"The first rule of compounding: never interrupt it unnecessarily." - Charlie Munger

For more than 18 months now the stock market has been on a tremendous run and Montaka's performance has been outstanding.

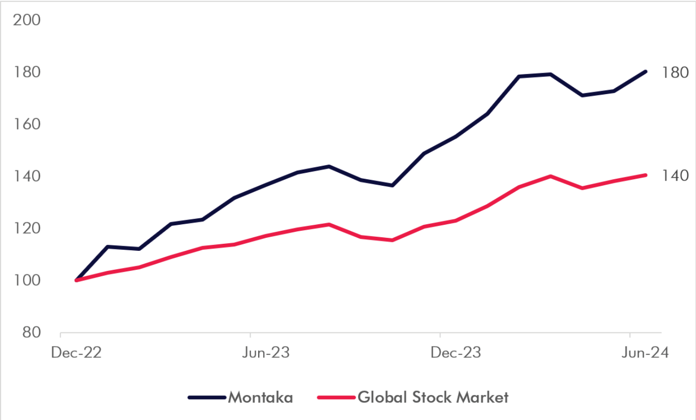
While most investors are delighted by the results, some are also uneasy about what comes next. They have asked us if the market has risen too fast too soon; if it's too concentrated in a handful of stocks; and if the portfolio still offers excellent value like it did previously.

When we examine the current market dynamics, we find that the recent performance and dominance of tech stocks shouldn't be so concerning. And when we examine our portfolio, we find that it is still offering fantastic long-term value.

We have also been asked if we are changing the portfolio, either to protect against a temporary pullback or to benefit from the next move in the market.

But we have largely left the portfolio unchanged, especially among the top holdings, including Microsoft, Amazon and KKR. That's because we remain confident the portfolio will create far greater value in the future than it already has today.

Montaka vs Global Stock Market Performance
(Last 18 months; Indexed to 100 at 31 Dec 2022)



Note: Montaka refers to Montaka Global Long Only Equities Fund; Global Equity Market refers to MSCI World Index in A$.

Montaka Top 10 Holdings
(Position sizes at 1H24 compared to 1H23)

HOLDINGS	1H24	1H23
Amazon	10.6%	10.6%
KKR	10.2%	8.3%
Microsoft	10.0%	10.1%
Blackstone	8.8%	8.2%
ServiceNow	6.7%	4.5%
Meta	6.6%	8.5%
Spotify	6.2%	4.5%
S&P	5.3%	4.2%
Salesforce	5.1%	5.8%
Tencent	5.0%	3.1%
Top 10	74.5%	67.9%

Market dynamics: 2023 redux?

So far, 2024 has looked a lot like 2023.

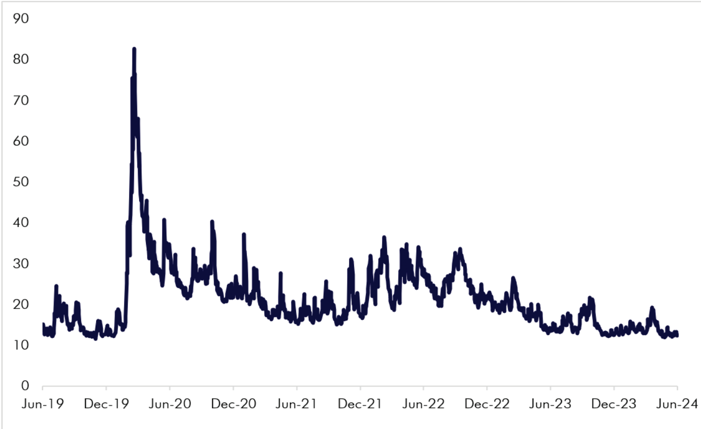
Stocks have rallied strongly again this year.

The S&P500 index of the largest US companies was up by more than 14% in the first half and hit a new all-time high in July. Last year, the market had advanced 16% by midway through the year and was on its way to a new record.

In both years volatility has been remarkably low, too.

The VIX index, which measures the volatility of the S&P500, started 2023 above its long-run average of 18. But by the middle of the year, it had fallen to 14. This year the VIX sunk to 12, a level not seen for more than four years.

VIX Index Last 5 Years

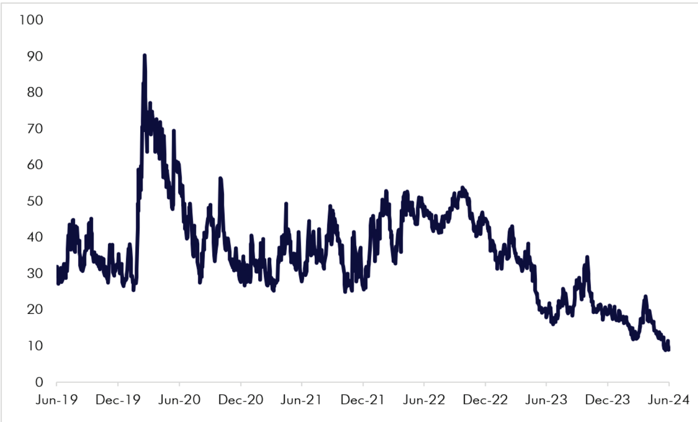


And while the S&P500 has had daily swings of 2% or more 15 times a year, on average, in the past decade, in the last year there has been just one such day.

But the market's steady rise has belied highly varied performance among individual stocks.

The tendency of stock prices to move together – or correlation, as measured by the CBOE Implied Correlation Index – has never been lower.

CBOE Implied Correlation Index Last 5 Years



Meanwhile dispersion – or the amount by which stock prices move compared to each other – is near the highest it has ever been as measured by the CBOE S&P500 Dispersion Index.

That's meant the market has been bifurcating into winners and losers.

And just like last year, the winners have been a few big tech leaders that have driven most of the market's gains again this year.

The 'Magnificent Seven' – Microsoft, Apple, Nvidia, Google, Amazon, Meta and Tesla – accounted for almost 80% of the increase in the S&P500 in 2023. In the first half of 2024, they accounted for 60% of the increase.

But that alone shouldn't worry investors.

This is a typical market dynamic

The dominance of big tech, again, might appear striking.

However, this 'power law' phenomenon – where a handful of stocks power most of the gains – is typical in equity markets.

We have often cited the seminal research of Professor Hendrik Bessembinder of Arizona State University. He found that just 4% of stocks accounted for all the US$35 trillion of wealth created in the US stock market from 1926 to 2016.

Bessembinder recently updated his research, extending the study to global stocks, covering 64,000 companies across 43 countries, from 1990 to 2020.

The results showed that the original findings in the US were no fluke.

In fact, global stock market returns were even more skewed, with just 2.4% of stocks accounting for all the US$76 trillion of shareholder wealth created.

Tech's dominance is structural

The market's narrow performance is also simply a result of the biggest companies delivering the best performance.

As the Magnificent Seven have become enormous, so has their impact on the market.

Their total market capitalisation stands at almost $16 trillion, representing about one third of the value of the S&P500. That's up from 30% at the beginning of this year and just over 20% in the middle of last year.

Although many worry this level of market concentration is too high, we think it reflects the importance of many of these companies and it is still much lower than some levels seen in the past.

We recently explained the structural tendency of mega-cap tech companies to capture an outsized share of the market's value.

Technology is becoming a bigger part of the economy, these companies are extending their dominance and AI is providing another huge boost.

Still, the market share of the Magnificent Seven falls far short of the US rail companies in the early 20th century, when they made up two-thirds of the US stock market's value.

Putting price rises into context

And if we step back, the price gains aren't as dramatic as they first seem.

Despite the Magnificent Seven growing to colossal size, their stock prices have continued to outpace the rest of the market.

This year their weighted average share price appreciated by 31% compared to 8% for the other 493 stocks. They were up 60% in the first half of last year, compared to 4% for the rest.

After soaring so high so quickly, it's understandable that many doubt that the big tech companies can keep strongly outperforming.

We are aware that trees do not grow to the sky, but it is important to put these results in perspective before drawing conclusions.

Firstly, Nvidia alone accounted for around half of the group's performance this year as its stock price skyrocketed two and a half times in the first six months. That followed a tripling in 2023.

Nvidia has taken advantage of its stranglehold on the insatiable demand for AI chips in a supply constrained market. Yet we find it difficult to confidently predict its future success, especially with large rivals and customers developing competing chips. As a result we have not owned the stock.

Secondly, the group's performance looks much less extreme when viewed over a longer timeframe.

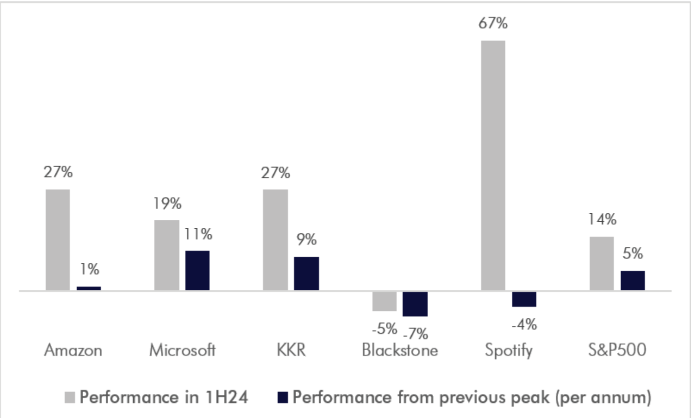
The Magnificent Seven are, on average, just 11% above the peaks reached before 2022's heavy sell off.

Without Nvidia, they would be just 2% higher and lag the S&P500, which is 5% per annum above its previous high.

Our portfolio in focus

When we examine some of the most important holdings in Montaka's portfolio we see a similar dynamic.

Montaka Portfolio Holdings Performance



Note: 1H24 performance for half year unannualized; vs peak performance annualized.

Amazon and Microsoft are among the largest holdings in the portfolio because we believe their leading 'hyperscale' cloud platforms – AWS and Azure – will keep winning big from the AI revolution.

Together, they represent just over 20% of the portfolio's value.

Amazon and Microsoft surged in the first half, with their stocks up 27% and 19%, respectively. Amazon surpassed its previous high set three years ago and Microsoft extended the gap above its former peak.

Yet if we look at their annualized returns from their 2021 high points, Amazon's is just 1% and Microsoft's is 11%.

Of course, there are other important themes in the portfolio besides AI and cloud computing.

KKR and Blackstone also remain top holdings because we believe they will continue to lead explosive growth in the alternative asset management industry. Together, KRR and Blackstone account for almost 20% of the portfolio.

KKR's stock gained 27% in the first half, while Blackstone's share price was down slightly. KKR is now 26% above its prior high, but that's still just 9% ahead on an annualized basis. And Blackstone itself is still 17% below its high-water mark reached in late 2021.

(We detailed our investment thesis on KKR this time last year, and Amit has followed that up with a fascinating piece exploring the parallels between KKR and Warren Buffett's Berkshire Hathaway. That case study appears at the end of this letter.)

Meanwhile, the best performer and the stock that has added the most value to Montaka's portfolio this year is Spotify – the world's pre-eminent audio streaming company.

Spotify's share price soared 67% in the first half. But, again, it is still 14% away from its last peak in early 2021.

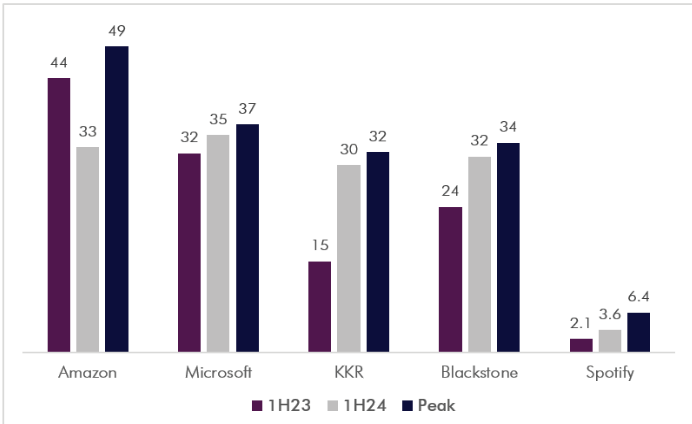
Our holdings are excellent value

But perhaps our most important answer to investor's 'fear of heights' after recent strong gains in our portfolio is that past price moves give us very little insight into future value.

When we go deeper and relate share prices to earnings it's clear our portfolio companies still represent fantastic value for long term investors.

Investors typically look at share prices compared to the last twelve months of reported earnings or the next twelve months of projected earnings.

Montaka Portfolio Holdings Forward Earnings Multiples



Note: Spotify multiple is price to sales per share (earnings not available in prior periods); for other holdings multiple is price to earnings per share.

Over the past year the multiple of share price to forecast earnings has certainly expanded across Montaka's main holdings, except for Amazon. And, forward earnings estimates have also increased across the board, substantially in some cases.

The market is no doubt ascribing a higher multiple to earnings that are larger and growing faster now.

We'd point out, however, that these multiples are still lower than when these stocks traded at their previous peaks, some by a wide margin. Yet earnings have improved.

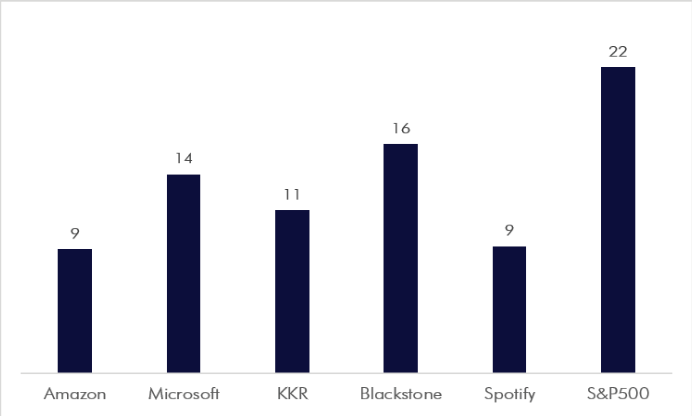
So, we could argue that valuations are the same or better than they were previously.

Still, this type of analysis is very short-sighted.

For companies that can strongly compound their earnings power with a high degree of certainty, like Montaka's portfolio holdings, it makes sense to look well beyond the next year when considering their valuation.

We can compare current share prices with estimated earnings five years from now. This approach accounts for the extraordinary growth rates that leading companies can achieve as they transform their industries.

Montaka Portfolio Holdings 5-Year Forward Earnings Multiples



It then becomes immediately clear that the long-term earnings multiples for Montaka's main portfolio holdings are low, both absolutely and relative to the market.

In other words, we are accepting a higher multiple, or lower earnings yield, today for a much lower multiple, or higher earnings yield, in the future.

On top of that we expect these companies will still be growing at high rates five years from now because the runway in their markets extends far beyond the end of this decade.

To us that means Montaka's top portfolio holdings look like excellent value over the longer term.

* * *

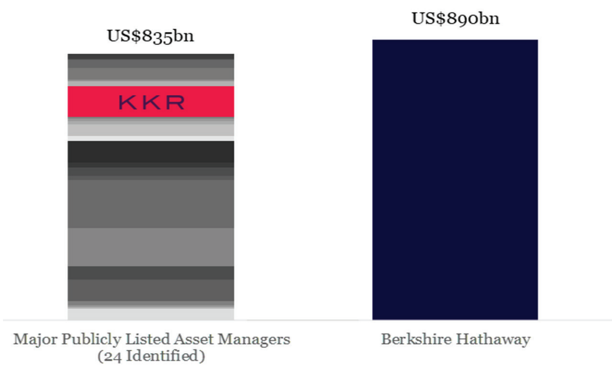
CASE STUDY: KKR

What would you find if you compared the market cap of Warren Buffet's famed Berkshire Hathaway with the combined market cap of all major publicly listed asset managers (both traditional and alternative)?

You'd find the asset management group is valued at roughly $US835 billion. While Berkshire Hathaway alone, is worth $890 billion.

That's quite incredible. Berkshire has created more value for its shareholders by itself than the entire investment management industry combined!

Market Capitalization



Source: Bloomberg

Note: 'Major Publicly Listed Asset Managers' include 3i Group, Affiliated Managers Group, AllianceBernstein, Amundi, Apollo, Ares, BlackRock, Blackstone, Blue Owl, Bridgepoint Group, Brookfield Asset Management, Brookfield Corporation, Carlyle, EQT Partners, Franklin Resources, Invesco, Janus Henderson, KKR, Legal & General, Onex Corporation, Partners Group, T. Rowe Price, Tikehau Capital and TPG.

This fact hasn't been lost on KKR. The co-CEO of the alternative asset management giant, Joseph Bae, recently noted that the key drivers for Berkshire's success can be boiled down to three learnings:

> *"The learning is about the power of long-duration ownership of great businesses. The learning is about the power of compounding. And the learning is about the power of smart strategic capital allocation."*

KKR, being the quick study, has taken this lesson to heart and acted. If you look closely, you can see the growing strategic parallels between KKR and Berkshire Hathaway's business models. In fact, KKR has been evolving into the 'Buffett of alternatives' for quite some time. This could mean a multi-decade runway of material value creation and massive upside for shareholders in the future.

Below we look at several ways in which KKR has numerous characteristics that resemble Berkshire Hathaway.

KKR has simplified its financial reporting

KKR has simplified and increased financial disclosure, which reveals a stark alignment with Berkshire's reporting.

Alternative asset managers have notoriously complicated accounting and reporting. That's driven by their ownership of hundreds of businesses on behalf of investors, other businesses on their own balance sheet, and their collection of fees for providing investment management services. Combined, these dynamics create a tricky jigsaw for investors to untangle when picking up financial statements.

However, at the start of 2024, KKR significantly simplified earnings into a more digestible format, splitting out its Core Business (investment management fees), Strategic Holdings (owned operating businesses) and Insurance earnings.

This segmentation mirrors Berkshire Hathaway which broadly reports in a similar format.

From 'cyclical cigar butts' to 'quality compounders'

KKR and Warren Buffett seem to have studied at the same school.

Traditional value investing formed the foundation of both firms' strategies early on. Buffett was heavily influenced by Benjamin Graham's investing principles, while KKR sought stable but usually low-growth earnings streams to support financial leverage.

In both cases, upside was limited, and the requirement to 'turn-the-book-over' (continually sell and replace assets) did not allow for the magic of compounding to occur.

Thanks to some sage advice from Charlie Munger on the benefits of quality compounders over cheap cyclical stocks, Warren Buffet significantly shifted his investment strategy in this direction.

As Albert Einstein said, "compound interest is the eighth wonder of the world. He who understands it, earns it...he who doesn't... pays it."

The value creation has been extraordinary for Berkshire and have clearly been enjoying the fruits of the eighth wonder of the world for many decades.

Here in lies another similarity between KKR and Berkshire. When deploying their own capital, both are disciples of long duration, cash generative, structurally growing businesses that have limited competition. There are only a handful of asset managers that use substantial amounts of balance sheet cash for buying businesses for themselves (versus distributing cash). KKR and Berkshire are wholly aligned here as well.

Key Characteristics of KKR's Balance Sheet Investments

Source: Bloomberg

Overlapping investment philosophy

Whether it's Berkshire Hathaway's investments in businesses with strong brand loyalty and customer entrenchment (e.g. Coca-Cola, Apple, etc), or KKR's investments in companies with high switching costs and significant market share (e.g. ERP software, 1-800 Contacts, etc), both firms prioritize businesses with durable competitive advantages.

This focus on 'moats', as Warren Buffett calls them, seeks to ensure investments can withstand competitive pressures and continue generating growth and profits in most economic environments.

For example, Berkshire Hathaway's legendary purchase of See's Candies and KKR's investment in Arnott's, share several parallels.

Both are market-leading household names with ubiquitous brand recognition and enduring cultural heritage in their respective regions (100+ years old). Similarly, both seemed expensive when purchased. However, have proved this perspective wrong over time as earnings compound and the inherent quality within each business is demonstrated.

See's CANDIES® Famous Old Time Candies Since 1921

Berkshire Hathaway

ARNOTT'S SINCE 1865 ENJOY.

KKR

As an aside, See's Candies is much more reliant upon pricing power than unit growth to generate earnings compared with Arnott's, which is more of a mix of the two and addresses a broader market (less niche/less premium).

A convergence of business models

Over the years, KKR has transformed from a pure-play private equity firm to a diversified investment platform (credit, real estate, infrastructure, etc) which we have discussed several times over the years (including here if you would like to revisit some of those perspectives).

While KKR and Berkshire's corporate structure, cash generating businesses and growth opportunities differ, their core principles and strategic approach are increasingly in harmony.

As investments take on longer-term horizons with quality prioritized, supported by a growing insurance business, it certainly suggests KKR is converging with Berkshire Hathaway's model in many ways.

Many more fruitful years ahead

The future is full of extraordinary opportunities for KKR. That includes the enormous opportunity to further penetrate massive new markets like insurance and private wealth, the opportunity to leverage scale advantages in highly attractive growth markets like Asia, and the potential for continued valuation re-rating as smoother earnings streams become a larger proportion of the mix.

There is significant fragmentation in the investment management space which KKR has identified as an inability to compound capital on balance sheet over the long term. KKR's differentiated approach mirrors Berkshire Hathaway.

KKR has been a long-term holding for Montaka and we anticipate it will remain as such for many years to come. Its share price is beginning to appreciate the evolution that is occurring beneath the surface which mirrors Berkshire Hathaway's highly successful model in more ways than meets the eye at first glance.

Source: Bloomberg, Montaka

Investors should embrace this multi-decade, secular growth story before the market fully grasps – and prices in – the tremendous value creation trajectory KKR is on.

* * *

We are grateful for the trust you have placed in us to protect and grow your wealth over time.

Sincerely,

Andrew Macken

Chris Demasi

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