reasonable price.

Pursuant to this objective, The Fund aims to deliver superior positive returns where suitable investment opportunities are abundant, and to preserve capital through cash allocations where suitable investment opportunities are scarce.

INVESTMENT MANAGER
Montgomery Investment Management Pty Ltd

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

BENCHMARK
The S&P/ASX 300 Accumulation Index

FUND CONSTRUCTION
The Fund’s All Cap portfolio will typically comprise 20-40 high-conviction stocks listed on the ASX and/or NZSX. Cash typically ranges from 0%-30%, but up to 50% in extreme situations.

APIR
FHT0030AU

RECOMMENDED INVESTMENT TIMEFRAME
5 years

MINIMUM INITIAL INVESTMENT
$25,000

INCEPTION DATE
17 AUGUST 2012

FUND SIZE
$666.6M

MANAGEMENT FEE
1.36% per annum, which includes a management fee of 1.18% per annum. Both figures are GST inclusive and net of RITC.

PERFORMANCE FEES
15.38% of the total return of The Fund that is in excess of the Index. No performance fee is payable until any previous periods of underperformance has been made up.

APPLICATION & REDEMPTION PRICES
montinvest.com/tmf

INVESTORS
Dean Curnow
t 02 8046 5019
e dcurnow@montinvest.com

ADVISERS, RESEARCHERS AND PLATFORMS
Scott Phillips
(NSW, ACT & QLD)
t 02 8046 5005
e sphillips@montinvest.com

David Denby
(VIC, TAS, SA & WA)
t 0455 086 484
e dddenby@montinvest.com

CONTACT DETAILS

PERFORMACE GRAPH
The Montgomery Fund S&P/ASX300 Accum.

$200,000
$180,000
$160,000
$140,000
$120,000
$100,000

17 August 2012 30 June 2014 31 May 2016 30 June 2018

$198,090

$183,710

PORTFOLIO PERFORMANCE
(to 30 June 2018, after all fees)

INCOME
CAPITAL GROWTH

THE MONTGOMERY FUND
S&P/ASX 300 ACCUM. INDEX
OUT/UNDER PERFORMANCE

1 month  7.45% -6.77%  0.68%  3.19% -2.51%
3 months  7.81% -2.35%  5.46%  8.36% -2.90%
6 months  7.55% -4.35%  3.20%  4.27% -1.07%
12 months  9.08%  0.21%  9.29%  13.24% -3.95%
3 years (p.a.)  4.97%  2.34%  7.31%  9.14% -1.83%
5 years (p.a.)  5.63%  3.78%  9.41%  9.99% -0.58%
Since inception#  47.09%  51.00%  98.0%  83.71%  14.38%

Compound annual return (since inception)#

6.80%  5.56%  12.36%  10.92%  1.44%

# 17 August 2012
The June quarter of 2018 saw a return to strength for the Australian equity market, with the S&P/ASX 300 Accumulation Index returning a very healthy 8.36 per cent for the quarter – equivalent to a compound annual return of close to 40 per cent.

Similarly, The Montgomery Fund (The Fund) enjoyed a positive quarter, but as you might expect, The Fund’s significant cash weighting and low-risk orientation saw it trail the broader market, delivering a return for the quarter of 5.46 per cent.

The strongest positive contributors to Fund performance for the quarter included IDP Education, Healthscope – which was the subject of takeover proposals during the quarter, and the recently-established position in Aristocrat Leisure, which was outlined in our last quarterly report.

The largest single negative contributor to relative performance was of course cash, which averaged 23 per cent for the month, and accounted for the majority of the gap between The Fund and its benchmark. However, The Fund was also held back by the performance of some of its health care positions, being Ramsay Health Care and Primary Health Care.

Starting with Ramsay Health Care, in June, Ramsay cut its FY2018 Core EPS guidance to growth of 7 per cent (from 8-10 per cent previously) and announced a non-cash onerous lease provision of A$125 million net of tax in respect of some of its UK sites. The cut to guidance reflected unexpectedly weak trading conditions primarily in its Australian business.

Continued on the next page...

**TOP COMPLETED HOLDINGS* (TCH)**

(at 30 June 2018, out of 28 holdings)

<table>
<thead>
<tr>
<th>COMPANY NAME</th>
<th>RETURN ON EQUITY (%)</th>
<th>NET DEBT/EQUITY (%)</th>
<th>PRICE/EARNINGS (X)</th>
<th>WEIGHT (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aristocrat Leisure</td>
<td>38.7</td>
<td>48.5</td>
<td>25.0</td>
<td>5.13</td>
</tr>
<tr>
<td>Primary Health Care</td>
<td>4.1</td>
<td>42.0</td>
<td>19.6</td>
<td>3.98</td>
</tr>
<tr>
<td>REA Group</td>
<td>21.4</td>
<td>16.7</td>
<td>41.1</td>
<td>3.88</td>
</tr>
<tr>
<td>Pendal Group</td>
<td>23.5</td>
<td>-24.3</td>
<td>15.6</td>
<td>3.83</td>
</tr>
<tr>
<td>Spark New Zealand</td>
<td>24.6</td>
<td>51.1</td>
<td>17.4</td>
<td>3.78</td>
</tr>
<tr>
<td>Trade Me Group</td>
<td>13.1</td>
<td>11.5</td>
<td>19.0</td>
<td>3.58</td>
</tr>
<tr>
<td>Woolworths Group</td>
<td>16.3</td>
<td>21.5</td>
<td>23.5</td>
<td>3.56</td>
</tr>
<tr>
<td>Resmed</td>
<td>22.8</td>
<td>13.1</td>
<td>28.5</td>
<td>3.48</td>
</tr>
<tr>
<td>Westpac Banking Corp</td>
<td>13.4</td>
<td>N/A</td>
<td>11.8</td>
<td>3.44</td>
</tr>
<tr>
<td>Seek</td>
<td>17.5</td>
<td>11.8</td>
<td>34.6</td>
<td>3.16</td>
</tr>
<tr>
<td><strong>TCH AVERAGE</strong></td>
<td>19.5</td>
<td>21.3</td>
<td>23.6</td>
<td>74.8</td>
</tr>
<tr>
<td><strong>MARKET AVERAGE</strong></td>
<td>15.9</td>
<td>67.9</td>
<td>20.3</td>
<td>25.2</td>
</tr>
</tbody>
</table>

Total equity weighting 74.8
Total cash weighting 25.2

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

**MARKET CAPITALISATION EXPOSURE**

<table>
<thead>
<tr>
<th>MARKET CAPITALISATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 50</td>
</tr>
<tr>
<td>Top 100 ex. Top 50</td>
</tr>
<tr>
<td>Top 300 ex. Top 100</td>
</tr>
<tr>
<td>Outside top 300</td>
</tr>
</tbody>
</table>

**INDUSTRY EXPOSURE**

<table>
<thead>
<tr>
<th>INDUSTRY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
</tr>
<tr>
<td>Consumer Staples</td>
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<tr>
<td>Energy</td>
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<tr>
<td>Financials</td>
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<tr>
<td>Health Care</td>
</tr>
<tr>
<td>Industrials</td>
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<tr>
<td>Information Technology</td>
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<tr>
<td>Materials</td>
</tr>
<tr>
<td>Telecommunication Services</td>
</tr>
<tr>
<td>Services</td>
</tr>
<tr>
<td>Utilities</td>
</tr>
<tr>
<td>Real Estate</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>WEIGHT</th>
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<tbody>
<tr>
<td>0%</td>
</tr>
<tr>
<td>10%</td>
</tr>
<tr>
<td>20%</td>
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<tr>
<td>30%</td>
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<tr>
<td>40%</td>
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<tr>
<td>50%</td>
</tr>
<tr>
<td>60%</td>
</tr>
<tr>
<td>70%</td>
</tr>
<tr>
<td>80%</td>
</tr>
</tbody>
</table>

*Top Completed Holdings are businesses we own but are not actively buying or selling at the time of writing.
During the month we have closely reviewed our investment thesis and expectations for Ramsay and have revised our thinking somewhat. We continue to believe that Ramsay is a very high-quality business with strong long-term growth prospects but have reduced our valuation and level of conviction in the holding. In particular, we believe that steady growth in the cost of healthcare and private health insurance in the context of subdued wages growth has resulted in affordability pressures that will continue to impact Ramsay’s earnings prospects for some time to come by driving volumes towards the public hospital system.

We anticipate that the public system will not be able to sustain these trends indefinitely, and that government intervention to address this will follow, but until we see evidence of this happening, we are inclined to be more cautious. While we see long term value as attractive and we remain holders, we have reduced the position size for the time being.

In the case of Primary Health Care, a sudden share price decline in June followed the publication of a UBS research report with a “sell” recommendation, where UBS had previously maintained a “buy” recommendation. Interestingly, this change in recommendation did not reflect a change of heart of the part of the UBS analyst, but rather a change to the UBS team. The previous analyst, with a positive view, left UBS to join an independent research house and was replaced by an analyst from another investment bank, but one with a negative view.

As such the change in recommendation did not represent “new” insight. However, following these developments, we met with company management and with both analysts and reviewed our investment thesis. Following this work, we remain comfortable with the long-term prospects for Primary, and are confident that management has a clear plan to improve the performance of the business. While it may take some time for this performance improvement to materialise, we are comfortable maintaining the position.

Portfolio Changes

There were a number of significant changes to The Fund’s portfolio during the quarter. New positions were established in Telstra, National Australia Bank and Link Administration Holdings, while a position in New Zealand fixed network owner, Chorus, was sold.

Telstra is a business that The Fund has never previously owned (and indeed is one we have been somewhat critical of), but which we are now happy to hold, albeit at a limited position size. Our reasons for taking this position are set out in some detail in the “business in focus” section of this report.

In the case of National Australia Bank, we note that Australian bank stocks have been under significant pressure for most of the last year, and while there are good reasons for this, the value equation has improved somewhat as a result. While there are certainly risks to the banks, the improving trade-off between risk and return has led us to increase slightly our exposure to them, via a new position in NAB.

In the case of Link, we took a position opportunistically in May, when the share price declined sharply following the announcement of proposed regulatory changes. We have previously examined Link and saw it as a high-quality business, but one whose valuation had been a little too demanding. Following the price decline in May our assessment was that the market had overreacted to the proposed regulatory changes, and that valuation had become sufficiently attractive to warrant establishing a position.

Finally, in the case of Chorus, we determined that our original investment thesis had substantially been realised, and that future potential gains did not warrant the risk of continuing to hold the position.

Fund Positioning

As many investors will know, a cornerstone of The Fund’s approach is preservation of capital. The Fund aims to deliver better returns than the broader equity market but, importantly, aims to do this with a lower level of risk. While it is nice to beat the market when prices are rising steadily, we believe it is more important to “beat” the market when conditions become challenging. The Fund seeks to provide a measure of shelter from the storms that periodically wreak havoc on equity prices, and the portfolio is structured to do relatively well when prices fall. We do this because it is at these times that good long-term opportunities can emerge, and it is helpful to preserve the ability to capture them when they do.

Accordingly, The Fund holds cash, and when equity prices become stretched it holds relatively large amounts of cash. This is where we are today, with The Fund towards the high end of its normal 0-30 per cent cash range. Indeed, this is where we have been for an extended period. In addition, the securities held in The Fund are chosen in part for their ability to weather difficult conditions. This generally means holding a portfolio with modest aggregate financial or other fixed leverage and limited sensitivity to economic conditions. Because of these structural features, The Fund is more likely to trail the market when times are buoyant, but beat the market when times are challenging.

The continued strength of the Australian equity market makes it increasingly difficult to find high quality businesses trading at attractive prices, and after reducing its cash holdings slightly in the early part of the quarter, The Fund finishes the quarter with its cash weighting in the mid-20s.

The largest sectoral exposures currently in The Fund are financials, which has increased slightly to make up around 21.5 per cent of Fund assets, and consumer discretionary, which represents close to 15 per cent of Fund assets and where Aristocrat Leisure is the largest holding. The Fund’s health care exposure has declined slightly to around 13 per cent, in part driven by a reduction in the Ramsay Health Care position.
Business in Focus – Telstra

As noted above, during the quarter The Fund established a position in Telstra – a business The Fund has never owned before.

Readers will be very familiar with the travails of Telstra, which has been one of the poorest performing stocks in the S&P/ASX200 Index over several years. A lot of attention has been given to the headwinds facing the company, which include the earnings “hole” left by the transition to the nbn, pressure on mobile telephony pricing due to vigorous competition, and the prospect for further cuts to the dividend.

We don’t disagree with any of these headwinds and believe that Telstra will continue to face challenges. Indeed, we believe it is highly likely that the dividend will need to be cut further as earnings decline for several years to come. However, the investment question is not whether the headwinds are real – it is whether the headwinds are now fully reflected in the Telstra share price, or indeed more than fully reflected.

Our assessment is that the known headwinds are now fully incorporated into Telstra’s market value, but that there may be some sources of potential upside that are yet to be fully appreciated. The key elements of our thinking here are as follows:

• Mobile telephony, which represents the bulk of Telstra’s value, is a scale game. The largest players in a market should be able to earn a disproportionate share of total industry profitability, while smaller players struggle to earn satisfactory returns. Telstra is by some margin the largest player in Australia, holding a market position that is almost impossible for others to replicate.

• However, owing in part to its legacy as monopoly fixed line provider, Telstra carries an inflated cost base, and needs to become much more efficient to realise its potential. We believe that while Telstra’s market position is almost impossible for others to replicate, there is nothing preventing Telstra from achieving an efficient cost structure, and it is clearly heading in this direction. It will take time and effort, but we expect that the market will demand that Telstra achieve this outcome, and if current management is unable to execute, management change will follow.

• Telstra recently announced significant increases to its productivity improvement targets, and we believe that management understands clearly what is needed. While execution is still to be delivered, Telstra is clearly headed in the right direction on this.

• In respect of the nbn earnings hole, we believe that over time, fixed line economics for resellers like Telstra will improve. Currently, the high wholesale charges imposed by NBN Co make it difficult for resellers to earn satisfactory margins, and we believe that this may be unsustainable. Once the nbn is fully rolled out and customers have made a choice as to their provider, we think that industry focus may shift from retaining customers at all costs, to earning a more satisfactory return. In Telstra’s case, economics could improve through less aggressive discounting by resellers, through reductions in NBN Co’s wholesale pricing, or though wireless bypass utilising 5G.

• Finally, we believe that 5G represents a significant growth opportunity, particularly for mobile network operators with the capacity to invest early in network quality and coverage. Over time, we anticipate strong growth in the number of devices connected to the mobile network, including things like sensors, tracking devices, autonomous vehicles and a host of other connected devices as part of the “Internet of Things”. We believe this growth will be facilitated by the step change in performance made possible by 5G, combined with increasing demand for the data needed to drive growth in automation, robotics and artificial intelligence applications.

We do however, acknowledge, that these opportunities will take some time to be realised, and with Telstra earnings set to decline in the near term we may be too early on this investment. Nonetheless, we believe that a value case exists today, and are happy to hold a modest position with a view to increasing it where justified by the value/risk trade-off.

Final Distribution

At the end of the June The Fund paid a distribution of 1 1.255 cents per unit, and so after ending the 2018 financial year with a unit price of $1.5208 per unit, we commence the 2019 financial year with a unit price of $1.4082 per unit.

We will shortly send out to unit holders The Fund’s annual letter, which will provide additional commentary on the performance of The Fund for the full year, as well as a perspective on the market more generally.