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Montgomery Investment Management

Should clients reduce their direct share exposure?

David Buckland
CEO

Scott Phillips
Head of Distribution

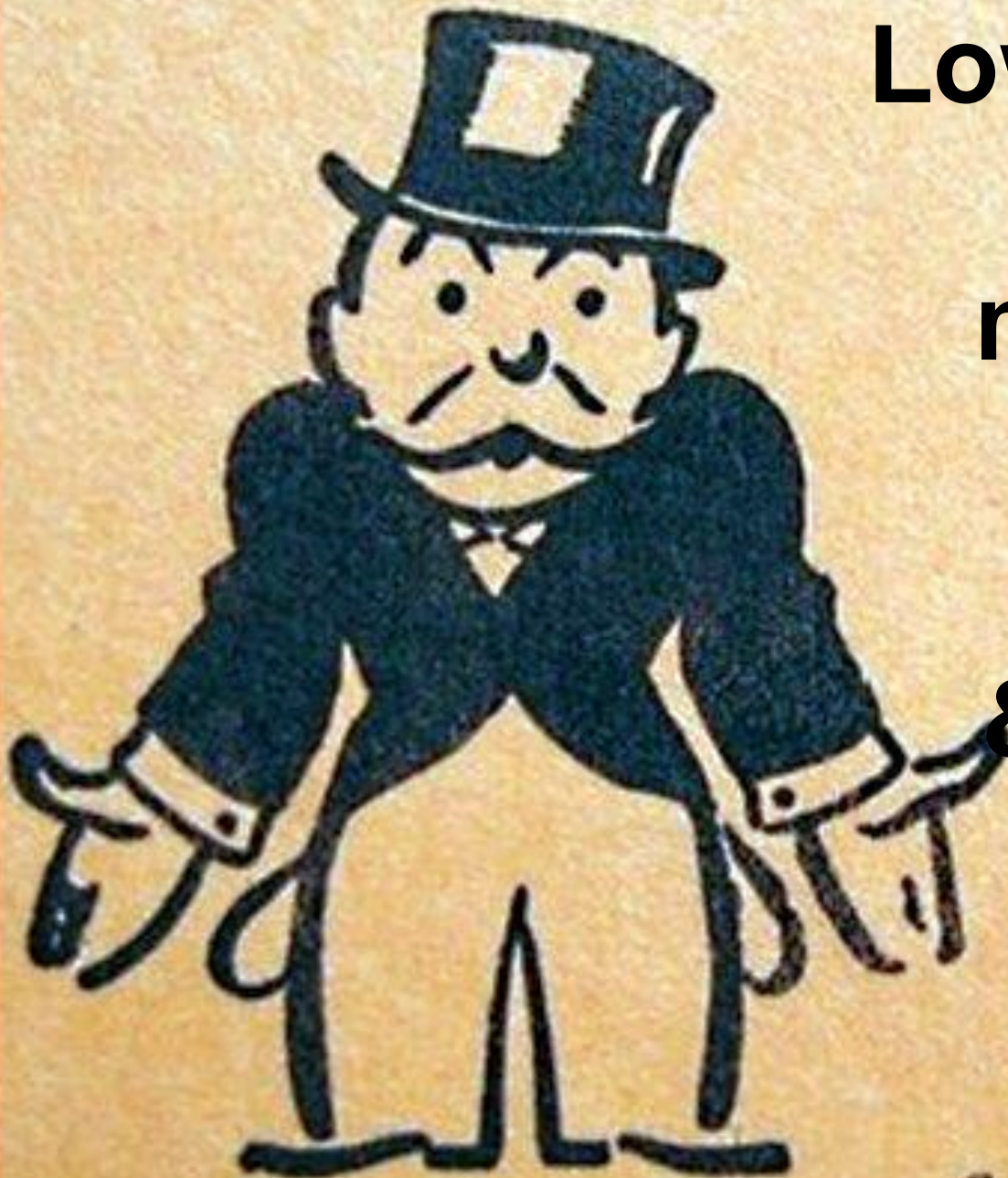
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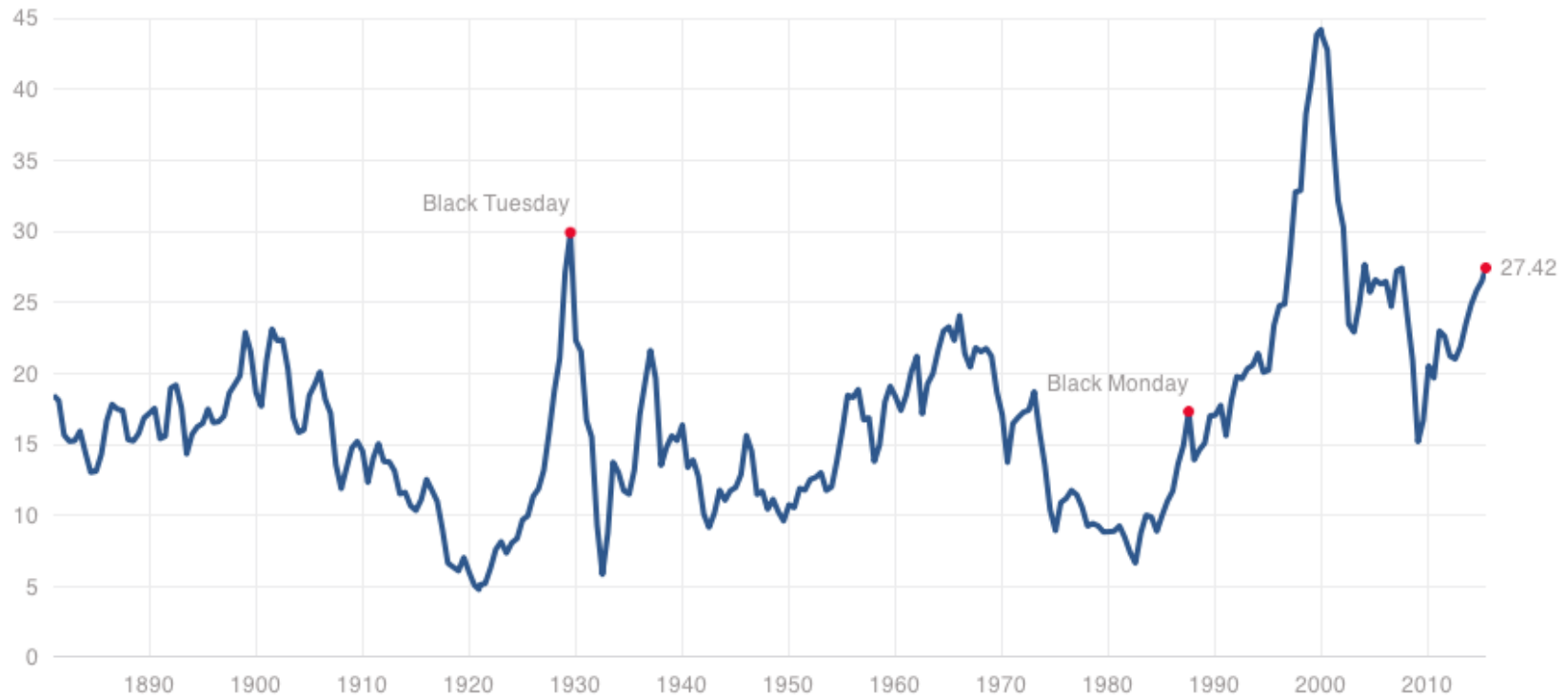
**Low interest rates
have made
millionaires feel
poor...**

**& Chasing yield
is their mistake**

Losing Interest

Country	Peak/Year	2015 Low (%)	4 th June 2015 (%)	1900-2011 average rate of inflation (%)
United States	16% / 1981	1.64	2.29	3.0
United Kingdom	16% / 1982	1.32	2.02	4.0
Germany	11% / 1982	0.07	0.67	4.8
France	16.3% / 1981	0.35	0.99	7.2
Italy	24% / 1980	1.03	1.86	8.4
Japan	10% / 1976	0.19	0.45	6.9
Australia	16% / 1982	2.30	3.05	4.0
Ave. of 7 countries	15.6%	0.99	1.72	

Higher prices = Lower returns (Shiller P/E 10yr)



- **With exception of bubbles, P/E's peak here**

Driving low quality gains.

Date	ASX300 - Price	ASX 300 Price Return (Capital Growth)	ASX 300 Earnings Index (Earnings Growth)	ASX 300 P/E Ratio (Multiple Expansion)
2/28/2010	4631.09		\$343.81	13.47
2/28/2011	4843.35	4.58%	\$389.02	12.45
2/29/2012	4302.13	-11.17%	\$380.05	11.32
2/28/2013	5077.15	18.01%	\$354.55	14.32
2/28/2014	5356.52	5.50%	\$375.37	14.27
2/28/2015	5860.03	9.40%	\$362.63	16.16
5 year change		26.54%	5.47%	19.97%

House prices

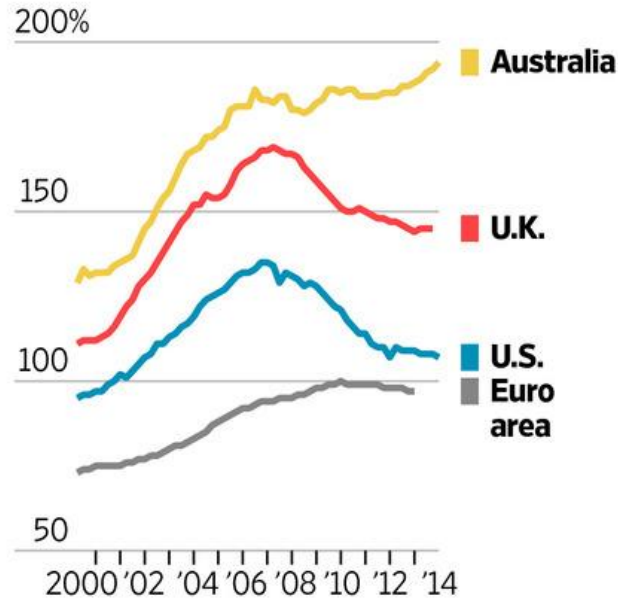
Through the Roof?

Low interest rates and a booming housing market are driving Australians to take on record debt. Real estate is less affordable in Wollongong, a steel town near Sydney, than in New York City.

Overnight cash rate



Household debt as a percentage of annual income



Home prices as a multiple of annual income

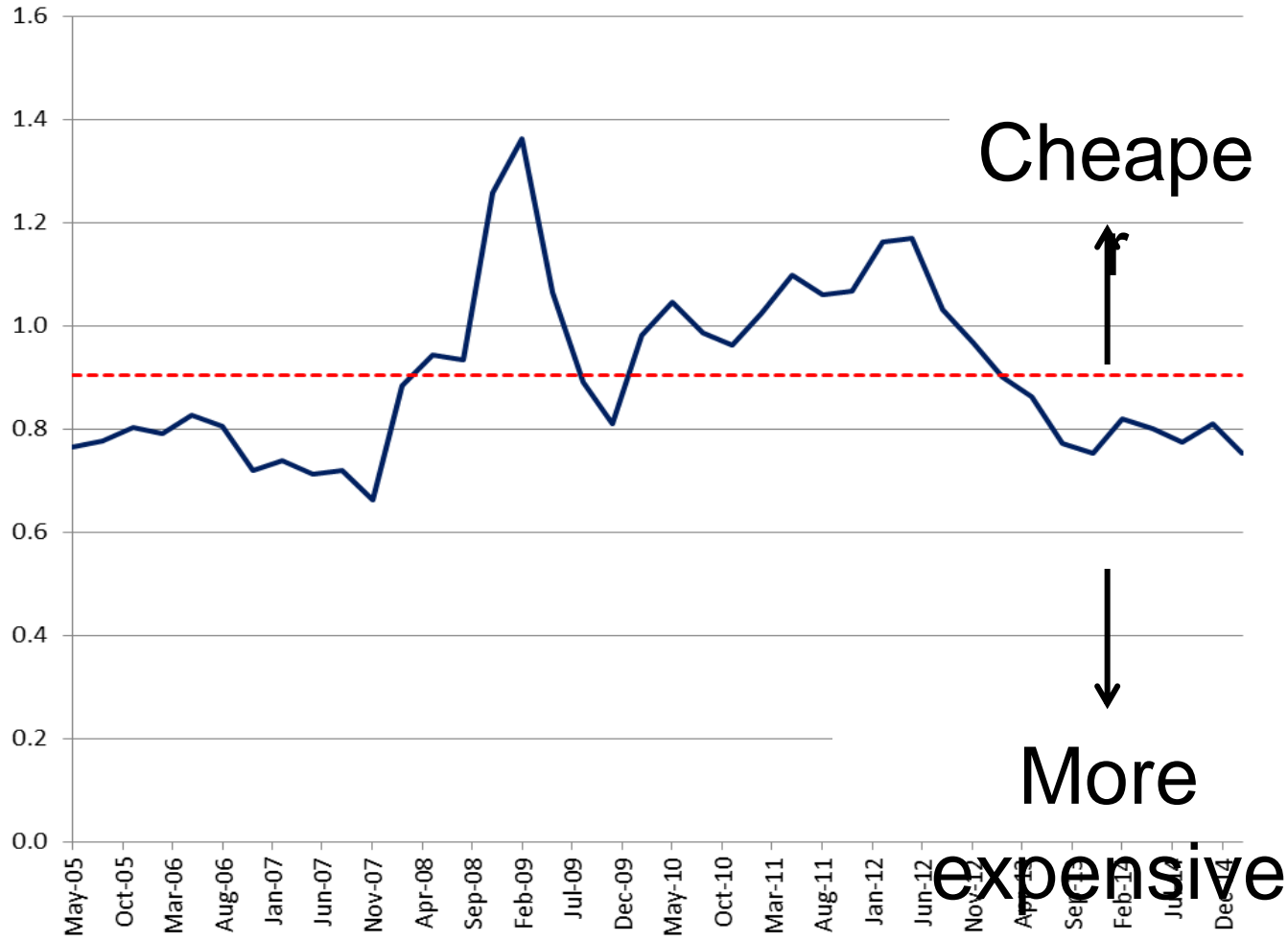


Sources: Reserve Bank of Australia (cash rate); Barclays (debt); 11th Annual Demographia International Housing Affordability Survey (2015) (home prices)

THE WALL STREET JOURNAL.

RATIO OF VALUE TO PRICE (Normal if rates stay low)

Selected Companies



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Caution Required

- The higher the price you pay, the lower your return
- Bonds no safe harbour from high P/Es
- Risk spectrum migration
- Discount rate's 'gravitation' pull on assets
- Concentration of risks (eg: Retirees and Property)

Montgomery's Quality and Performance Scoring

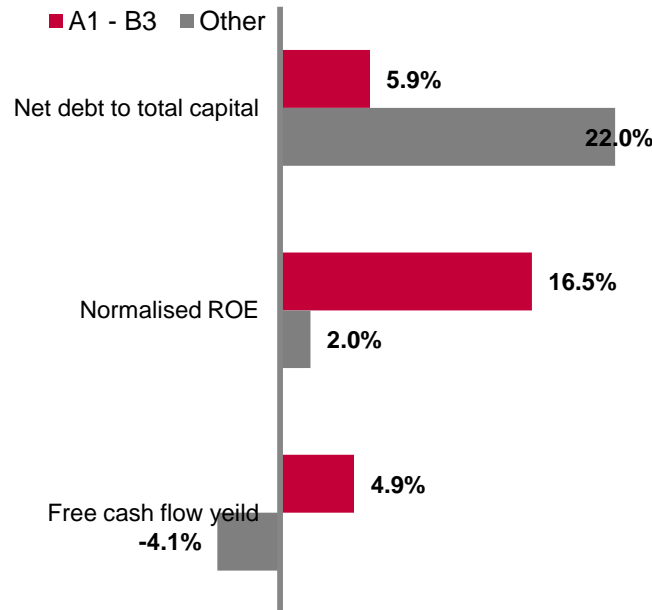
Quality and Performance Matrix
Categories

▲ Improving performance

◀ Improving credit quality

A1	B1	C1
A2	B2	C2
A3	B3	C3
A4	B4	C4
A5	B5	C5

Selected Financial Parameters¹
Arithmetic averages



Quality and performance scores are calculated automatically, using 37 individual financial ratios

The methodology is based on published academic work, adapted and improved by Montgomery

Companies within the A1-B3 range are stronger across a range of financial metrics relevant to future investment performance

¹Listed companies with market capitalisation above \$250m; Analysis current as at October 2014.

Investing 101. What are you doing?

- **Stocks or Business**
 - Stocks = Up/Down, Business = Value accretion
- **Quality**
 - If business, which businesses?
- **Valuation**
 - How is business value increased?

Focus on businesses growth – not yield alone

2005

*m2*telecom

Telstra

Investment	\$100	\$100
Price	\$0.32	\$4.69
Dividend	\$0.0125	\$0.28
Yield	3.91%	5.97%
Total Income	\$3.91	\$5.97

2015

*m2*telecom

Telstra

Investment	\$3,453	\$132
Price	\$11.05	\$6.18
Dividend	\$0.30	\$0.30
Yield	2.71%	4.85%
Yield on Purchase	93.75%	6.40%
Total Income	\$93.75	\$6.40

WHERE DO WE SEE OPPORTUNITIES?

Sectors of Interest

Sector	Appeal	Examples	Comments
Telecoms (ex-TLS)	<ul style="list-style-type: none">• Solid growth• Strong ROE potential• Recurring revenue	<ul style="list-style-type: none">• AMM/ VOC• MTU	<ul style="list-style-type: none">• Opportunity set diminishing due to industry consolidation
Health Care	<ul style="list-style-type: none">• Good long-term structural theme• Pricing power	<ul style="list-style-type: none">• CSL• RHC• SRX?	<ul style="list-style-type: none">• Prices now generally reflect quality and prospects
Asset managers	<ul style="list-style-type: none">• Long term growth in asset pool• Low capital requirements – good incremental economics	<ul style="list-style-type: none">• CGF• BTT• HGG	<ul style="list-style-type: none">• Prices now generally reflect quality and prospects

UnBlue Chips – Are prospects deteriorating?

- **Woolworths**
 - Aldi threat a serious risk to margins
- **BHP**
 - Triple the debt in five years, 2X equity in 7, and lowest profits in a decade.
- **NAB, CBA, WBC & ANZ**
 - CET1, and MRWR and rising bond yields
- **Telstra**
 - Nil NPAT growth in 12yrs

Solutions: An unconventional approach

(be cautious around interest rate sensitive assets)

- **Taking Profits or Holding for income**
 - Cautious on REIT's and selected infrastructure assets
- **Aim for growing income rather than yield**
 - M2/Telstra
- **Cash guarantees 2.58%**
 - Floundering 'Blue Chips' and recent bank share price performance demonstrates risk
- **Some international opportunities**
 - Quality and prospectus at a reasonable price vs IV

An approach to your “cash weighting”

Portfolio Model – Screen shot

20%	25%	30%
5%	15%	25% +

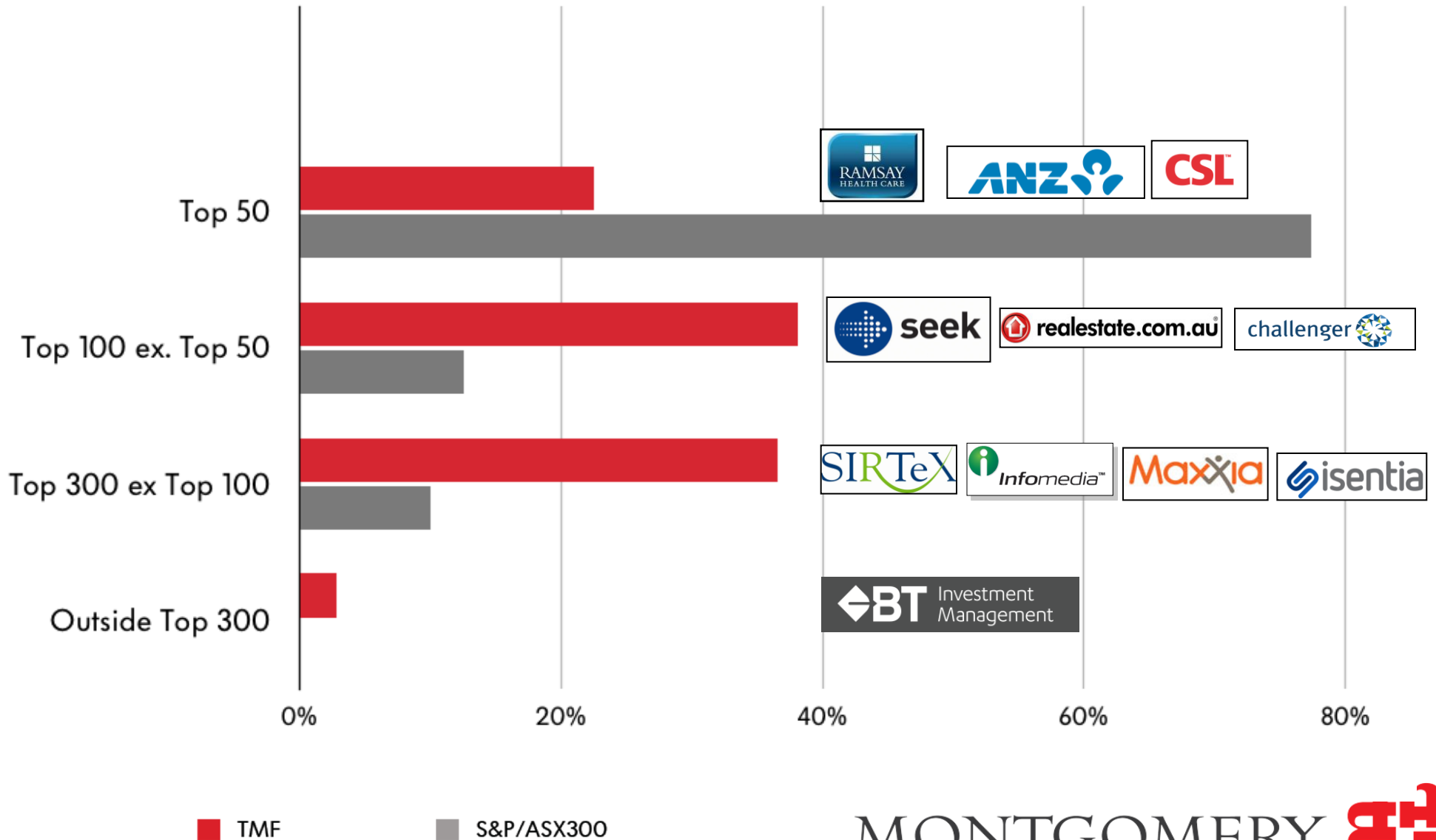
Comments

- An indicative cash weighting is produced by the TMF portfolio model based on two factors:
 - **Portfolio discount to intrinsic value** is based on the aggregate discount to intrinsic value for the companies selected into the portfolio, calculated from SALT valuations (without analyst adjustment).
 - A larger discount leads to a lower cash weighting.
 - Historic **index volatility** is also measured. Where volatility rises above a determined threshold, the indicative cash weighting is increased.
- Analysis by Montgomery indicates that setting cash weighting with regard to these factors has the potential to both lower risk and enhance returns
- Montgomery may modify the suggested cash weighting if it believes there are grounds to do so

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Logical Market Capitalisation Spread – May 2015



The Montgomery Fund

PORTFOLIO PERFORMANCE

(to 31 May 2015, after all fees)

	INCOME	CAPITAL GROWTH	THE MONTGOMERY FUND	S&P/ASX 300 ACCUM. INDEX	OUT/UNDER PERFORMANCE
1 month	0.00%	0.30%	0.30%	0.43%	-0.13%
3 months	0.00%	0.96%	0.96%	-1.28%	2.24%
6 months	1.02%	10.45%	11.48%	11.18%	0.29%
12 months	3.32%	12.35%	15.67%	9.93%	5.75%
2 years (p.a.)	4.85%	9.48%	14.33%	12.98%	1.35%
Since inception#	12.78%	54.79%	67.56%	49.22%	18.34%
Compound annual return (since inception)#	4.21%	15.78%	19.98%	15.17%	4.81%

17 August 2012

The Montgomery Fund – the benefits of a high quality portfolio combined with a flexible weighting to cash

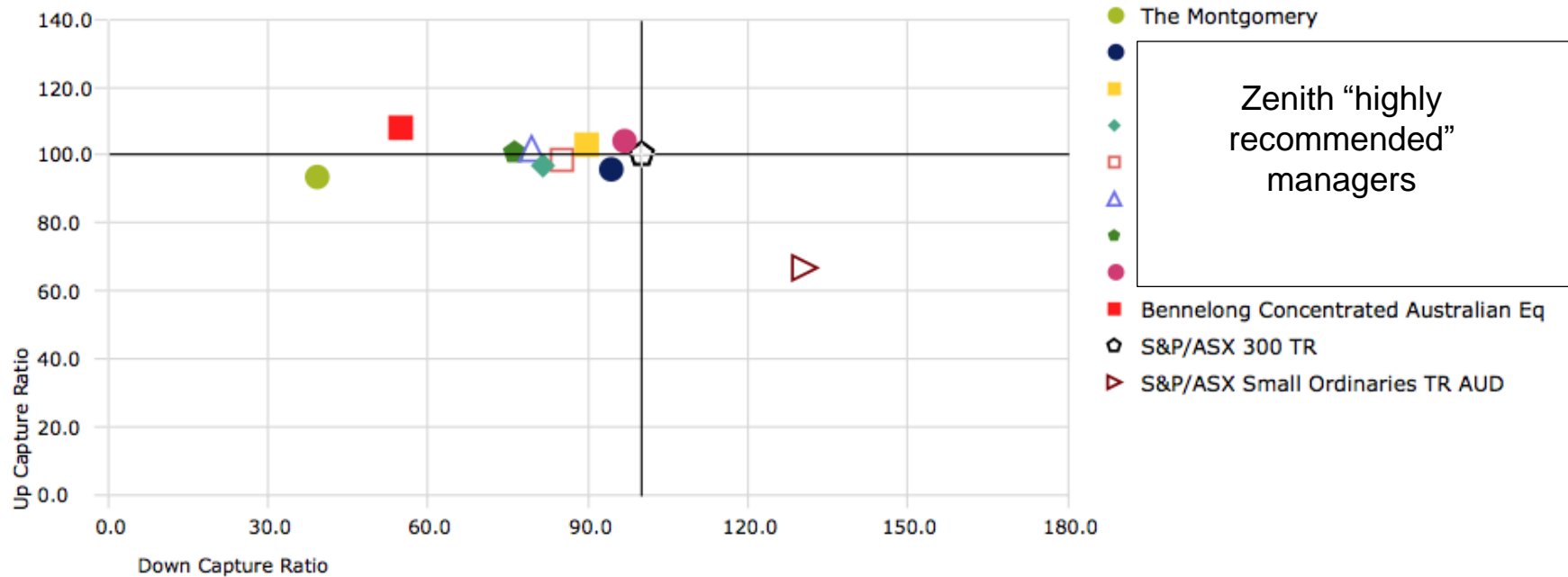


Manager Analysis

Upside-Downside Capture

Time Period: 1/09/2012 to 30/04/2015

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



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For enquires into:

- The **Montgomery** Fund

- Montgomery **Global**
Fund

Please contact:

Scott Phillips
David Buckland

Montgomery Investment
Management
ph 02 8046 5000
www.montinvest.com

sphillips@montinvest.com
dbuckland@montinvest.com

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