THE MONTGOMERY FUND

INVESTMENT REPORT & FACT SHEET

FUND OVERVIEW

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.

FUND FACTS

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
$617.5M

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

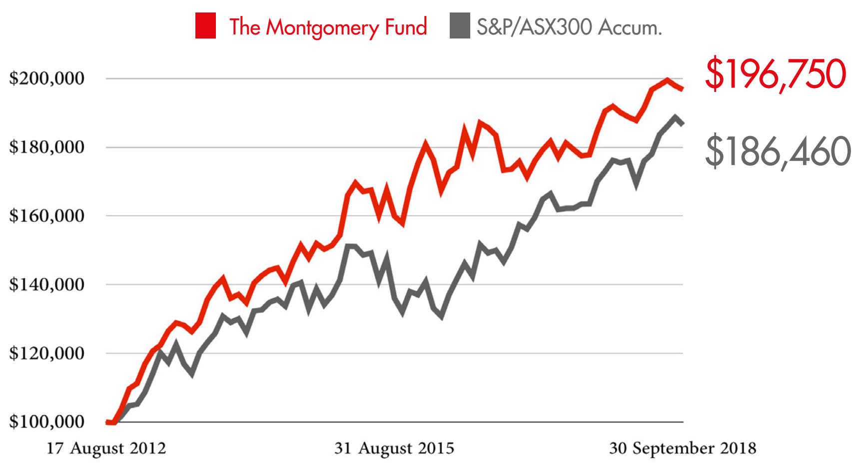
FINANCIAL YEAR RETURNS

FINANCIAL YEAR	THE MONTGOMERY FUND	S&P/ASX 300 ACCUM. INDEX
2013*	26.3%	14.1%
2014	11.6%	17.3%
2015	13.7%	5.6%
2016	11.2%	0.9%
2017	1.7%	13.8%
2018	9.3%	13.2%
Since Inception**	11.7%	10.7%

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

**Compound annual returns

PERFORMANCE GRAPH



PORTFOLIO PERFORMANCE

(to 30 September 2018, after all fees)

	INCOME	CAPITAL GROWTH	THE MONTGOMERY FUND	S&P/ASX 300 ACCUM. INDEX	OUT/UNDER PERFORMANCE
1 month	0.00%	-0.59%	-0.59%	-1.19%	0.60%
3 months	0.00%	-0.67%	-0.67%	1.50%	-2.17%
6 months	7.81%	-3.06%	4.75%	9.99%	-5.24%
12 months	9.32%	1.34%	10.66%	14.03%	-3.37%
3 years (p.a.)	5.46%	2.14%	7.60%	12.17%	-4.57%
5 years (p.a.)	5.44%	1.72%	7.16%	8.19%	-1.03%
Since inception#	47.09%	49.66%	96.75%	86.46%	10.29%
Compound annual return (since inception)#	6.51%	5.18%	11.69%	10.72%	0.97%

\# 17 August 2012

FUND COMMENTARY

After a strong June quarter, the September quarter of 2018 saw a moderation of growth for the Australian equity market, with the S&P/ASX 300 Accumulation Index returning a subdued, but still positive 1.5 per cent. In comparison, The Montgomery Fund (The Fund) delivered a small negative return of 0.67 per cent.

Most of The Fund's portfolio companies delivered satisfactory positive returns during the quarter. However, one holding, Speedcast Limited, delivered a negative surprise during reporting season, pulling down the overall result for the quarter.

As we outlined in the August monthly update, Speedcast's reported half year results fell short of expectations, and the picture was further complicated by the announcement of a significant acquisition. The market's response was harsh, with Speedcast shares losing almost 40 per cent in a single trading day.

Following the announcement, we studied in some detail the result and the acquisition, and met with Speedcast management on several occasions. These investigations led us to conclude that the market's response was unduly harsh relative to the underlying facts, and we increased the position slightly in the wake of the price decline. The Speedcast share price has been volatile since then, reflecting significant uncertainty in the medium-term outlook for the company's earnings. While we estimate the company's value to be above the current share price, we continue to monitor the position dispassionately for any signs of further weakness.

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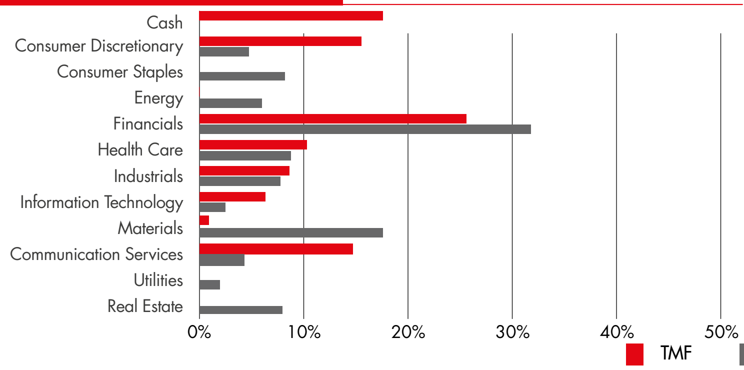
TOP COMPLETED HOLDINGS* (TCH)

(at 30 September 2018, out of 25 holdings)

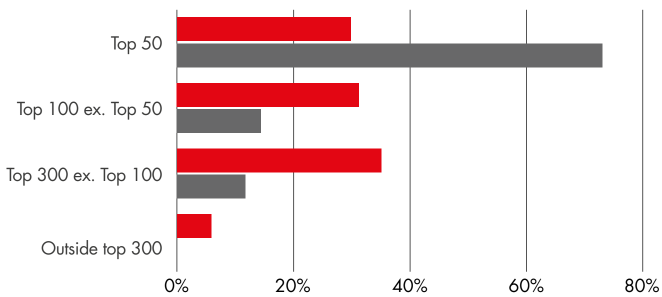
COMPANY NAME	RETURN ON EQUITY (%)	NET DEBT/EQUITY (%)	PRICE/EARNINGS (X)	WEIGHT (%)
Aristocrat Leisure	38.7	48.5	23.2	6.09
Spark New Zealand	24.0	69.6	16.9	5.58
Link Administration Holdings	14.3	29.3	16.4	4.83
Pendal Group	23.5	-24.3	13.7	4.41
National Australia Bank	12.8	N/A	11.6	4.41
Westpac Banking Corp	13.4	N/A	11.6	4.39
Seek	14.9	57.3	34.3	4.24
Primary Health Care	3.9	42.7	18.0	4.16
Steadfast Group	8.0	-15.9	19.6	4.08
Ramsay Health Care	23.2	130.0	20.1	4.08
TCH AVERAGE	17.7	42.1	18.5	
MARKET AVERAGE	17.2	61.1	20.4	
Total equity weighting				82.42
Total cash weighting				17.58

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

INDUSTRY EXPOSURE



MARKET CAPITALISATION EXPOSURE



PLATFORMS WE ARE ON: Ausmaq AMP PortfolioCare AMP Summit AMP Wealthview AMP North Asgard BT Wrap BT Panorama Colonial First Wrap Clearview Wealthsolutions Investment Exchange (IX) Federation Accounts HUB24 Linear Managed Accounts Macquarie Wrap MLC Wrap Navigator Netwealth IPDS Netwealth Super OneVue Powerwrap UBS

The strongest positive contributor to The Fund's performance for the quarter was Telstra – a recent addition to The Fund, and one that we discussed in the June quarter report. One reason for the good performance was the announcement during the quarter of a proposed merger between Vodafone Australia and TPG Telecom. One of the concerns weighing on Tesltra had been the potential for increased competition in mobile telephony upon entry to the market of TPG as the fourth network operator. The proposed merger returns the market to what is arguably a more rational three-player structure, and alleviates some of the prior concerns. We note that TPG appears to have played its hand very well in securing the proposed transaction.

Portfolio Changes

Notable changes to The Fund's portfolio included the exit of several positions where market prices had – in our view – become too far removed from underlying values. These included holdings in Wesfarmers Limited and Woolworths Limited, both of which had enjoyed strong share price gains in recent months, and also Resmed Inc.

It was with some sadness that we exited the position in Resmed. A holding in Resmed has been a core part of the portfolio for most of The Fund's life, and it has delivered strong returns over that time. There is little room however, for sentiment in investing, and we move on in search of better value alternatives.

The Fund also exited a position in Commonwealth Bank during the quarter, with National Australia Bank seen to offer a preferable mix of value and quality. Overall The Fund retains a very low weighting to the major banks compared with its benchmark, the S&P/ASX300 Accumulation Index, and is likely to continue to do so. We note however, that in a generally expensive market, share prices for the major banks now appear to have priced in a fairly pessimistic long-term outlook, and this pessimism appears to offer a reasonable balance of risk and return. It is easy to identify reasons to be wary of the major banks: a softening property market, tighter lending restrictions and the scope for punitive measures to follow the Hayne Royal Commission. However, the important question is whether the market price incorporates too much or too little wariness. This is a question we will continue to examine closely.

There was relatively little to report in terms of new additions to the portfolio during the quarter. One position that was added was in toll road developer and operator, Atlas Arteria (ASX:ALX), most of whose value lies in its 25 per cent stake in APRR – a network of 2,323km of motorway in France. Our analysis of the potential cash flows and balance sheet of ALX led us to conclude that, while it may not be one to shout from the rooftops, it offers a reasonable return with relatively low risk: a profile that has some appeal in the current (generally expensive) market.

Fund Positioning

With the market having moved relatively little since our last quarterly update, it will come as no surprise that The Fund retains a conservative positioning similar to the one it held previously. With markets showing high levels of apparent optimism, The Fund continues to hold a cash weighting towards the high end of its expected range, and portfolio holdings continue to be skewed towards companies that we anticipate will weather difficult conditions well. We note that in some instances during the quarter we saw the opportunity to add to selected positions on price weakness, resulting in a slightly lower cash weighting than held previously.

The largest sectoral exposures in The Fund at the end of the quarter were financials, at around 26 per cent (with banks making up 8.8 per cent of this), and consumer discretionary at around 16.5 per cent (where the largest holding is in Aristocrat Leisure).

Business in Focus – Challenger

Long term investors in The Fund are probably familiar with the Challenger name as it is a business The Fund has had a position (of varying size of) in for several years.

For those of you who are not familiar with the company, Challenger is in the business of structuring, marketing and selling fixed annuities. Fixed annuities are a pretty simple investment instrument that offers an investor a fixed and guaranteed return for a period of time. The main features of a fixed annuity are:

- The cash flow an investor gets is pre-determined and guaranteed. The investor does therefore not take any risk regarding stock market performance or interest rates movements etc. but the only risk they take on is the risk that the annuity provider continues to operate in a sustainable manner. This means that the income from an annuity can be relied upon to meet the basic needs of an investor and other investments can be used to cover other expenditures of more optional type.
- The period of time can be either set to a number of years or be open ended. This means that an annuity provides longevity protection for the investor if they happen to live well beyond their normal life expectancy.
- The annuities can also be structured to either consume the whole capital during the duration of the annuity or with a repayment of part or whole of the principal investment at the end (or with a liquidity option at a set point in time for a lifetime annuity).

These features together mean that a fixed annuity basically provides a very reliable and stable income stream that means that an investor can plan their expenses to match their known income stream. As it also can provide longevity protection, it is an investment instrument that is primarily attractive to people in the retirement phase of life when they have no longer a regular income from working.

We are positive on Challenger for the following reasons:

- New means testing rules for the old age pension will come into effect on the 1st of July 2019. The changes will mean that annuities will be treated more favourable than is currently the case and we believe that this will lead to retirees increasing their allocation to annuities. Currently, only around 4 per cent of the pre-retirement to post-retirement flow goes into annuities which is a very low number in an international comparison.
- The governments Comprehensive Income Products for Retirement (CIPR) review that was released on the 17th of May this year says that super fund trustees have to include an option that offers longevity protection to their members. The government proposed model portfolio included a 25 per cent allocation to annuities as the default option to provide longevity protection, but super fund trustees are free to develop other products that offer similar protection.
- Both of those factors point to increased use of annuities by retirees in the future and together with the underlying growth of more and more baby-boomers reaching retirement age, we believe that the market for annuities will grow substantially in the future. Challenger is currently the clear market leader in Australia in selling annuities with a market share of around 90 per cent and although we believe that the growing market will attract new entrants, Challenger have a clear first mover advantage and should be able to capture a significant portion of the market growth over the coming years.

The share price of Challenger increased strongly up until late 2017 but has since then been coming back a bit and we have recently increased our position on this pullback as we believe that the valuation is now attractive and does not factor in the strong growth we see going forward.