



Montgomery Small Companies Fund

2026 Annual Letter to investors

August 2026

To our investors:

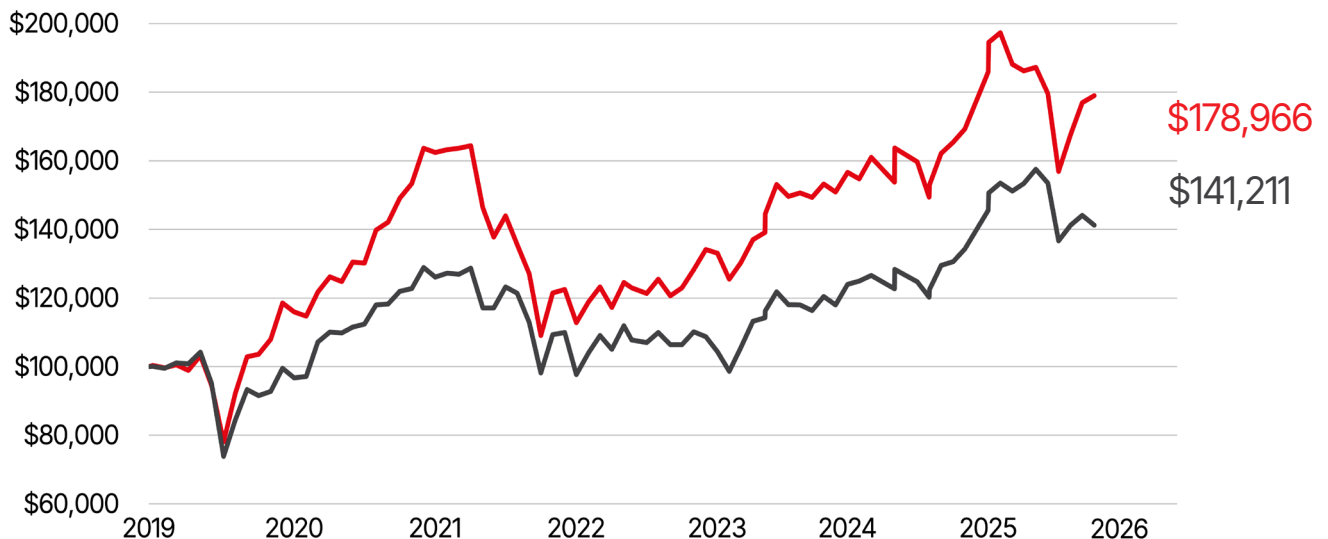
Dear fellow investors,

Welcome to the Montgomery Small Companies Fund 2026 Annual Letter, covering the financial year ended 30 June 2026. On behalf of Dominic Rose, Portfolio Manager, and myself, we extend our sincere thanks for your continued trust and support. Like you, our families have invested in the Fund alongside yours – an alignment that underscores our shared commitment to delivering strong outcomes for our investors in an ever-evolving market environment.

The Montgomery Small Companies Fund performance

For the year to 30 June 2026, the Montgomery Small Companies Fund (the Fund) returned 8.20 per cent, while its benchmark, the S&P Small Ordinaries Accumulation Index increased by 8.11 per cent. After all fees and expenses, the Fund outperformed the benchmark by 0.09 per cent over the period. Since the Fund's inception on 20 September 2019 to 30 June 2026, the Fund has returned 78.97 per cent, outperforming the benchmark by 37.76 per cent after all fees and expenses.

The Montgomery Small Companies Fund performance since inception to 30 June 2026



Source: Fundhost / Montgomery

Distributions

With the conclusion of the financial year, the Fund has paid a distribution of 6.0806 cents per unit. Accordingly, after ending the 2026 financial year with a unit price of \$1.5878, we commence the 2027 financial year with a unit price of \$1.5270.

Distribution history for the Montgomery Small Companies Fund to 30 June 2026

Year to June	Distribution (cents per unit)
2021	7.8912
2022	2.6168
2023	0.7777
2024	0.2438
2025	4.6193
2026	6.0806
Total distributions since inception	22.2294

Market overview

Global equities posted strong gains during the 2026 financial year, led by impressive performances in the United States (U.S) where the S&P 500 advanced 20.9 per cent and the tech-heavy NASDAQ surged 28.7 per cent, both making all-time highs in June 2026.

U.S. economic growth and corporate earnings proved much more resilient than markets feared heading into the period. Despite the initial overhang from the 'Liberation Day' tariffs introduced in early 2025, real-world corporate execution and aggregate household consumption remained robust, cushioned by tax cuts that insulated consumers from ongoing cost pressures. Concurrently, an unprecedented wave of capital expenditure (capex) driven by the artificial intelligence (AI) build-out acted as a massive fiscal engine. As hyperscalers and enterprises poured billions into physical hardware, semiconductor pipelines and advanced computing capacity, this structural investment tailwind provided a powerful offset to macroeconomic headwinds.

Beneath the surface, the path was highly volatile as investors navigated sharp geopolitical shocks and an aggressive bifurcation within the technology sector. The primary geopolitical disruption arrived in March 2026 with the outbreak of war involving Iran. The conflict caught the global market by surprise, particularly the closure of the Strait of Hormuz which is a key transport corridor accounting for roughly 20 per cent of the world's oil supply. This supply restriction caused crude oil and fuel costs to skyrocket overnight, prompting global investors to rapidly de-risk equity portfolios. Months later, a precarious ceasefire was brokered and long-term peace negotiations commenced, bringing much-needed supply-side relief to the global inflation outlook.

Technology stocks continued their equity market leadership, however within the sector the acceleration of the AI trade revealed a stark dividing line between infrastructure providers and application software. 'AI winners' such as physical compute infrastructure and memory capacity players were aggressively bought by investors, whilst simultaneously dumping 'AI losers' manifesting as a structural sell-off coined by the market as the 'SaaSocalypse.' Late in calendar year 2025, investors rapidly exited traditional Software-as-a-Service (SaaS), and technology services companies perceived to be vulnerable to AI-driven disruption or labour displacement. For decades, SaaS platforms represented the gold standard of business models due to high recurring margins and sticky retention. Financial year 2026 saw the market "shoot first, ask questions later," deeply penalising software businesses where competitive moats and pricing power came under question in an AI-native world.

This fluid backdrop was further complicated by the leadership transition at the U.S. Federal Reserve (The Fed), where newly appointed Chair Kevin Warsh struck a far more hawkish tone than anticipated. The Fed had cut interest rates by a cumulative 75 basis points over financial year 2025, however the new Chair used his initial meetings and press conferences to overhaul forward guidance, signalling less clarity and a renewed emphasis on maintaining restrictive settings.

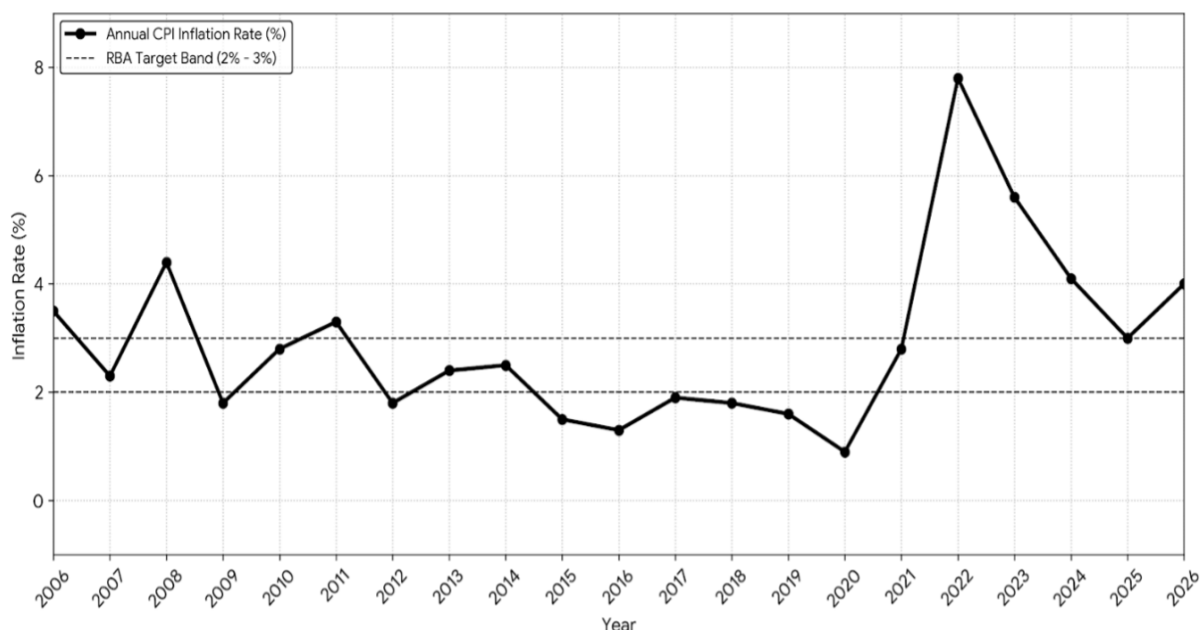
This unexpectedly hawkish outlook caught fixed income markets off guard, forcing global investors to price out expectations for near-term monetary easing and shifting consensus toward a higher-for-longer pause with risks of hikes.

Domestically, the Reserve Bank of Australia (RBA) executed a complete policy pivot that ran counter to early global easing trends. Faced with stubbornly high inflation, a tight labour market, and an economy running with aggregate demand well ahead of capacity, Governor Bullock shifted away from her previous easing trajectory to deliver three successive interest rate hikes in the second half of financial year 2026. Additionally, proposed tax changes in the Federal Government's May Budget fuelled market fears of a sharp economic slowdown driven by a slumping housing market, reduced consumer spending from falling household wealth, and persistent cost-of-living pressures.

The S&P Small Ordinaries Accumulation Index posted an 8.11 per cent gain over the 2026 financial year, though this headline figure masks a pronounced divergence between the index's two primary engines. Small Resources surged an extraordinary 29.2 per cent, significantly outperforming Small Industrials, which slid 3.9 per cent into negative territory.

The resources boom broadened beyond gold. Spurred by global geopolitical tensions and national security concerns, capital pivoted to energy and critical minerals feeding two structural trends: the green energy transition and the AI infrastructure build-out. Conversely, Small Industrials bore the brunt of deteriorating domestic macroeconomic conditions. Strengthening headwinds pressured rate-sensitive and discretionary consumption sectors, while a wave of global risk-off sentiment in the back half of financial year 2026 disproportionately compressed the valuation multiples of high-growth small cap industrials.

Australia annual Consumer Price Index (CPI) indicator (2006-2026)



Source: Australian Bureau of Statistics

Winners and losers in the 2026 financial year

The top three winners for the Fund over the 2026 financial year were Codan (ASX:CDA), Megaport (ASX:MP1) and NRW Holdings (ASX:NWH). Codan's share price gain was driven by strong earnings delivery and new product development, capitalising on the elevated gold price and increasing global defence expenditure.

Megaport shares surged following major new compute contract wins, driving material consensus earnings upgrades. Investors are rewarding the company's pivot from a pure-play Network-as-a-Service provider into a global, distributed "neocloud" infrastructure model, capturing direct structural tailwinds from AI inference and high-performance workloads. NRW Holdings remains in an earnings upgrade cycle, underpinned by a strong order book and tender pipeline across the core resources and infrastructure engineering and civil construction divisions, as well as the newly acquired Fredon business which is directly exposed to data centre capex.

On the downside the three biggest detractors in the year were Generation Development (ASX:GDG), Liontown (ASX:LTR) and Smart Parking (ASX:SPZ). Generation Development shares were punished after missing near-term fund inflow targets within its recently acquired Evidentia managed accounts business, temporarily clouding its structural growth narrative. Liontown's appearance on the downside ledger was predominantly a function of investment timing. The holding caught the global downdraft in spot lithium pricing that materialised in the backend of the financial year. Smart Parking sold off as investors feared that spikes in global fuel prices stemming from the Middle East conflict would negatively impact international traffic mobility, compounded by the stock's relatively tight liquidity.

Investment strategy

The Fund concentrates on investing in small domestic companies and does not rely on significant macroeconomic predictions. When shaping the portfolio, our approach focuses on minimising exposure to geopolitical or macroeconomic risks, instead prioritising 'bottom-up stock' analysis for whatever market conditions we find ourselves in, with the aim of finding where the best value is to drive portfolio returns no matter what the macroeconomic conditions are. However, any view of the future would not be complete without first acknowledging (as we always do) the current macroeconomic climate and the risks and opportunities in markets that we see today.

Outlook

The U.S. economic growth outlook remains resilient, driven by a strong AI capex cycle, robust corporate earnings, and a firmer-than-expected labour market. While recent commentary from the Federal Reserve Chair indicates that inflation is still tracking above target, this is largely attributed to transitory factors, with long-term inflation expectations remaining anchored to the downside.

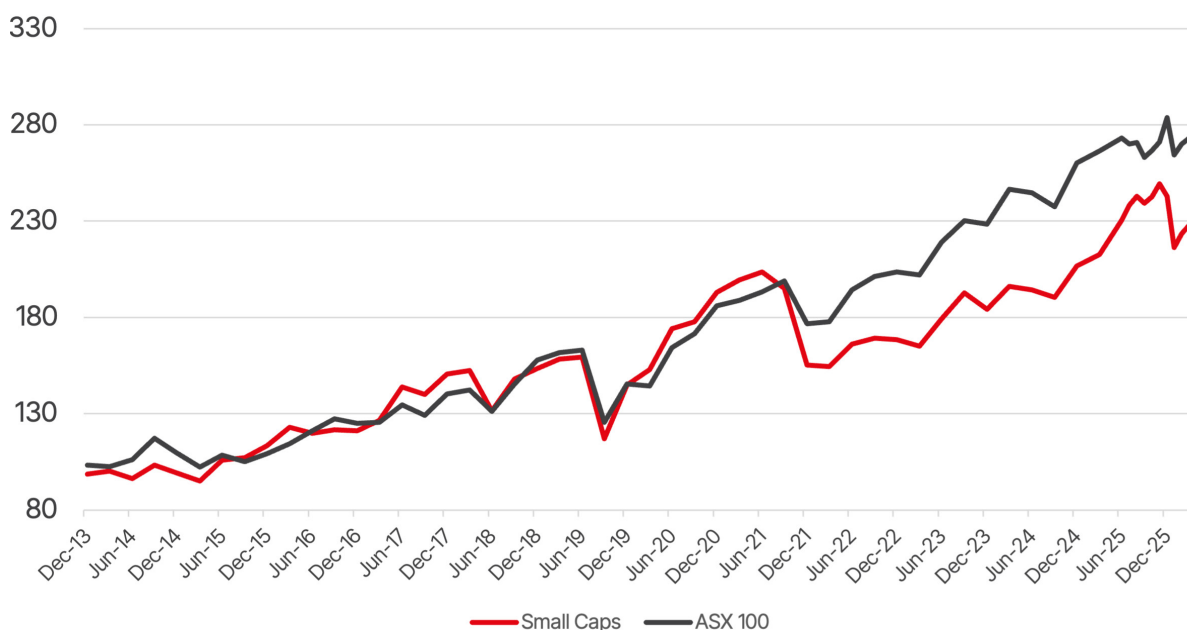
Confronted with a more hawkish Fed stance and stronger economic data, the bond market has priced out expectations for rate cuts this calendar year. Consensus now points to a 'higher-for-longer' pause, with risks skewed toward a potential rate hike. On the consumer front, recent tax cuts have helped cushion the impact of elevated fuel prices, while oil markets have stabilised at more reasonable levels as a fragile ceasefire in Iran holds. Conversely, downside risks persist around private credit exposures, particularly regarding software company debt, which remains a key watching brief for markets.

The outlook for the Australian economy has deteriorated following three RBA rate hikes and a May Federal Budget that introduced fresh concerns regarding the housing market. Persistent public and private expenditure, alongside a tight labour market, have kept domestic inflation elevated relative to other developed nations. This stickiness has left economists divided on whether current RBA policy settings are sufficiently restrictive to drive inflation back into the target band.

While macroeconomic sensitive areas like consumer discretionary face clear headwinds, broader economic growth continues to find support from population growth and a robust pipeline of infrastructure projects – specifically data centre builds and energy transition initiatives. Additionally, the resources sector provides a strong growth platform, buoyed by sustained commodity prices and a narrative shift toward critical resource security.

The setup for small cap equities remains highly attractive. Ongoing macroeconomic uncertainty continues to weigh on investor appetite, creating a prime environment for bottom-up stock pickers. This environment allows us to find mispriced, early-stage, high-growth companies with earnings profiles that are typically less sensitive to macroeconomic trends compared to their larger counterparts.

Benchmark returns profile, December 2013-June 2026, small caps versus large caps (ASX 100)



As illustrated above, the performance gap between the Australian small cap benchmark (S&P/ASX Small Ordinaries Accumulation Index) and the domestic large cap index (S&P/ASX 100 Accumulation Index), which first emerged in 2022 amid aggressive global interest rate hikes to combat inflation, remains firmly in place. While domestic small caps outperformed large caps over the 2026 financial year (+8.1 per cent versus +6.1 per cent), it was ultimately a tale of two halves. Small caps materially outperformed during the first six months as investors rewarded their stronger, more certain earnings growth profile. However, small caps gave back a significant portion of those gains in the second half as global risk-off sentiment soured market confidence.

Portfolio positioning

Our portfolio positioning remains structured to capitalise on a stark disconnect between robust underlying small cap company fundamentals and depressed market sentiment which we see as transitory. We remain overweight to small cap growth companies that are directly leveraged to powerful, multi-year structural tailwinds. While these secular drivers remain firmly intact, broader macroeconomic uncertainty and weaker risk sentiment have dragged small cap valuations down to historically cheap levels. We view this dislocation as non-fundamental and expect to capture substantial re-rating potential as investor sentiment normalises and earnings growth comes through.

This attractively priced earnings growth profile is accompanied by unprecedented balance sheet strength within the asset class. Small caps have been hoarding liquidity, with roughly 40 per cent of the domestic small cap index currently sitting in a net cash position. This insulates our companies from the risk of tougher macroeconomic conditions whilst providing significant strategic optionality. As the macroeconomic outlook stabilises, we expect this cash hoard to fund highly accretive sector consolidation, opportunistic bolt-on acquisitions, and aggressive expansion initiatives that will drive long-term market share gains.

Complementing this growth exposure, we maintain an overweight position in resources and contractors which continue to exhibit strong sector fundamentals. We are seeing demand growth outpacing supply across key commodities, supporting a robust pricing environment. This backdrop is being driven by immense, non-discretionary global spending programs, including the clean energy transition, the securing of critical minerals supply chains, rising defence budgets, and the massive capital expenditure required to build out artificial intelligence infrastructure.

Conversely, we remain underweight consumer discretionary and rate-sensitive bond proxies. Near-term macroeconomic headwinds such as higher interest rates, weaker housing activity and cost of living continue to pressure discretionary consumption. Additionally, we think this backdrop also warrants caution around investing heavily into real estate investment trusts.

Conclusion

The financial year 2026 was defined by profound market dispersion, accelerating structural megatrends, and sudden macroeconomic regime shifts. Globally, it was a highly rewarding period for major indices, yet beneath the surface lay extreme style and sector crosscurrents. Domestically, the Australian small cap market became a battleground of two distinct speeds: a roaring resources sector contrasted against a highly pressured industrial complex. As we have seen many times before, risk-off sentiment swings present compelling investment opportunities for those brave enough to look beyond the next quarter.

Despite geopolitical tensions, shifting monetary policy, and changing investor sentiment, we believe the outlook for Australian small caps remains highly compelling. The broader market continues to overlook persistent valuation gaps, robust balance sheets, and quality growth businesses that are consistently executing.

At the Montgomery Small Companies Fund, our focus is on uncovering differentiated, high-conviction investment opportunities through disciplined, bottom-up research. We continue to back businesses with sustainable competitive advantages, strong management teams, and long-term growth runways – companies built to outperform across a variety of economic conditions.

We are optimistic about the road ahead. As the macroeconomic environment stabilises, we believe investors will increasingly recognise the value within the small cap segment. Thank you for taking the time to read our Financial Year 2026 Annual Letter. We look forward to sharing more insights with you in the months, quarters, and years ahead. Thank you for your continued support, and happy investing.

Sincerely,



Gary Rollo
Portfolio Manager
Montgomery Small Companies Fund



Dominic Rose
Portfolio Manager
Montgomery Small Companies Fund

Important information

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