



MONTGOMERY  
INVESTMENT MANAGEMENT PTY LTD

## Exclusive Subscriber Content

21 AUGUST 2015

# Getting there is half the fun

*"...Yet our lessons come from the journey, not the destination." Don Williams, Jr*

*By Roger Montgomery*

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## **Background**

Launched on July 1, 2015, the Montgomery Global Fund is a brand new fund so its track record is too short to glean valuable insights.

Investing in an Australian-managed overseas fund however, such as the Montgomery Global Fund, can provide the benefits of 1) diversification away the Australian Dollar, 2) access to demographic, technology and social trends unavailable in Australia, and 3) freedom from the need to investigate, research and analyse a universe of tens of thousands of global companies and stocks.

Using the three-year track record of The Montgomery Fund we demonstrate that our particular brand of Value Investing – with its focus on Quality and Value as well as the ability to park funds in the safety of cash when a sufficient number of qualifying investments are unavailable – has produced not only returns superior to the market and many peers but a profile or pattern of returns that are equally attractive.

Importantly, the focus on quality, value and cash holdings applied in The Montgomery Fund, is the same approach being adopted in the newer Montgomery Global Fund.

We invite you to consider the benefits of Montgomery's value investing approach combined with the benefits of investing overseas.

## **Introduction**

Since 2010 Montgomery has been generating superior returns for its clients, focusing on three characteristics in the investments it has made through The Montgomery [Private] Fund and The Montgomery Fund.

We have previously described our focus as being directed towards extraordinary businesses, those with strong and growing free cash flows, as well as a proven track record of smart capital allocation favouring reinvestment and high returns on incremental equity that drives significant increases of intrinsic value per share.

Three P's however can more succinctly summarise our focus and the characteristics we seek.

The first is **P**remium quality. The second are bright **P**rospects, and finally we seek an attractive **P**rice.

We have always been confident that the historical demonstration, over many decades, of the efficacy of this three-part approach would be repeated in the future. And it has been repeated through the performance of our funds. But in an environment where much of the interest rate declines have already occurred - and further general P/E expansion is therefore unlikely - our focus on the Three P's should, we believe, become even more valuable.

You may have previously tracked our individual stock stories - and the returns that have followed.

What you may not know however is the attractive profile of the returns produced by our combination of focusing on quality and price, as well as the ability to hold cash when sufficiently compelling opportunities were unavailable.

## Investing Globally

The following series of charts for The Montgomery Fund reveals that there is more to your returns than just how high they are – although we are also delighted with their magnitude to date.

Those interested in investing in The Montgomery Global Fund, may also like to keep the following findings in mind as our approach and philosophy towards extraordinary global businesses is the same as that which we have applied to extraordinary Australian listed companies and their businesses.

No doubt with tongue-in-cheek, many investors have told us their simple goal is to see their investments go up with everyone else, but not fall with them. The following charts show that, since inception of The Montgomery Fund three years ago, such a goal may not be completely unattainable.

With thanks to Morningstar, the following series of charts reveals there are a number of benefits that accrue to investors when quality, value and flexible cash holdings are combined.

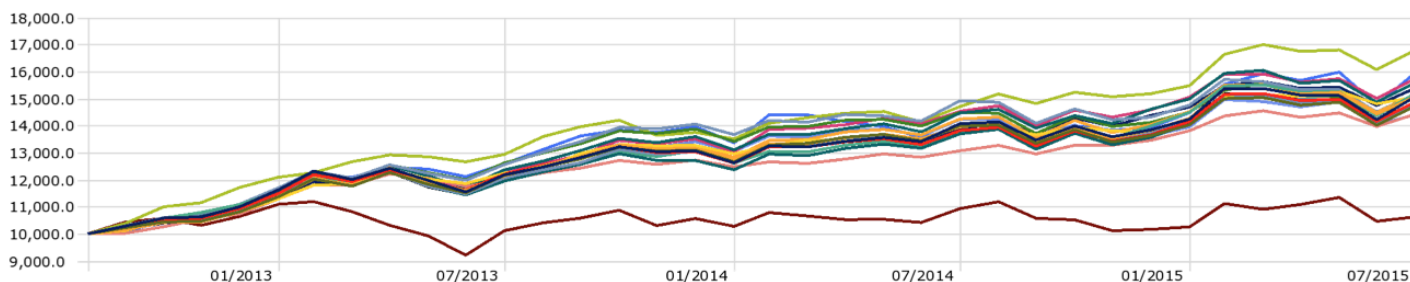
### Chart 1 – Returns

#### Manager Analysis



##### Growth of \$10,000

Time Period: 1/09/2012 to 31/07/2015



15,061.5	15,752.8	14,408.7
16,800.4	15,082.3	14,730.4
15,085.5	14,878.4	14,753.6
14,712.1	15,205.8	15,065.3
15,156.9	14,433.1	15,170.6
15,600.3	15,399.5	15,969.9
14,795.3	10,631.1	

##### Performance

Time Period: 1/09/2012 to 31/07/2015

	Return	Cumulative Return	Standard Deviation	Excess Return	Information Ratio (arith)	Sharpe Ratio (arith)	Tracking Error
The Montgomery	19.47	68.00	9.62	5.09	0.70	0.73	7.29
Montgomery Growth Style	15.13	50.62	11.30	0.70	0.37	0.22	2.05
Montgomery Value Style	14.20	47.30	11.31	-0.17	-0.13	0.15	1.31
Montgomery Share	15.14	50.85	10.77	0.76	0.43	0.25	1.78
Montgomery Share Index	14.59	48.78	11.18	0.22	0.17	0.19	1.32
Montgomery Shares	14.26	47.54	11.25	-0.11	-0.45	0.16	0.25
Montgomery Shares Class A	14.15	47.12	11.54	-0.22	-0.13	0.14	1.71
Montgomery Shares	15.45	52.06	10.89	1.08	0.41	0.27	2.66
Montgomery Turn	15.09	50.65	8.02	0.71	0.13	0.32	5.64
Montgomery Company Trust	15.32	51.57	10.94	0.95	1.18	0.25	0.80
Montgomery Class A	13.41	44.33	7.14	-0.97	-0.16	0.13	6.08
Montgomery Share W Port	15.36	51.71	10.94	0.99	0.41	0.26	2.41
Montgomery Australian Share	16.47	56.00	11.46	2.10	0.82	0.35	2.54
Montgomery Australian Equities	15.95	53.99	8.63	1.58	0.45	0.40	3.53
Montgomery Australian Equities	17.41	59.70	12.38	3.04	0.47	0.40	6.41
S&P/ASX 300 TR	14.37	47.95	11.33	0.00	0.00	0.17	0.00
S&P/ASX Small Ordinaries TR AUD	2.12	6.31	14.04	-12.25	-1.36	-0.74	9.00

Source: Morningstar Direct

Chart 1 sets the scene, since the inception of The Montgomery Fund, and reveals the returns of The Montgomery Fund compared to a wide selection of Australian Equity managers - including those with five-star ratings. The chart also notes that along with the highest cumulative return, The Montgomery Fund has generated the fourth-lowest standard deviation in the cohort and produced the highest Sharpe Ratio<sup>1</sup>.

## Delivering comfortable returns

### Chart 2 - Upside Downside Capture

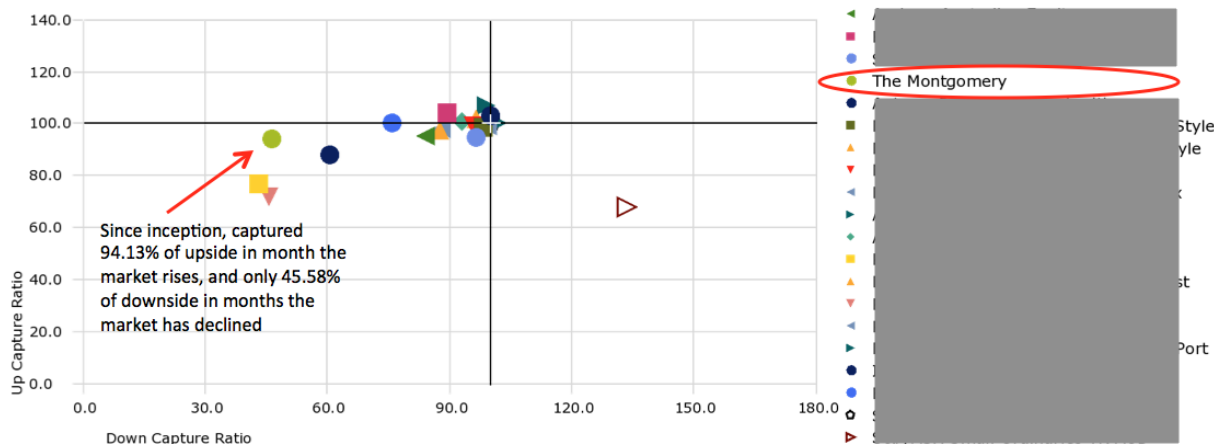
#### Manager Analysis



##### Upside-Downside Capture

Time Period: 1/09/2012 to 31/07/2015

Peer Group (5-95%): None - None



##### Market Performance

Time Period: 1/09/2012 to 31/07/2015

	Up Period Percent	Down Period Percent	Best Month	Worst Month	Best Quarter	Worst Quarter	Up Capture Ratio	Down Capture Ratio	R2
The Montgomery	74.29	25.71	7.50	-4.33	12.83	-5.45	94.13	46.58	82.04
Other managers (partially obscured)	65.71, 71.43, 65.71, 68.57, 71.43, 68.57, 62.86, 68.57, 65.71, 71.43, 74.29, 57.14, 68.57, 71.43, 62.86, 68.57, 57.14, 60.00, 57.14	34.29, 28.57, 34.29, 31.43, 28.57, 31.43, 37.14, 31.43, 34.29, 28.57, 25.71, 42.86, 31.43, 28.57, 37.14, 31.43, 42.86, 40.00, 34.29	6.40, 6.36, 7.00, 6.92, 7.13, 6.80, 7.62, 6.64, 6.25, 6.73, 5.23, 6.45, 6.31, 5.34, 8.15, 6.92, 9.81, 9.71, 9.51, 7.58	-5.19, -5.11, -5.63, -4.33, -5.45, -5.34, -5.56, -5.81, -2.97, -5.27, -3.46, -5.37, -5.13, -4.39, -7.64, -5.37, -7.77, -5.80, -7.12, -8.27	11.07, 10.35, 10.00, 12.83, 11.17, 10.11, 11.39, 10.85, 10.37, 10.48, 9.95, 11.99, 11.66, 14.29, 10.31, 14.89, 18.28, 17.23, 14.41	-7.53, -5.70, -5.71, -5.45, -6.78, -6.58, -6.48, -7.39, -2.18, -6.59, -3.99, -7.11, -7.37, -7.31, -6.48, -14.85, -7.68, -9.00, -11.16	95.36, 104.18, 104.63, 98.57, 98.72, 98.96, 99.34, 100.07, 100.74, 76.96, 101.94, 71.96, 98.11, 107.16, 87.90, 100.00, 100.00, 67.90, 112.60, 97.72, 78.45	84.17, 89.33, 86.60, 98.25, 87.70, 95.96, 99.44, 101.94, 92.96, 43.17, 96.62, 45.73, 87.92, 98.94, 60.59, 75.77, 100.00, 133.59, 112.60, 97.34, 67.01	97.40, 98.43, 98.04, 99.44, 99.02, 99.44, 99.98, 99.07, 97.85, 89.75, 99.78, 90.65, 98.10, 97.84, 97.71, 86.37, 100.00, 78.85, 88.17, 83.82, 79.88

Source: Morningstar Direct

<sup>1</sup> The Sharpe ratio is a risk-adjusted measure of return used to evaluate the performance of a portfolio. The ratio renders the performance of one portfolio comparable to another by adjusting for risk. For example, if manager A generates a return of 15% while manager B generates a return of 12%, it would appear that manager A is a better performer. However, if manager A, who produced the 15% return, took much larger risks than manager B, it may actually be the case that manager B has a better risk-adjusted return. If the risk free-rate is 5%, and manager A's portfolio has a standard deviation of 8%, while manager B's portfolio has a standard deviation of 5%. The Sharpe ratio for manager A would be 1.25 while manager B's ratio would be 1.4, which is superior to manager A. Manager B generated a higher return on a risk-adjusted basis.

Chart 2 is the Upside/Downside Capture chart and it reveals the ability of The Montgomery Fund, since inception, to shepherd investors through months that have been negative for the broader market. When investors demand their wealth to rise with everyone else but not fall at the same time, they are usually being facetious. Chart 2 reveals it is possible albeit not guaranteed.

The vertical black line intersecting the horizontal axis at 100 per cent reveals the market's natural and expected predisposition to capturing 100 per cent of the downside movement in any month that generated a negative return, since inception. If the market falls in a month, obviously the market index will capture 100 per cent of that movement.

Similarly, the black line intersecting the vertical axis at 100 per cent reveals the market's predisposition to capturing 100 per cent of the upside movement in any month that generated a positive return.

In all the months since its inception, The Montgomery Fund has captured 94.13 per cent of the upside movement during months where the index recorded a positive return. Importantly however, investors have enjoyed the benefits of The Montgomery Fund capturing an average of only 46.58 per cent (less than half) of the downside movement in any month that the index recorded a negative return.

This is a very desirable outcome and while there is no guarantee that this return profile will be repeated in the future, it remains a testament to the advantages and benefits of the particular brand of value investing that Montgomery Investment Management applies across its funds - combining quality and value, with an ability to hold funds in the safety of cash, when the preservation of capital is paramount.

The final two charts may help to explain the hitherto attractive returns and return profile of The Montgomery Fund. If you own a portfolio of direct shares such as the banks and Telstra – as many investors do – or if you have already invested with other fund managers, the following charts demonstrate a significant diversification benefit from adding The Montgomery Fund to your portfolio of investments.

## True Diversification

Chart 3 – Uncommon Holdings

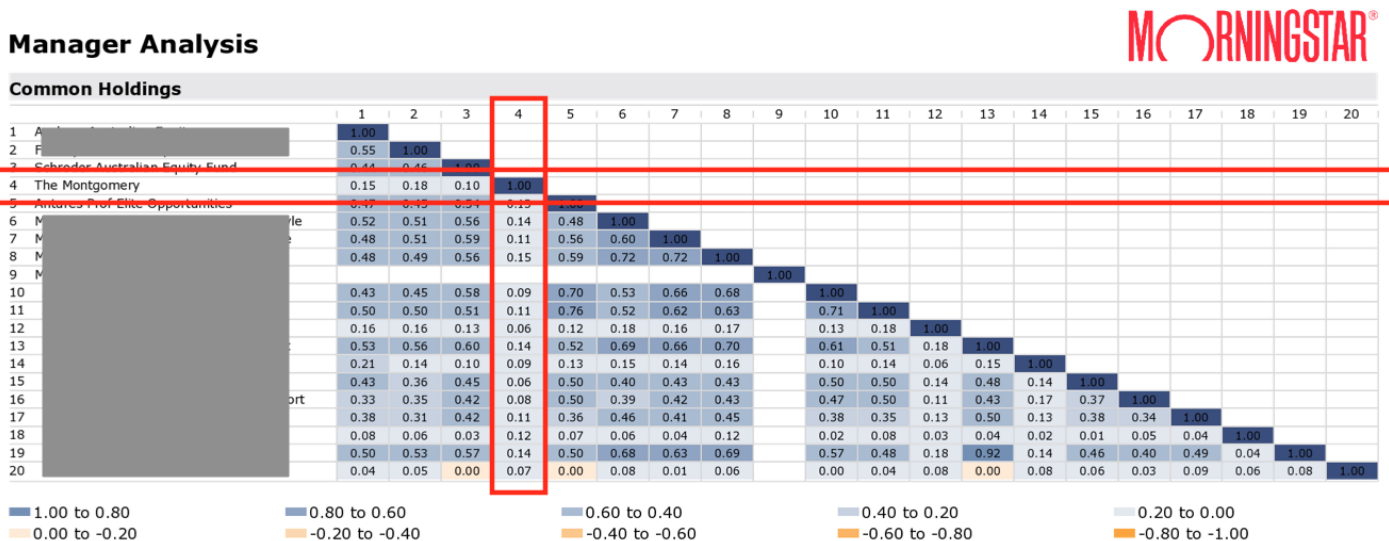


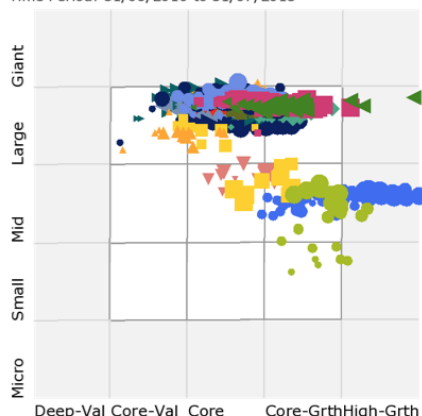
Chart 3 reveals The Montgomery Fund holds very few shares, by proportion of the total portfolio, in common with other managers. In other words, real diversification may be a little harder to come by through blending the other manager's funds together. Adding The Montgomery Fund however offers genuine diversification because The Montgomery Fund's holdings are very different.

## Real Blue Chips

### Chart 4 – Uncommon Ground

#### Holdings-Based Style Trail

Time Period: 31/08/2010 to 31/07/2015



Source: Morningstar Direct

▲	...	30/09/2010	30/06/2015
■	...	31/08/2010	30/06/2015
●	...	31/08/2010	31/03/2015
●	The Montgomery	31/12/2012	30/06/2015
▲	...	31/08/2010	31/05/2015
■	...	30/09/2010	30/04/2015
▲	...	30/09/2010	30/04/2015
▼	...	30/09/2010	30/04/2015
×	...		
▶	...	31/08/2010	31/05/2015
▶	...	31/08/2010	31/05/2015
■	...	30/09/2010	30/06/2015
▲	...	31/08/2010	30/06/2015
▼	...	30/09/2010	31/03/2015
▶	...	30/09/2010	31/05/2015
▶	...	31/08/2010	30/06/2015
●	...	31/08/2010	30/06/2015
●	...	31/08/2010	31/07/2015

The final chart shows the field from which 75 per cent of The Montgomery Fund’s portfolio is gleaned. Very few funds in the cohort invest where The Montgomery Fund does. As you know, we do not believe the conventional definition of a ‘blue chip’ company makes any sense. We believe true blue chip companies come in a variety of sizes because quality is unrelated to size.

The light green spheres represent some of The Montgomery Fund holdings and what we find very interesting is that while we describe ourselves as true value investors, our holdings are labeled by Morningstar as “Core Growth” or “High Growth” companies.

In our view, growth and value are two sides of the same coin. One cannot value a company’s shares without estimating its growth, also known as its prospects. In the long run, share prices are determined by intrinsic values and we prefer businesses that can grow their intrinsic value at an attractive rate. Only then will the share price take care of itself to our investors’ satisfaction.

Perhaps because we focus on businesses that grow their intrinsic value, rather than stocks that merely rise and fall on a screen, we are fishing in a different pond to many others as Chart 4 reveals.

None of this would matter of course if the returns hadn’t been attractive (Chart 1), or the combination of quality and cash didn’t lead to a more attractive return profile (Chart 2). Fortunately, so far, it seems investors have received tangible benefits from genuine diversification, a truly different approach to investing in the stock market, the ability to hold cash (which has protected the downside) and a focus on value and quality companies, which have both contributed to the superior returns to date.

The data presented in this Whitepaper applies to The Montgomery Fund. More recently we have launched the Montgomery Global Fund, which adopts the same approach to extraordinary global businesses, many with what we believe a very long term non-discretionary growth profiles. Past returns however should not be relied on as a guide to future returns so be sure to speak to your adviser about the appropriateness of a Montgomery fund to your needs and circumstances.

To express your interest now in The Montgomery Fund or the Montgomery Global Fund [please click here](#). We will be in touch promptly.

Alternatively, you can read more information about both funds here:

- [\*The Montgomery Fund\*](#)
- [\*Montgomery Global Fund\*](#)