THE MONTGOMERY FUND

Annual Letter to Investors

July 2020

IMPORTANT INFORMATION

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To our Investors:

July 2020

Dear Investors,

The S&P/ASX300 Accumulation Index, which is The Montgomery Fund's benchmark, returned a loss of 7.61 per cent for the 2020 Financial Year, its first loss in eight years.

Pleasingly, The Montgomery Fund (The Fund) outperformed its benchmark index by 2.74 per cent, however The Fund delivered a net loss of 4.87 per cent for the financial year to 30 June 2020 after all fees and expenses. The decline represents The Fund's first-ever negative annual return since its inception in 2012. We always view a loss of capital as disappointing and will endeavour to minimise their occurrences.

Our conservative positioning however served investors well during the COVID-19 crisis sell off in February and March with The Fund delivering outperformance over one, three and six months as well as over one year, two years and three years.

By way of example, for the six months ending 31 March 2020, The Fund's benchmark S&P/ASX300 Accumulation Index returned a loss of 22.86 per cent. The Fund outperformed its benchmark by 7.20 per cent over the same period.

As Figure 1. demonstrates, The Montgomery Fund was positioned as a top quartile fund, or better (each shade of grey represents a quartile), against the comparable peer set in almost all periods to the end of March 2020.

Figure 1: Relative performance to peers

Source: Morningstar

By electing to remain conservatively positioned, we have put some of our cash to work. But we've been very selective about the companies we bought. We remain of the view that the unprecedented circumstances and turbulence in both real-world events and in financial markets have further to play out. And as demonstrated by the Morningstar data opposite, in periods where a correction has occurred, this has served our investors well.

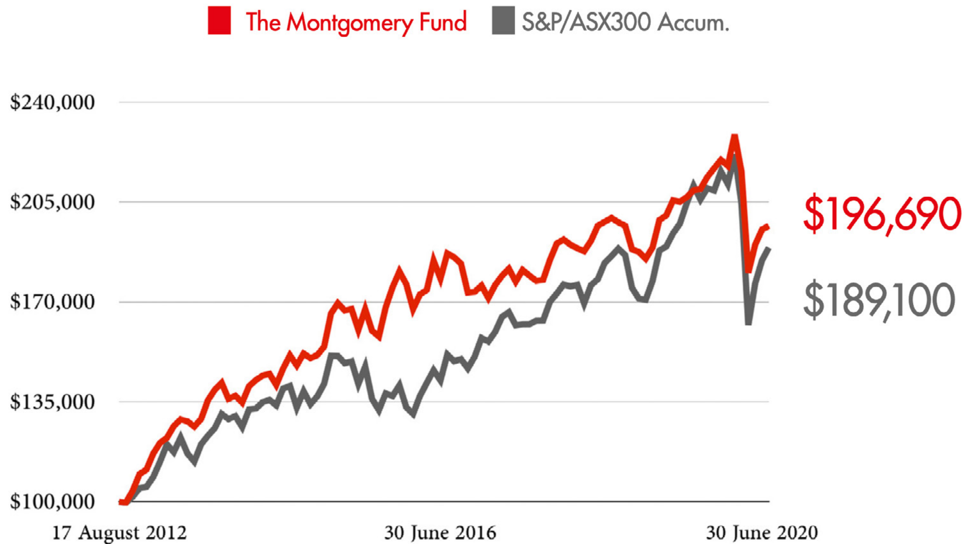
During the year, two changes were made in the investment methodology for The Montgomery Fund. The first change was the de-emphasis of the quantitative element of our process. Our screening tool, which is one of the ways we identify investment candidates, uses Quality, Value and 'Quant' to suggest investment ideas. With Quality and Value not changing very often over the last couple of years, it was the Quant factor that was driving much of the new ideas suggested by the screen.

Fewer and fewer of the candidates being suggested however were passing through our subsequent fundamental research process. It was also the case globally that quantitative strategies themselves were suffering an extended period of under-performance. Indeed, Bloomberg recently reported the world's largest and hitherto most successful quantitative fund manager, Renaissance Technologies "posted double digit declines in three of its quantitative hedge funds..."

The second change naturally followed the first. With Tim Kelley's focus on improving Quant and The Fund's quantitative inputs de-emphasised, Tim was given the role of Head of Quantitative Research and Joseph Kim was moved to the role of Lead Portfolio Manager alongside the existing Co-Portfolio Manager Andreas Lundberg. Joseph's experience as a Portfolio Manager at both Colonial and Ellerston made the decision a relatively easy one. From our perspective, these changes assisted in the relative outperformance for the year to June 30, 2020.

As we do at the start of every annual letter, we set out in the following figures some performance data for The Fund for the period since its inception in August 2012.

Figure 2: The Montgomery Fund Performance Since Inception



Source: Fundhost

Table 1: Annual Performance Information

Period	Returns			Maximum Drawdown		Annualised Volatility	
	The Montgomery Fund	S&P/ASX 300 Accum. Index	Relative Performance	The Montgomery Fund	S&P/ASX 300 Accum. Index	The Montgomery Fund	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%
Since Inception	**+9.0%****	**+8.4%****	**+0.6%****	**+30.2%*****	**+36.2%**	**+12.1%**	**+15.3%**

*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 0.0857 cents per unit. The Fund paid a distribution of 1.5974 cents for the December half year, so the total distribution was 1.683 cents.

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. For the June half of the 2020 financial year, the extraordinary drawdowns in March due to the significant change in outlook for many of our investments necessitated significant rotation, leading to greater realised losses than usual. Proceeds have been reinvested into companies where we see better prospects for long-term returns, and have elected not to crystallise short-term gains during this financial year.

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 2020

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
Total	57.3449

*17 August 2012 to June 2013

Since inception, distributions have totalled 57.3449 cents per unit, which equates to an annual average 7.2 cents per unit or 7.2 per cent per annum on the $1.00/unit price at inception.

The distribution at 30 June 2020 was 0.0857 cents per unit, and so after ending FY 2020 with a unit price of $1.2997, we commence FY 2021 with a unit price of $1.2989.

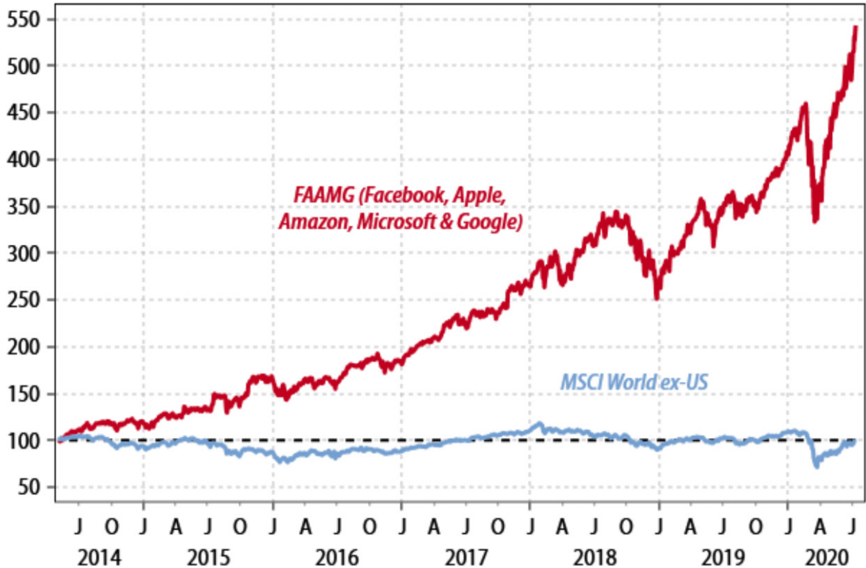
Looking back at the 2020 financial year

The Australian equity market delivered its first negative total return in eight years, with the broader market recording a loss of 7.6 per cent including dividends over the twelve-month period as measured by the S&P/ASX 300 Accumulation Index. Most major global equity markets also delivered negative returns for the year. The main exception was the US, where gains from technology 'megacap' stocks more than offset the negative returns from the rest of the market.

At the time of writing, the US S&P500 is hovering down a couple of per cent for the year, but this observation masks a material divergence between 'megacap' technology stocks and everything else (see Figure 3.). In the absence of six technology stocks – Apple, Google, Facebook, Microsoft, Amazon and Nvidia, the US S&P500 would be down 10.6 per cent year-to-date.

Over the six years illustrated in Figure 3, an index of five 'megacap' technology companies, Facebook, Apple, Amazon, Microsoft and Google, has surged five-fold. The latest and steepest extension of the rally reflects a belief in the benefits to these companies of stay-at-home orders globally. It suggests investors in these companies believe lockdowns and COVID-19 counter-measures will persist for some time. But more worrying is that it also reflects a concerning narrowing in the companies being bet on to benefit from COVID-19 restrictions as well as an alarming increase in the number of part-time and first-time home-based investors and traders.

Figure 3. Divergence between US Megacap Tech and everything else



Source: Gavekal Data/Macrobond

The 2020 financial year can be broken down into two periods. The first eight months, to the peak of the market on 20 February 2020, followed by the COVID-19 driven sell-off and subsequent recovery. The first period was broadly positive for all indices, while only the tech heavy NASDAQ was able to eke out a positive total return during the COVID-19 crisis among the world's major markets.

Importantly, The Fund outperformed during this period despite holding a high level of cash in anticipation of volatility. The Fund then outperformed impressively during the COVID-19 inspired panic, outperforming the benchmark by 5.82 per cent over the two months to 31 March 2020.

Table 3: FY20 total return of major global indices in Australian dollars

			28-Jun-19	20-Feb-20	30-Jun-20	Total Return to 20-Feb-20	Total Return From 20-Feb-20	Total FY20
Americas								
S&P 500 Total Return	USA	SPXT	8,427.1	10,366.5	9,218.7	23.0%	(11.1%)	9.4%
NASDAQ COMP TOTAL RETURN	USA	XCMP	13,342.2	17,329.4	17,234.5	29.9%	(0.5%)	29.2%
Russell 2000 TR Idx	USA	RU20INTR	11,216.5	12,977.7	10,657.3	15.7%	(17.9%)	(5.0%)
S&P/TSX COMPOS TR INDEX	Canada	0000AR	62,298.1	72,702.1	59,631.7	16.7%	(18.0%)	(4.3%)
S&P/BMV Mexico TR	Mexico	INMEXRT	236.9	269.8	180.6	13.9%	(33.1%)	(23.8%)
Europe								
FTSE 100 TR GBP	UK	TUKXG	12,190.6	13,449.0	10,426.4	10.3%	(22.5%)	(14.5%)
CAC 40 GR	France	CACR	24,290.0	26,905.7	22,211.7	10.8%	(17.4%)	(8.6%)
TECDAX PERFORMANCE INDEX	Germany	TDXP	4,659.0	5,323.6	4,819.7	14.3%	(9.5%)	3.5%
FTSE MIB TR	Italy	TFTSEMIB	70,760.9	85,164.4	66,672.4	20.4%	(21.7%)	(5.8%)
IBEX 35 INDEX	Spain	IBEX	14,903.6	16,196.0	11,800.1	8.7%	(27.1%)	(20.8%)
Asia								
Nikkei Total Return Idx	Japan	NKYTR	451.5	513.5	491.9	13.7%	(4.2%)	8.9%
HK HSI Total Return Index HS	Hong Kong	HSI 1	14,873.0	15,531.0	13,468.7	4.4%	(13.3%)	(9.4%)
SHANGHAI TOTAL VAL INDX	China	SHCOVAL	37.9	82.7	55.0	118.0%	(33.5%)	45.0%
FTSE ST STI USD TR	Singapore	TSTIU	7,656.9	7,714.6	6,144.4	0.8%	(20.4%)	(19.8%)
NIFTY 50 TR	India	NIFTYTR	340.1	356.2	279.1	4.7%	(21.7%)	(17.9%)
KOSPI 200 TR	South Korea	KSP2TR	0.4	0.4	0.4	10.4%	(8.2%)	1.3%
S&P/ASX TR 300 INDEX	Australia	ASA52	69,384.8	76,910.4	64,102.1	10.8%	(16.7%)	(7.6%)
S&P/NZX 50 Index Gross	New Zealand	NZSE50FG	10,048.8	11,550.8	10,708.1	14.9%	(7.3%)	6.6%
The Montgomery Fund			1.3813	1.5612	1.3157	13.0%	(15.7%)	(4.9%)

Source: Bloomberg

The eight months to February

The first half of the 2020 financial year was unremarkable. Investors grappled with earnings disappointment in the August 2019 reporting season and trade tensions between the US and China, which limited equity market gains for the most part.

However, this soon gave way to a 'melt up' in equity prices, as the perception of 'lower for longer' bond yields combined with a positive outlook on the US economy lifted risk assets. This helped push equity prices higher in Australia, despite our more challenged economic outlook due to the NSW bushfires and high levels of household leverage.

New concerns were emerging for us as price rises for some companies disengaged from underlying earnings. As one-year forward earnings per share for the major Australian indices declined between June 2020 and December 2020, rising share prices produced rising price-to-earnings multiples.

The expansion of Price-to-Earnings has real world limits. They may expand for a time, but history reveals a tendency for mean-reversion.

Nevertheless, by the end of 2019, it appeared 2020 would be a positive year for equity markets, as downside risks were perceived to be limited given supportive policy stance from Central Banks and firmer footing for the US economy as trade tensions dissipated and unemployment fell to historic lows.

In January, despite alarming news of a new coronavirus spreading through the Chinese province of Wuhan, markets remained complacent. This misplaced complacency combined with our conclusions from an internal project to track Coronavirus testing, infection and death rates globally resulted in Montgomery raising cash across all of its domestic funds.

Only in the last week of February, when it became clear that efforts to contain the outbreak within Wuhan Province had failed did global markets begin collapsing. Fortunately, The Fund had further increased its cash weighting ahead of this sell off.

The COVID-19 months

The world altered in March 2020. As the spread of COVID-19 infections accelerated globally, the actions required to limit the spread of an extremely transmissible pandemic with potentially severe and unknown health consequences, produced legitimate market panic.

Throughout March, it became clear to many others in the market that the lockdown measures required to initially contain the virus's spread would have dramatic economic consequences. Most developed economies – including Australia – came to a stop.

From the peak of the Australian market on the 23 February to the lows precisely one month later, the value of the ASX 300 had fallen a stunning 36 per cent.

This number however conceals the wild volatility experienced. March recorded:

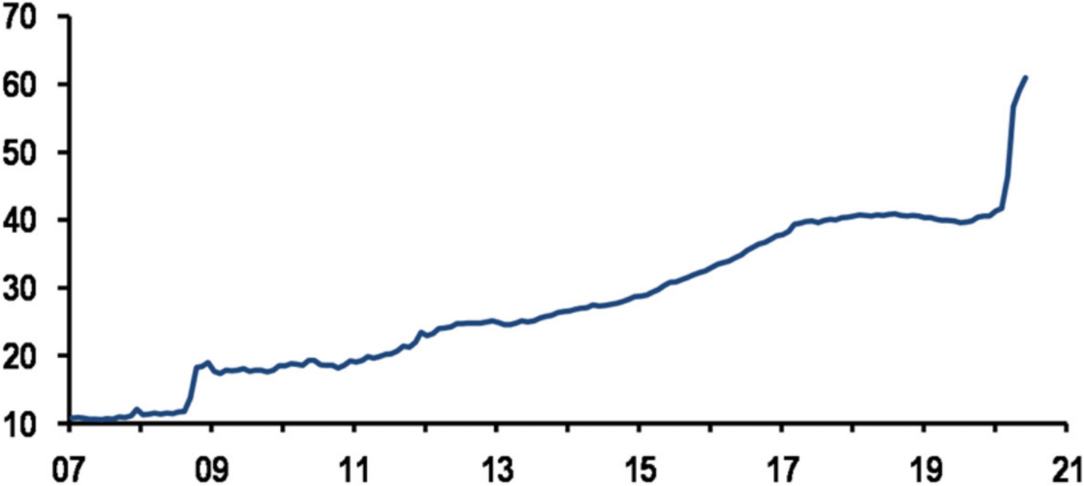
- A 9.5 per cent fall on 16 March, the biggest one-day fall since 1987;
- 13 of 22 days registering more than 3 per cent moves in either direction on the prior close;
- An intra-day swing of 13.5 per cent on 13 March – down 8.5 per cent at one point, before reversing course to close 4.3 per cent higher that day.

Revenue for some businesses fell to zero overnight. Companies generally have the ability to adapt, but business models are not designed to accommodate such a sudden halt in activity. Managers aren't taught how to deal with a sudden economic stop in graduate business schools. The resulting emergency action severely impacted retail, tourism and hospitality and sent shockwaves through the broader value chain, with as yet unknown contagion implications.

Governments scrambled to announce and implement fiscal measures that, as a percentage of GDP, were unprecedented. This was followed by progressive announcements from the US Federal Reserve and other global Central Banks, materially boosting liquidity in the financial system.

The policy responses culminated on the 23 March when the US Federal Reserve announced that it was embarking on massive Quantitative Easing (QE), which would be far broader than any previously undertaken. The bond buying by The Federal Reserve (The Fed) went far beyond the purchase of US Treasuries to include Mortgage Backed Securities, Municipal Debt, and the unprecedented purchasing of Corporate Debt including junk bonds.

Figure 4: G4 Central bank balance sheet as a percentage of GDP



Source: JPMorgan

This back-stopping of the default risk of the entire economy by The Fed was the catalyst for an enormous and rapid recovery in markets.

As an aside, the consequence of this action is that we are enduring a health crisis and an economic crisis but not a financial crisis. The question on our mind is whether the mere absence of a financial crisis is sufficient to justify record level price to earnings multiples and elevated major index levels.

By the end of the 30 June financial year, the Australian equity market had recouped 54 per cent of its peak-to-trough losses.

During this period, there were some notable winners. Companies facilitating working from home, such as cloud providers and electronics retailers, as well as those supporting the dramatic change in logistics in the broader economy did well. The big losers were those in the travel and hospitality value chain, as well as banks, energy and media companies.

The big iron ore companies also performed strongly due to elevated commodity prices resulting from ongoing production disruption and capacity constraints in Brazil. Brazil's disruptions were, in turn, due to the effects of the coronavirus on their workforce, combined with China's reported recovery in economic activity after its initial outbreak in January/February.

Review of The Fund's performance

In the first half of the financial year, The Fund deployed cash, taking advantage of an anticipated sustained period of low interest rates. Despite being wary of asset valuations in certain areas of the market, The Fund anticipated broader asset price strength resulting from the Reserve Bank seeking to reduce rates due to downward pressure on consumer spending.

The lower cash balance was also a function of new investments as The Fund assessed positive risk-reward in a number of new opportunities, most notably CSL. CSL enjoys a tailwind of positive immunoglobin pricing due to global shortages. Other opportunities included smaller companies such as fast-growing property fund manager Centuria Capital Group and leading mortgage broker Australian Finance Group.

This saw The Fund's cash position fall from 23.5 per cent at the start of the financial year to close at 16.7 per cent by the end of December.

The major banks performed well in the first quarter of the 2020 financial year. Having increased The Fund's exposure to the major banks in June 2019, the decision was taken to materially reduce exposure again in August 2020 given the deteriorating risk/return trade off ahead of the release of full year results in late October and early November. This proved prescient with the banks releasing weak results and disappointing capital ratios.

Coronavirus

It was clear to the team at Montgomery that dark clouds were gathering well before the 20 February peak in the market. Initially the market took little notice of news reports of a new coronavirus sweeping through Wuhan China. Our internal Coronavirus tracking project however indicated transmission rates of the virus were concerning, and importantly, people could become infectious while asymptomatic.

We undertook proprietary analysis of multiple data sources. Our focus, which included tracking testing data in major countries, rather than just infection and death rates, indicated sanguine indifference in many countries merely reflected low testing rates. Low levels of testing provided those countries with a false sense of security, while allowing the virus to continue spreading. Our data collection and analysis revealed alarming deficiencies in the response from many countries, particularly the US.

Having identified the material risk of a market sell-off, the decision was made to increase the cash and reduce The Fund's exposure to stocks that would be directly exposed to either supply chain disruption, impacts on credit markets or directly impacted by changes in demand.

Consequently, The Fund reduced its holdings in Aristocrat Leisure, Macquarie Group, Westpac, Centuria, Steadfast Group and Healius. It subsequently exited Medibank Private and Australian Finance Group.

As the market sell-off took hold, The Fund began to selectively rotate the portfolio into high-quality businesses, while adding to positions that were oversold during the height of the crisis in March.

The main addition to the portfolio in March was Sydney Airport. Other stocks added to the portfolio over the proceeding months include Scentre Group, Magellan Financial Group, Wesfarmers, REA Group and Woolworths.

We also added two smaller positions that have the potential to be significant winners in a post COVID-19 world; Megaport and Redbubble.

The Fund also accumulated a position in the Commonwealth Bank of Australia. Bank share prices had underperformed, as anticipated, but the weakness then indicated that the market was factoring in risk-adjusted bad debts of 150 per cent of the losses taken following the last recession in the early 1990s. For the first time in many years, shares in three of the major banks were trading at discounts to their Net Tangible Assets (NTA). This was inconsistent with their critical role in Australia's economy, their relationship to Australia's long run population growth, and the assumed economic turnaround being factored into share prices in the rest of the equity market. We view Commonwealth Bank as best positioned to weather the COVID-19 crisis given its superior capital position, while also capturing market share thanks to a superior tech stack and brand.

Despite materially reducing The Fund's cash weighting during the June quarter, the aggressiveness of the subsequent rally caught us by surprise. While the economic consequences of the sudden lockdowns are only just beginning to play out, fiscal policy announcements have provided a short-term boost to market sentiment. We expect present optimism to deteriorate as the realities of the economic damage begin to be assessed.

We have a particularly difficult time gaining confidence when the employment picture is so clouded by artificial support mechanisms. Given mounting government debt, we expect economic support programs to become more targeted with some individuals and businesses allowed to go to the wall. The resultant vacuum will take years to salvage as will any return to 2019 levels of income.

Our portfolio positioning remains exposed to less economic sensitive sectors of the economy. We remain cautious, which we believe is warranted given the sharp recovery in asset prices is not justified by either economic circumstances or clarity with respect to economic prospects and the health crisis.

Drivers of performance in the 2020 financial year

The strongest contributor to FY2020 performance was metal detection and communications company Codan. The core metal detector business continues to grow strongly, helped by a buoyant gold price. The company's refresh of its recreational metal detector market product line, through the launch of its Vanquish product late in calendar 2019 was particularly notable. The company's earnings also benefited from strong results in its communications division.

The leading mobile phone network in New Zealand, Spark New Zealand, also generated attractive returns for The Fund, performing well during the sell-off due to its defensive characteristics.

Other notable positive contributors during the year were Link Group and QMS Media, which we exited prior to the COVID-19 driven sell-off.

Pleasingly, the new holdings in Commonwealth Bank, Wesfarmers, Magellan, REA Group and Woolworths, which were all initiated after the market sell-off, provided a significant positive contribution to performance over the final quarter of the financial year.

All of the banks had a poor year, with negative total returns between 16 and 37 per cent, in part due to revenue and margin pressure from low interest rates, a materially increased risk of bad debts and the need to raise additional equity capital. While The Fund maintained a very low exposure to the banks given concerns around weak credit demand and interest rate spread pressure, a holding in Westpac was a detractor from performance.

As previously noted, we added to The Fund's bank exposure through Commonwealth Bank late in the financial year given our assessment that investors were being well-compensated for potential risks at the prevailing purchase price.

Looking toward the new financial year

Thematics

1. Activity has recovered, but remains well below last year and the recovery is now stalling or even reversing

Market sentiment turned on its head from late March, precipitated by massive liquidity support from central banks and fiscal responses from governments looking to ward off the immediate impacts of a three-month lockdown on its citizens necessary to prevent further spread.

As economies began to reopen, it is not surprising that economic data and other measures of activity bounced back sharply, albeit from historic lows. This helped to entrench the recovery in equity markets.

While the trajectory of recovery appears impressive, we are mindful of the absolute level of revenue and earnings businesses will return to post lockdown. While share prices may in many cases be lower than prior to COVID-19, this may be more than justified due to the expected path of future earnings in a vastly changed economic landscape.

In Australia, a winding back of fiscal support, including the JobKeeper and JobSeeker programmes, was initially expected to occur in September. But the reintroduction of lockdowns in Melbourne, combined with APRA's four-month extension of waivers on recognition of impaired loans for the banks, indicates that fiscal support measures are likely to be extended to March 2021.

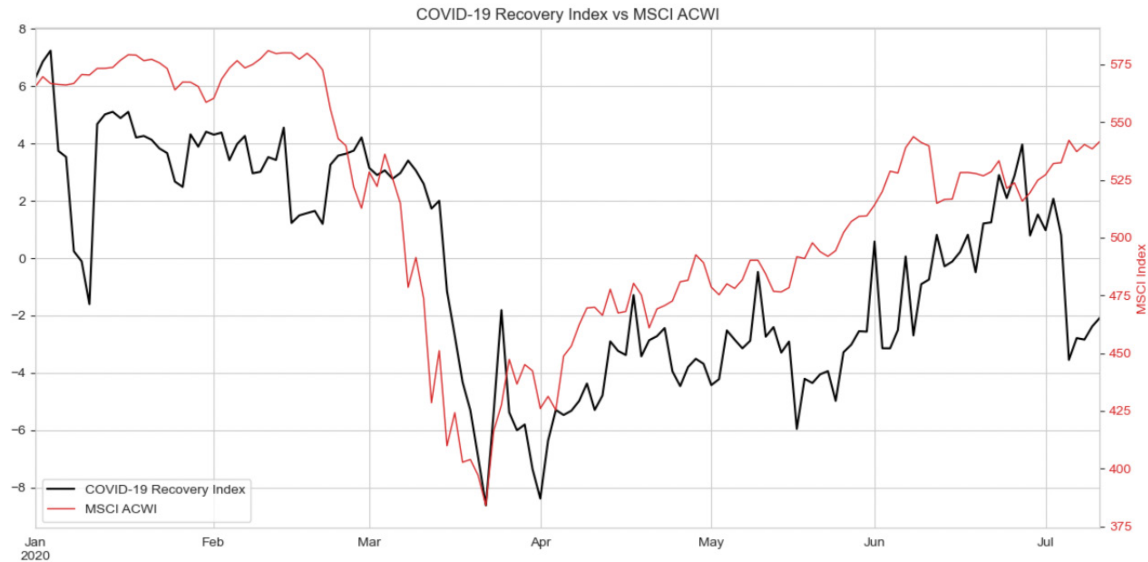
There is, however, a limit to how long and how broadly these policy supports can remain in place.

We also remain wary of the potential for additional lockdowns, further stalling the recovery.

As demonstrated in Figure 5., the second wave in the US and Europe, combined with a growing problem in developing market countries like Brazil and India as well as Africa, is already having an impact of activity levels. The JPMorgan Index measures a combination of COVID-19 case numbers, mobility indices, social activity, behavioural measures, consumption, as well as industrial activity and energy demand.

The Figure shows a material drop in activity in the last few weeks, with activity levels falling back to similar levels seen in April and May. Despite this, global equity markets remain at their recovery highs.

Figure 5: JPMorgan COVID-19 Recovery Index vs the MSCI World Index



Source: JPMorgan

This suggests to us a growing risk of another correction in equity markets.

2. A more challenging policy response environment

Much of the fiscal stimulus announced by governments has been funded through the monetisation of growing deficits. Even though further policy support is anticipated, we expect stimulus initiatives to combat a second wave of infections to largely be an extension of measures announced to date, with less direct impact on asset prices. This will of course see government debt levels balloon further.

The mantra "Don't fight the Fed" is often cited as a reason to buy any dip. We remain wary of blind optimism on liquidity considerations given the potential ramifications of unlimited printing of money, which extend beyond moral hazard and increased wealth inequality.

The stability of fiat currencies is based on trust. Once the trust is lost – and it remains impossible to pinpoint the precise tipping point – it is very difficult to regain. Taking excessive money printing to its logical conclusion, the US Federal Reserve could theoretically hand out $1 million to every household in the US, with no additional increase in goods or services produced. Given the implications of such a policy move, it is clear based on this analogy there are limits to central bank largesse.

3. Fear of rolling lockdowns would negatively impact business and consumer confidence

The biggest swing factor in GDP growth tends to be fluctuations in company profits and investment. Falling demand puts downward pressures on company profits, while uncertainty reduces the willingness of businesses to invest capital.

Additionally, any subsequent waves of infection, and government containment efforts, will further dampen economic activity and incrementally add to uncertainty until a more permanent solution can be found through a broadly available vaccine.

4. Vaccine development remains a possibility, improved testing will also help

The only permanent solution to COVID-19 is a vaccine. There are a large number of trials going on around the world investigating a number of potential candidates, however, the success of these trials remains uncertain. News flow on the vaccine front has been encouraging to date but should be viewed in context of a traditional development timeframe of six to seven years.

Table 4., reveals a list of some of the more promising COVID-19 vaccine candidates that are currently in clinical evaluation. While there are a reported 180 vaccine projects globally, there are currently 15 candidates in clinical trials.

Table 4: Candidate COIVD-19 Vaccines in Clinical Evaluation

Developer	Manufacturers	Platform	Current Stage of Clinical Evaluation /Regulatory Status	Same Platform for Non-Coronavirus candidates	Clinical Trial Location	Study Start Date	Estimated Study Completion Date	Participants
CanSino Biologics Inc/Beijing Institute of Biotechnology		Non-replicating Viral Vector	Phase 2 Phase 1	Ebola	China	10-Apr-20 17-Mar-20	31-Jan-21 31-Dec-20	108 500
Moderna	AstraZeneca, Merck, DARPA & BARDA (US Govt)	RNA	Phase 3 Phase 2 (IND Accepted) Phase 1	Multiple candidates	USA	27-Jul-20 16-Mar-20	27-Oct-22 20-Sep-21	30,000 45
Wuhan Institute of Biological Products	Sinopharm	Inactivated	Phase 1/2		China	11-Apr-20	10-Nov-21	1,432
Beijing Institute of Biological Products	Sinopharm	Inactivated	Phase 1/2		China	29-Apr-20	28-Nov-21	2,128
Sinovac	Sinovac	Inactivated	Phase 1/2	SARS	China	16-Apr-20	13-Dec-20	phase 1 144 phase 2 600
University of Oxford	AstraZeneca	Non-replicating Viral Vector	Phase 1/2	MERS, influenza, TB, Chikungunya, Zika Meningistis B, Plague	UK	23-Apr-20	1-May-21	1,090
BioNTech Fosun Pharma	Pfizer, BioNTech	RNA	Phase 1/2		Germany	20-Apr-20	8-Mar-23	7,600
Inovio	VGXI Inc, Richter-Helm Biologics, Ology Biosciences	DNA	Phase 1	Multiple candidates	USA	3-Apr-20	1-Apr-21	40

Source: WHO, UBS

Greatly improved testing methods should also facilitate the unwinding of significant movement restrictions, albeit with continued limitations on some sectors of the economy.

Fund positioning

For reasons we have previously outlined, The Fund remains cautiously positioned. The Fund has seen a period of meaningful turnover in the portfolio and looks vastly different to the one that exited December 2019. Our investments have focused on the following framework in a post-COVID world:

- Quality companies where earnings are not structurally impaired, and the current fall represents missed or delayed earnings;
- Asset backed companies with latent capacity where volumes will recover over time and are more attractive from a valuation perspective;
- Companies where competitors may or will suffer from a prolonged downturn;
- Companies more economically sensitive and impacted as a feedback loop, but will survive and be well positioned in a recovery; and
- Companies that may potentially be structural winners from COVID-19.

This framework is overlaid with a quality bias, whilst being mindful of valuation considerations.

In some cases, we believe the furious, and quicker-than-anticipated market pricing cycle has played out in the June quarter despite no material change or improvement to the outlook. Consequently, The Fund has reduced some positions – most notably in Magellan Financial Group.

In some cases, as investors seek to leverage anticipated market gains through riskier opportunities, some stocks are left behind (or even sold off). These laggards include businesses of unimpeachable quality, which leads to opportunity. One example of this dynamic is The Fund's purchase of Woolworths.

Shares in Woolworths suffered from an investor-led rotation out of 'defensive' names into what we believe is a premature "re-opening" trade.

Cash weighting and conclusion

Finally, The Fund's cash sits at 18 per cent, which is currently lower than the long-term average for The Fund.

Our cash balance is predicated on several factors – including market risk (as expressed through broad market valuations) and stock specific valuations for The Fund's investments. Should an opportunity arise where we believe the medium-term risk-reward is favourable relative to cash (which has no nominal risk and close to a zero-return profile), The Fund will seek to accumulate a position.

Our preference, at the right time, is to be fully invested.

To date we have invested where the shares of a company have traded at lower absolute prices without a material change in its outlook, or even where prospects have significantly improved. We have also invested where acceptable risks are being more appropriately priced. Recently, and as previously indicated, many of these are in less economically sensitive industries.

Invariably there are two camps with respect to investing. Today, there are those betting on an easy and quick recovery and those who believe it will be slow and halting. We lean towards a slow and halting recovery and believe it will be some years before 2019 levels of income are regained.

With respect to market valuations, there are also two camps – those who believe the market is stretched and those who believe it is stretched but that is ok because extended valuations are backed and supported by central bank incursions.

Our view remains that central bank support has natural limits in terms of its effectiveness. Central bank buying of corporate bonds can for example help to maintain low interest rates for those corporates but if the majority of their customers remain unemployed, it cannot deliver revenue nor customers.

We believe market volatility will remain a feature in 2020 as the full impacts of a shutdown in the economy become better understood. When cash is available, as it is now, anticipated volatility represents an opportunity for The Fund. An opportunity we plan, on your behalf, to preserve.

Thank you for your support for The Montgomery Fund. We appreciate the opportunity to work for you and look forward to continuing our investment partnership through FY2021 and the years that follow.

Sincerely,

Joseph Kim

Portfolio Manager and Head of Fundamental Research

The Montgomery Fund

Andreas Lundberg

Joint Portfolio Manager

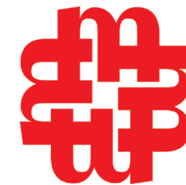
The Montgomery Fund

Roger Montgomery

Chairman and Chief Investment Officer

Montogmery Investment Management Pty Ltd

MONTGOMERY INVESTMENT MANAGEMENT PTY LIMITED



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