JM Financial Group

Issue 12: April 2016

Investment Newsletter

Market Performance (As at 31st April 2016)	April 2016 (%)	Calendar YTD (%)	1 Year Rolling (%)
S&P - All Ords Accum. Index	3.24	0.81	-3.65

Month in Review - *A review of events that influenced the share market in April.*

April was a better month for equities with the All Ordinaries Index rising 3% for the month. Despite fears over the US Quarterly Reporting season a number of large, influential companies recorded strong earnings numbers driving the Dow Jones Index to five month highs.

Domestically, interest rates remain a focus with recent inflation data coming in below expectation, opening the door to an interest rate cut in May. Finally, after much speculation the first double dissolution election in thirty years looks set to be called for July 2nd. Generally, election periods tend to be negative for consumer and business confidence and we remain cautious on companies leveraged to the Australian consumer. Already we have seen the early impacts of this thematic playing out with McGrath and Qantas highlighting lower house listing volumes and domestic travel than previously forecast for the final quarter of the financial year.

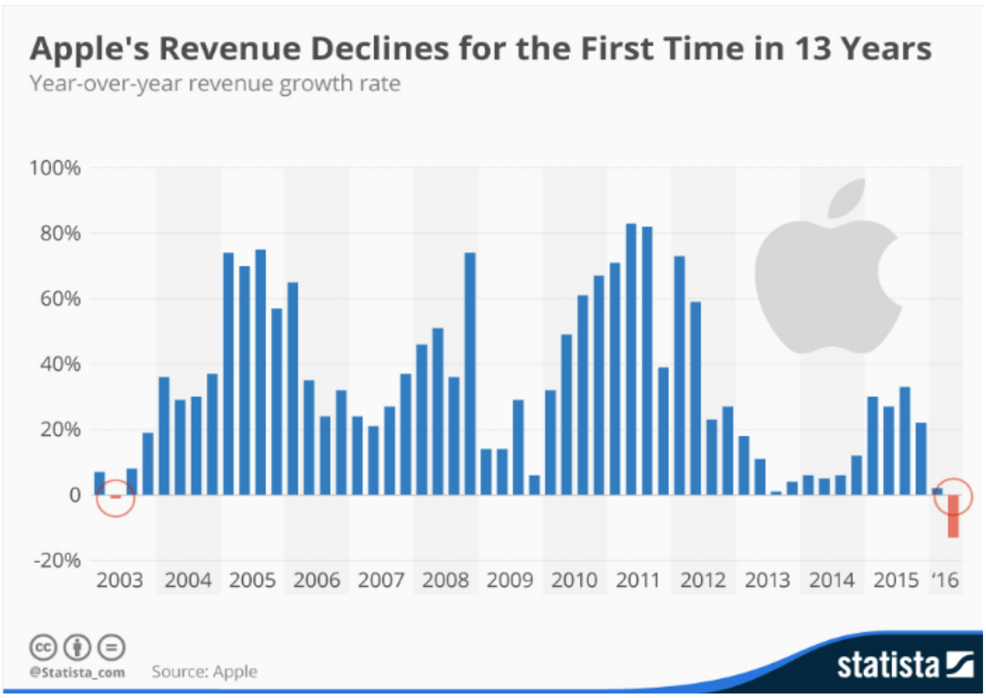
Oil remained one of the dominant influences on equity markets with a potential freeze on oil production volumes by OPEC members being rejected by Saudi Arabia at the recent Doha conference. Despite the failure of the meeting the oil price continued its strong rise ending the month at $45/bbl, up 80% from its February lows but still 50% lower than where it was trading two years ago.

Resources were again the key market movers with the Top 200 Resources Index up 15% for the month (BHP and Rio both up 20%) dramatically outperforming the Top 200 Industrials Index which only gained 1% for the month.

In company specific news, Arrium (formerly known as Onesteel) went into administration after failing to cut a satisfactory deal with its lenders and a number of stocks exposed to consumers put through earnings downgrades including Nine Entertainment Group, McGrath, Qantas and Murray Goulburn.

Previously market darlings, Bellamys and Blackmores came under strong selling during the month after the Chinese imposed stricter regulations on cross border trade of food, vitamins and infant formulas. (We discuss this in more detail later in the newsletter.)

Chart of the Month – When $50bn of quarterly sales is disappointing…



Over the last 13 years Apple has managed to grow revenues on a year on year basis for a staggering 51 consecutive quarters.

Well, that was until this most recent quarter which revealed revenues slowing due to macroeconomic weakness and a particular softness in China.

The market has for some time questioned whether Apple has the ability to continue to sustain its revenue growth without a new blockbuster product.

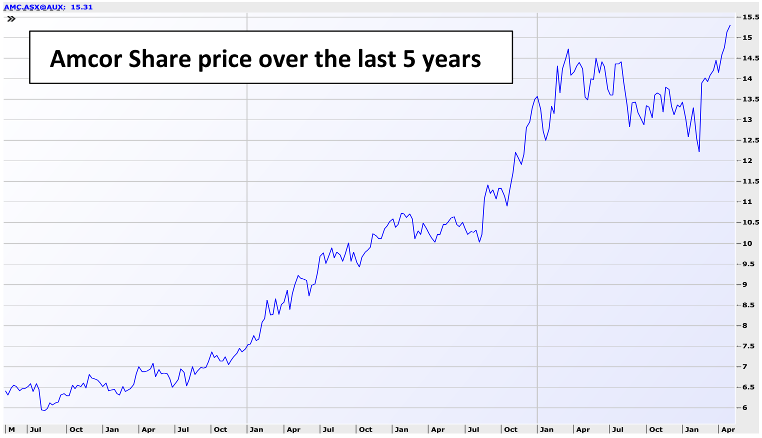
With high growth, non-hardware companies like Facebook, Google and Netflix attracting much greater investor attention, the question will now be what will Apple buy with its incredible $200bn of cash?

Due Diligence – *A closer look at a company of interest.*

Amcor - AMC

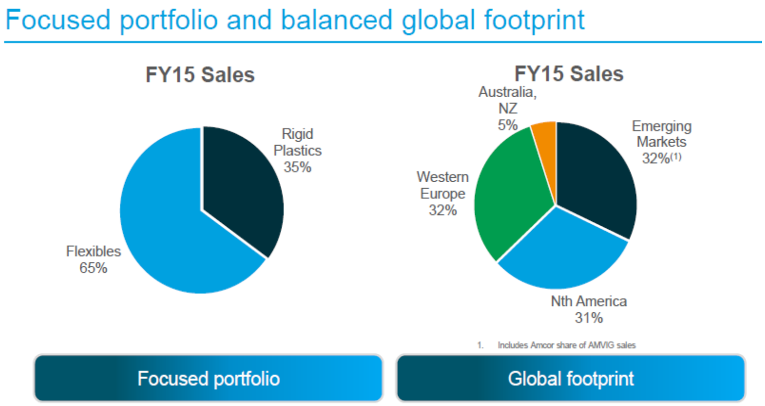
Manufacturing plastics and flexibles packaging may not sound like the most exciting business but it's something Amcor does incredibly well. During the month the Amcor share price hit all-time highs after announcing the $450m acquisition of South America's largest flexibles packaging business.

With a reputation for defensive, steady earnings it may come as a surprise to many to realise that the Amcor share price has risen over 170% in 5 years. An outstanding result for a relatively defensive and mature company.



Amcor is one Australia's few, truly global companies, with earnings across multiple sectors (Food, Beverage, Tobacco, Healthcare and Personal Care) and dominant market positions in Emerging Economies, North America and Europe.

With a focus on acquisitions, Amcor is able to build market leading positions in industries with one or two dominant players and in many cases duopoly like structures. With Amcor's superior management in charge of these assets, Amcor can quickly turn what were solid businesses into businesses that can generate high double-digit returns over time.



Sector Discussion – China crackdown

April was a tough month for former share market darlings, Bellamys, Blackmores and A2 Milk after the Chinese Ministry of Finance released a new tax policy on cross-border eCommerce. Under the new policy, cross-border eCommerce retailers will be subjected to an 11.5% VAT and consumption tax.

At the same time Chinese Customs released a "Cross-Border Retail Commodities List" which detailed which goods could be imported through eCommerce channels. If you think this all sounds rather confusing then you would be right as a number of items were initially left off the "allowed" list including adult milk powder, some health foods and cosmetics.

It appeared the confusion wasn't just at the Australian end with reports that Chinese customs were stopping infant milk powders and vitamins from crossing the border (even though they were on the positive list) as they sought clarity on the classification of each product.

Understandably with such confusion abounding, the stocks primarily leveraged to the Chinese consumer were heavily sold off. Despite assurances from management at Blackmores, Bellamys and A2, the exact long term impact on each of these businesses remains uncertain.

Each of these businesses has a large presence in the "grey markets", where merchants and individuals buy inventory in Australia and then on-sell those goods into China directly or through marketplace platforms such as Alibaba or Tmall. It's believed that the "grey market" trading volumes may be impacted heavily by the regulations given the increased taxes and more stringent requirements for labelling, inspection and licensing.

Whilst there is no doubt the long term demand for healthier nutritionals in China is growing rapidly, we are proceeding with caution on this sector until we gain greater clarity on the revenue impacts from these recent regulatory changes.

Cosmetics in arrivals hall of Shanghai's Pudong International Airport after being rejected by customs. Source: AFR