

## INVESTMENT REPORT & FACT SHEET

### FUND OVERVIEW

The Montgomery Global Equities Fund (Managed Fund) (the 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. The Fund also aims to target a minimum 4.5% annual distribution yield, paid semi-annually.

### FUND FACTS

#### INVESTMENT MANAGER

MGIM Pty Ltd

#### OBJECTIVE

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

#### BENCHMARK

MSCI World Net Total Return Index, in Australian dollars.

#### ASRN

621941508

#### RECOMMENDED INVESTMENT TIMEFRAME

5 years

#### INCEPTION DATE

20 December 2017

#### FUND SIZE (AUD)

\$82.7M

#### MANAGEMENT COST

1.32% per annum, inclusive of GST/RITC.

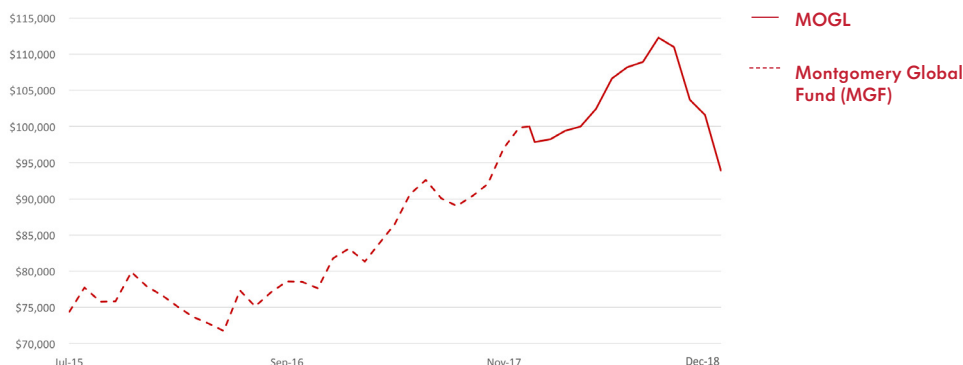
#### PERFORMANCE FEES

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.

#### APPLICATION & REDEMPTION PRICES

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

### PERFORMANCE GRAPH



### CONTACT DETAILS

#### INVESTORS

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### PORTFOLIO PERFORMANCE (to 31 December 2018, after all fees)

	INCOME	CAPITAL GROWTH	FUND RETURN	MSCI WORLD NET TOTAL RETURN INDEX <sup>1</sup>	OUT/UNDER PERFORMANCE
1 month	2.14%	-5.62%	-3.48%	-4.16%	0.68%
3 months	1.98%	-12.91%	-10.93%	-11.01%	0.08%
6 months	1.96%	-11.34%	-9.37%	-4.60%	-4.77%
12 months	4.80%	-4.57%	0.24%	1.42%	-1.18%
MOGL (since inception) <sup>2</sup>	4.70%	-6.64%	-1.94%	-0.43%	-1.51%
MGF (since inception) <sup>3</sup>	19.62%	12.65%	32.27%	25.51%	6.76%

<sup>1</sup> In Australian dollars <sup>2</sup> Inception: 20 December 2017 <sup>3</sup> Inception: 1 July 2015

Past performance is not an indicator of future performance. Returns are not guaranteed and so the value of an investment may rise or fall.



## FUND COMMENTARY

In the month of December, the Montgomery Global Equities Fund (Managed Fund) (the Fund), declined by 3.48 per cent, net of fees. By comparison, the MSCI World Net Total Return Index in Australian dollar terms (the Benchmark), declined by 4.16 per cent over the same period.

Over the calendar year of 2018, the Fund returned a flat 0.24 per cent, net of fees. By comparison, the Benchmark returned 1.42 per cent, over the same period. Since inception, the Fund has declined by 1.94 per cent, net of fees. By comparison, the Benchmark declined by 0.43 per cent over the same period.

Since inception of the underlying strategy, the Montgomery Global Fund (MGF) has increased by 32.27 per cent, net of fees, with an average cash weighting of 19 per cent. By comparison, the Benchmark – with zero cash weighting – returned 25.51 per cent over the same period.

The December quarter of 2018 marked a rather dramatic end to an already challenging year for global equity investors. Global equity markets declined significantly and experienced consequential intra-period swings on the way down.

Over the course of 2018, the global equity market environment has been influenced by a number of dynamics with unpredictable outcomes. From the decision-making processes of President Trump, to the retaliatory inclinations of President Xi, to the unfolding trajectory of Fed monetary policy or the enormously complex withdrawal of the UK from the EU. Any one of these dynamics alone could represent a material source of global equity market volatility. But it has been the combination and interaction of these dynamics that has made life very difficult for global equity investors.

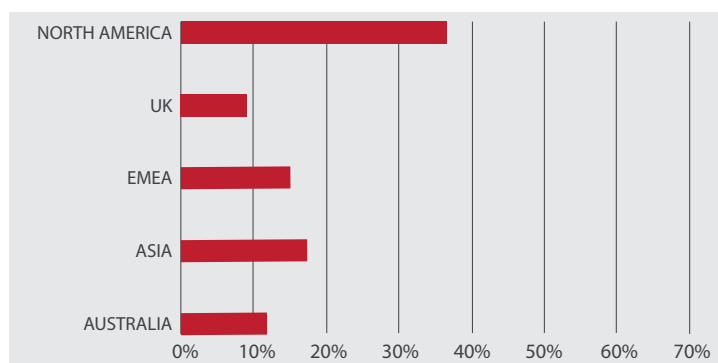
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## TOP COMPLETED HOLDINGS\* (TCH) (at 31 December 2018, out of 18 holdings)

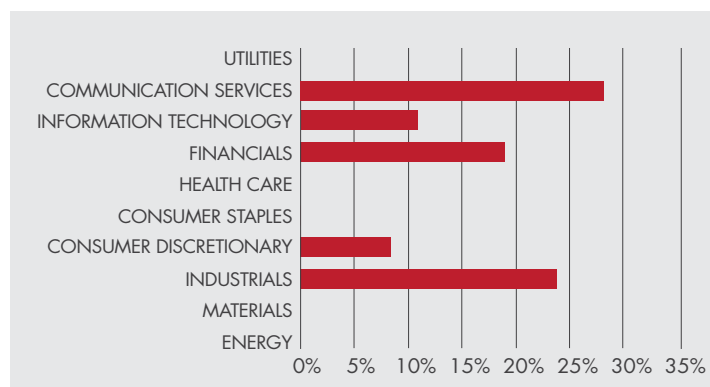
COMPANY NAME	COUNTRY OF DOMICILE	MARKET CAP (\$USDM)	WEIGHT (%)
Vivendi	FR	31,866	7.0
Insperty	US	3,903	6.7
Facebook	US	377,278	6.1
Challenger	AU	4,088	6.1
Microsoft Corp	US	785,026	5.9
Prudential	GB	46,358	5.8
Alphabet	US	723,246	5.6
REA Group	AU	6,868	5.6
51job	CN	3,858	5.4
Apple	US	748,539	4.9
<b>PORTFOLIO MEDIAN</b>		<b>60,546</b>	<b>5.2</b>
<b>Total equity weighting</b>			<b>89.8</b>
<b>Total cash weighting</b>			<b>10.2</b>

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

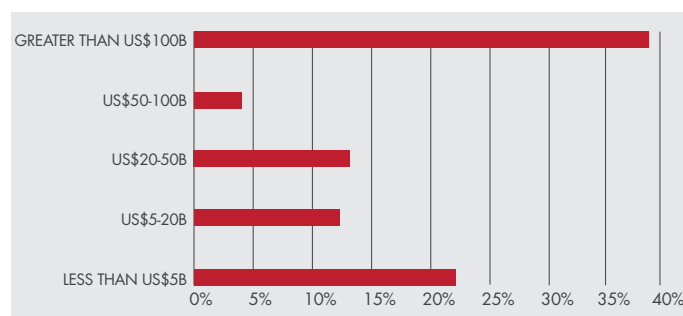
## GEOGRAPHIC - COUNTRY OF DOMICILE



## GICS SECTOR INDUSTRY EXPOSURE



## MARKET CAPITALISATION EXPOSURE



#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) (CAR) #001 007 050 (Montgomery) the investment manager of the Montgomery Global Equities Fund (Managed Fund). The issuer of units in Montgomery Global Equities Fund (Managed Fund) is the Fund's responsible entity Perpetual Trust Services Limited ACN 000 142 049 (AFSL 236648). Copies of the PDS are available from Montgomery Global Investment Management (02) 8046 5000 or online at [www.montinvest.com/mogl](http://www.montinvest.com/mogl). Before making any decision to make or hold any investment in the Fund you should consider the PDS in full. The information provided is general information only and does not take into account your investment objectives, financial situation or particular needs. You should consider your own investment objectives, financial situation and particular needs before acting upon any information provided and consider seeking advice from a financial advisor or stockbroker if necessary. You should not base an investment decision simply on past performance. Past performance is not an indicator of future performance. Returns are not guaranteed and so the value of an investment may rise or fall.



## FUND COMMENTARY

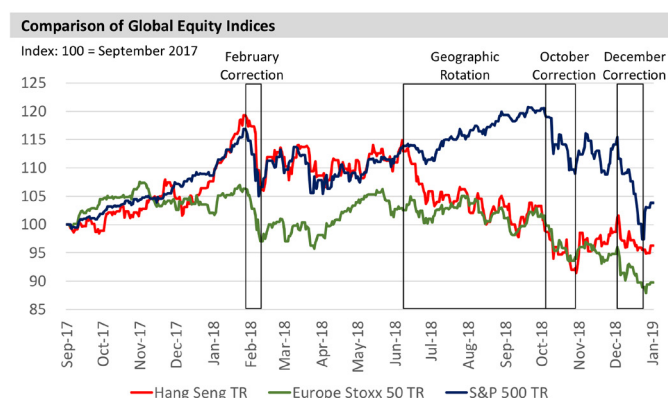
In the Fund's December 2017 Letter, we identified two key sources of risk that we believed would be most significant to investors in calendar 2018:

1. Fed monetary policy and balance sheet normalization; and
2. The breakdown of the US-China relationship and the resulting consequences thereof.

During the year – and especially in recent months – both dynamics have been a genuine source of volatility. Furthermore, the interaction of the two dynamics have compounded the complexity facing investors.

Beginning around July 2018, a significant geographic rotation started to emerge. Equities in Asia and Europe started to materially underperform, while US equities started to outperform. Furthermore, within US equities, we observed it was the sectors perceived by many to be “defensive” that performed particularly well, such as Utilities.

### 2018 — A YEAR OF ROTATION & CORRECTION



Source: Bloomberg, MGI

In September 2018, we made the following estimations about the drivers of the observed rotation.

“Our assessment of the drivers of this rotation can be simplified as follows:

- President Trump’s escalating trade war – and the ongoing deterioration of the US-China relationship – has increased the risk aversion of global investors, especially with respect to Asian and European equities.
- US monetary policy, heightened risk aversion and the expectation of a declining US trade deficit are all pushing the US dollar higher. This, in turn, is wreaking havoc in some emerging market economies – especially those which have significant outstanding US dollar-denominated borrowings.”

We found these conditions difficult to navigate and believed that much of the selling and buying was indiscriminate, rather than based on any business fundamentals. We also assessed the probability that the persistency of these drivers was long-term as being material. Therefore, in the beginning of September, we significantly reduced our China exposure.

Of course, the corrections of October and December grabbed even more headlines in the world of global equity markets. In October, the MSCI World Net Total Return Index declined by nearly 10 per cent; and in December by nearly eight per cent.

The extent of the declines through December surprised us here at MGIM. While we understand that equity markets can decline at any time, we were surprised by the continued market declines in the face of improving information.

The new datapoints we found most compelling over recent weeks were as follows:

1. **The Fed blinks:** During a speech at The Economic Club of New York in late November, Chairman Jerome Powell said that “Interest rates are still low by historical standards, and they remain just below the broad range of estimates of the level that would be neutral for the economy.” This is significant because just two months earlier, Powell said “We’re a long way from neutral at this point.” This was effectively a reduction in the Fed’s expectations for future monetary policy, which was subsequently confirmed two weeks later when they published their downgraded forward guidance.
2. **Oil plummets:** In the December quarter, the price of crude oil declined by more than 40 per cent. This represents a source of deflation for the global economy and further reduces the need for aggressive monetary tightening over the short term.
3. **Trump and Xi make peace:** At a well-publicised dinner at the G20 summit in Buenos Aires in early December, President Trump and President Xi appeared to make some sort of peace and effect a 90-day reprieve on the proposed escalation of trade measures. While many have rightly observed the lack of a concrete agreement, the temperature has most definitely cooled between the two superpowers and the probability of cooperation has increased materially.

These events are incremental positives for equity valuations, in our view. And they coincided with a near-20 per cent decline in the MSCI World Net Total Return Index, a significant decline in aggregate hedge-fund gross leverage since September and a clear increase in the general level of bearishness amongst global equity investors. Finally, we observe that President Trump appears to view the performance of the US stock markets as a referendum on his Presidency. There is a high probability that President Trump wants a strong US stock market and will act accordingly – including direct attacks on Fed Chair Powell for raising interest rates too quickly.

MGIM’s philosophy on portfolio construction does not include a prediction of the future. This might seem strange to some readers. But to us, predicting the future is typically not a good use of time because predictions are seldom correct. Instead, we think through the range of possible outcomes and seek to assign probabilities to those outcomes. In doing this, we are essentially building the shape of the probability distribution profile of possible future events. We then seek to design the Fund’s portfolio to be consistent with this probability distribution profile.



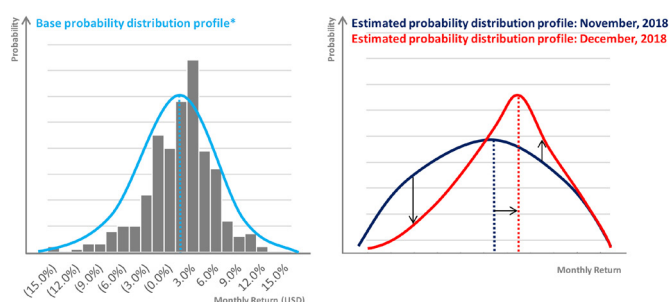
## FUND COMMENTARY

In MGIM's estimation, the incorporation of the previous information changes the shape of the probability distribution profile of medium-term global equity returns. Shown below, the shape of the curve has evolved from being flat (which is difficult to navigate for investors) to one which is skewed to the right.

In plain English, we believe the previous outlined dynamics result in the following changes to the shape of the probability distribution profile for medium-term global equity returns:

- The median return outcome has likely increased (or shifted to the right);
- The probability of negative returns has decreased; and
- The probability of higher returns has increased.

Probability Distribution of Monthly Global Equity Returns



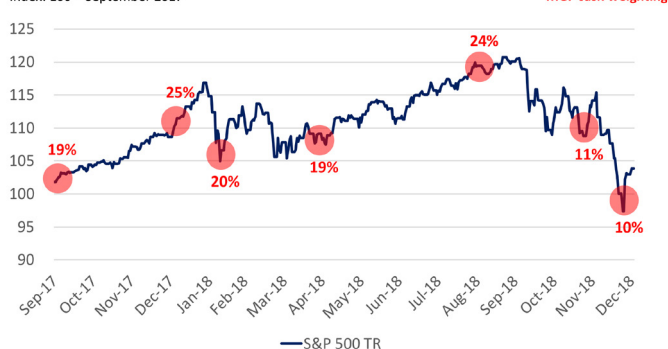
\* Based on historical monthly returns of MSCI World TR Index (USD) dating back to September 1987  
Source: Bloomberg, MGI

On this basis, MGIM has deployed a significant portion of the Fund's cash into our existing high-conviction long portfolio of high-quality global businesses that we believe remain undervalued.

This highlights a key benefit of a "variable cash weighting" within a long-only strategy, like that which is employed by the Fund. We can vary the portfolio's cash weighting based on the prospective risk/reward profile we are seeing, as described above. As can be observed by the chart below, we typically increase the Fund's cash weighting as prices rise and deploy the cash when prices fall. And should prices fall even further from here, investors should expect the Fund's cash weighting to decrease yet again.

MGF Cash Weighting vs S&P 500

Index: 100 = September 2017



Source: Bloomberg, MGIM

By way of example of an existing portfolio holding to which we have recently added, Amit Nath discusses our investment thesis for French-based conglomerate, Vivendi (Euronext: VIV). This investment is a play on Vivendi's wholly-owned Universal Music Group business and the structural growth in digital music streaming.

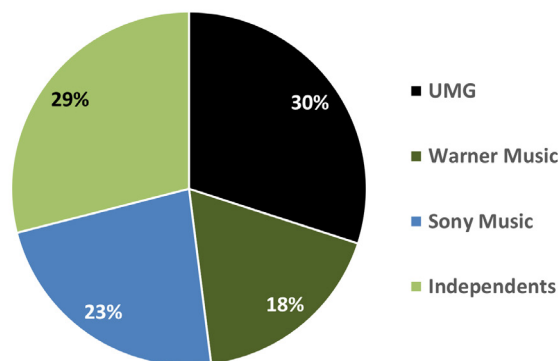
## CASE STUDY: VIVENDI

Vivendi is a market leading, vertically integrated, global media platform which owns some of the most privileged assets in the world. With dominant positions in music (Universal Music Group), pay-TV (Canal+), advertising (Havas) and mobile games (Gameloft), Vivendi represents an extremely unique collection of properties.

Core to our investment thesis however is Vivendi's ownership of Universal Music Group (UMG) which represents ~70 per cent of Vivendi's total earnings (EBITA). Underappreciated and undervalued by the market, UMG is a high-quality business that is embarking upon a period of secular growth and high margin economics. UMG is the world's largest music label and owns the rights to ~30 per cent of all recorded music on earth. Given music cannot be imitated (e.g. The Beatles, etc) it represents extremely strong intellectual property, making UMG's current position in the industry irreplaceable (significant moat).

Recorded Music — Global Market Share

Percent of Global Revenues

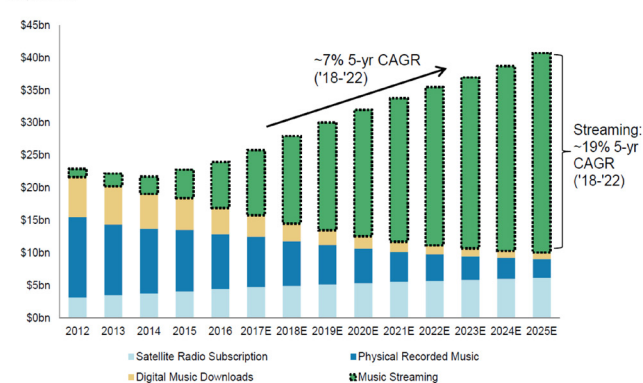


Source: Morgan Stanley

Driven by the secular transition to online, digital music streaming is expected to grow at 19 per cent p.a. for at least the next 5 years (Morgan Stanley). UMG's music assets are perfectly positioned to benefit from this multi-year structural tailwind.

Global Recorded Music Spending

US\$ Billions



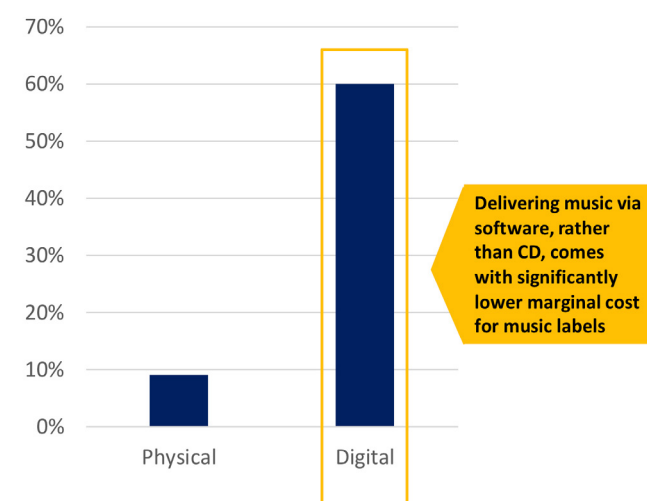
Source: Morgan Stanley



As consumers become increasingly accustomed to paying for music via Spotify, Apple Music and elsewhere, UMG finds itself in a privileged position to benefit from substantially all digital music offerings. Now, it is worth noting that ~65 per cent of all music streaming is “back-catalogue” (i.e. older music) with consumers gravitating towards older, more nostalgic tracks over the newest releases. As highlighted, UMG is the largest music owner in the world and also has the largest back-catalogue. Given the back-catalogue has already been paid for (i.e. artist advances, recording studios, marketing, etc), there is little incremental cost associated with selling it again – particularly in digital form – which is precisely what music streaming is facilitating. This results in a very high profitability to UMG of this renewed industry growth.

We believe the economics of music streaming will prove to be a game changer for UMG and Vivendi, with the incremental margins (EBITA) significantly higher than anything the music industry has experienced before. In fact, we estimate the delivery of music streaming can produce approximately six times the incremental EBITA margin over the delivery of physical music (i.e. ~60 per cent versus ~10 per cent).

#### Incremental EBITA Margin — By Product

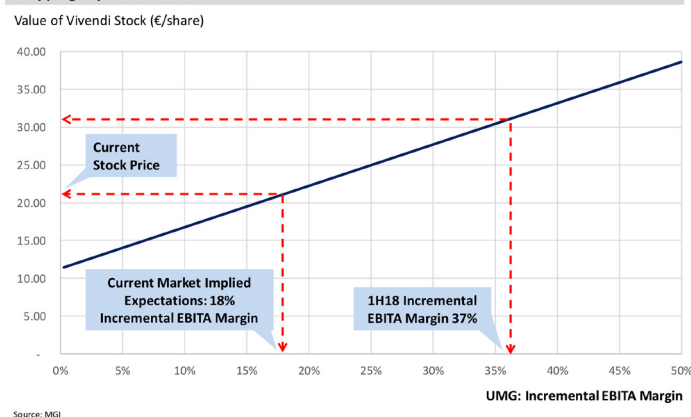


Source: MGI Estimates

Given that UMG continues to invest in new artists and maintains its legacy platforms which are lower margin, today UMG’s average EBITA margin is around 13 per cent. But as digital music grows and becomes a larger share of UMG’s revenue mix, this EBITA margin will increase significantly. For example, in the first half of 2018 (latest numbers), UMG delivered a 37 per cent incremental EBITA margin powered by this secular shift to highly-profitable music streaming.

Based on Vivendi’s current share price, we calculate that the market is implying that UMG achieves incremental EBITA margins of only 17 per cent on a sustained basis – well below what the business is currently achieving. We think these market-implied expectations are too conservative and, therefore, the stock is materially undervalued. As illustrated, if UMG can continue achieving the incremental profit margins they are currently generating, then there is 50 per cent upside in the stock price.

#### Mapping Expectations to Value



Source: MGI

An important question to consider is as follows: “Why is the stock market mispricing Vivendi today?” We believe there are at least two possible reasons. The first relates to the unusual uptick in the level of monetization of UMG’s music assets. We believe the market has not yet fully appreciated this. Second, recall that UMG is just one of a large number of portfolio businesses in the Vivendi group. We believe the market does not fully appreciate that UMG drives substantially all of the value of the group.

The gap between the market price and our estimate of Vivendi’s intrinsic value should close over time and we have positioned your capital in anticipation of this...in the meantime, enjoy streaming those good time oldies!

\* \* \*

As we enter 2019, we remain fully aware and engaged on the significant global risks that persist and must be navigated by global equity investors. The relationship between the US and China remains top of the list. And, of course, this will be impacted by the impending legal issues facing President Trump which appear to be building. How Brexit is managed (or not) will be a major development over the coming weeks. And, of course, global liquidity conditions are always key determinants of equity valuations in general.

There are certainly a number of negative scenarios on the horizon which are very possible. And yet, as we described above, the Fund has been deploying cash, not building cash. This is because the shape of the probability distribution of possible future equity returns has improved, in our view.

The primary driver of the improvement in the shape of the probability distribution profile is lower stock prices. That is, the market’s expectations for future corporate revenues and profits are significantly lower than they were three months ago. These lower expectations are obviously easier to exceed over time – which would subsequently result in stock prices re-rating higher.

We know that if we consistently invest based on our assessment of the shape of the probability distribution (and our assessment of the shape is approximately correct), then we know we will deliver an attractive return profile to our investors over the long term.





The Fund employs a strategy that seeks to own a relatively small number of high-quality global businesses when they are materially undervalued; and a limited amount of cash to help preserve capital when prices fall and enable the rapid deployment of dry powder when opportunities present themselves. We employ this strategy in a measured and systematic way with appropriate risk limits constraining the maximum size of any position, the maximum exposure to any one sector and the resulting net exposure the portfolio has to the overall equity market. Our ability to vary the Fund's cash holdings based on the prospective risk/reward profile is a key attribute of our strategy that we can take advantage of in volatile market conditions – such as those we find ourselves in today. We believe the value of such flexibility is only increasing in the current market conditions.

I would like to thank every MGIM team member for their continued hard work and dedication to our mission of delivering attractive returns and a positive experience to our investors. And, on behalf of the entire MGIM team, I thank each of our investors for the trust you have placed in us to preserve and grow your capital over the long term.

At the end of the 6-month period to December 2018, the Fund will pay a distribution of 7.1 cents per unit. A full tax statement will be issued post the June 30, 2019 tax year calculations. Any capital component may affect your cost base. So after ending 2018 calendar year with a Net Asset Value per unit of \$ 3.1973 we commence the 2019 calendar year with a Net Asset Value per unit of \$3.1264.

Sincerely,



Andrew Macken

Chief Investment Officer