# JM Financial Group

Issue 4: August 2015

## Investment Newsletter

| Market Performance (As at 31st Aug 2015) | August 2015 (%) | Calendar YTD (%) | 1 Year Rolling (%) |
|---|---|---|---|
| S&P ASX 200 Accum. Index | -7.79 | -0.75 | -3.16 |

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

August produced one of the worst monthly market performances since 2008 with further worries of a slowdown in global growth being exacerbated by a series of large capital raisings in the bank sector and a weaker than expected company reporting season.

A 9% daily fall in Chinese stocks rippled through global markets with the Dow Jones falling 3.5%, the Nikkei falling 4.6% and European markets 4%. Although this was the largest daily fall in the Dow Jones since 2008 only two days later we witnessed the largest positive move in the Dow Jones across the same period with a 3.95% rise.

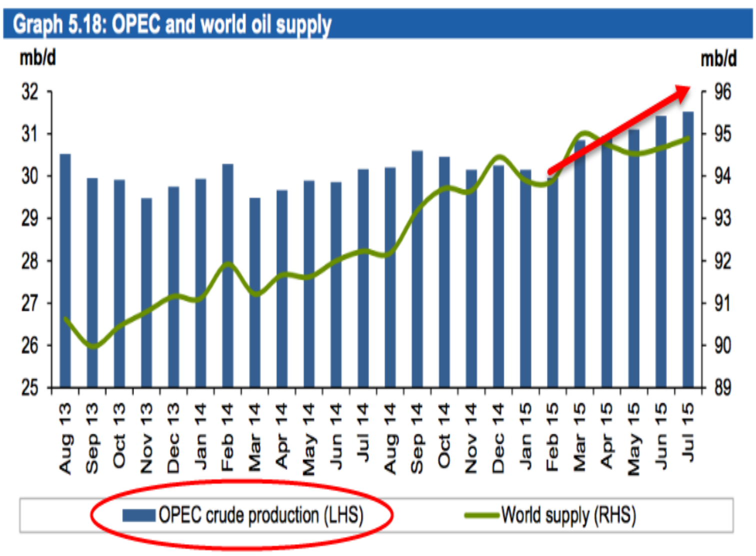
ANZ and CBA followed NAB's lead earlier in the year raising $3bn and $5bn of new capital respectively to satisfy the recent APRA recommendations for Tier 1 capital buffers. Although this was not completely unexpected by the market, the combination of the discounted raising and a higher than expected bad debts charge from ANZ saw the bank sector heavily sold off over the month.

The rather familiar theme of macroeconomic issues adversely impacting our market continued yet again with the Chinese intervening in their currency markets to revise the calculation of the Yuan currency band. This intervention by the People's Bank of China caused panic selling, resulting in the largest one-day fall since the Chinese pegged the Yuan to the US Dollar in 1994. With most commentators now forecasting the first US rate rise for 9 years to occur later this year, it is clear the Chinese are concerned about the impact a strong US dollar (and resulting Yuan) may have on their export markets.

Weakness in commodity markets persisted, with fears over China's growth and the announcement of record oil production from OPEC (chart below), pushing oil prices below $40/bbl, nearly $50 lower than the same time last year. Copper, long seen as the commodity which most truly represents global health, worryingly fell to a 5 year low, dragging a range of Asian currencies with it.

As we flagged last month, the focus of our domestic market was on Company Reporting Season which saw the majority of Australian companies reporting their FY15 financial results. Although results were mixed, it appeared that the magnitude of the disappointments outweighed the positive surprises with some companies seeing double digit percentage falls in their share prices following their results.

**Chart of the Month -** Increasing OPEC oil production vs oil price




*Source: Business Australia*

Oil Price


The oil price fell dramatically in August when it was revealed that OPEC was surprisingly increasing its production amidst an environment of significantly lower prices. Conventional economics would suggest that production should decrease at lower prices. However, this move by OPEC indicates how heavily committed it is to guarding market share regardless of price.

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

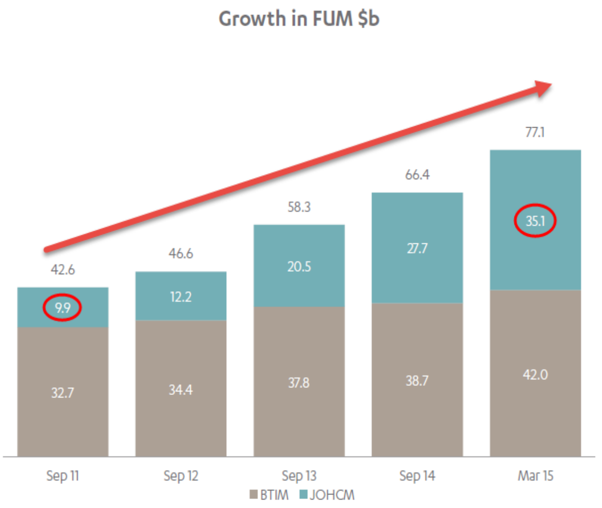
### BT Investment Management (BTT)

Whilst BT Investment Management is well known through the BT Superannuation, Investment and Insurance brands what is less well known is that BT now earns more than half of its revenues from overseas.

In 2011, BT acquired the UK based JO Hambro, a European focussed investment management business which allowed BT to diversify its earnings and open up to new markets.
In the 4 years since the acquisition, JO Hambro has grown funds under management (FUM) from $10bn to $40bn.

This strong growth from JO Hambro has been complimented by a 61% growth in earnings in the traditional BT business which benefits from a diverse offering of funds and the mandated 9.5% Australian Superannuation Guarantee.

In June of this year BT's 59% owner, Westpac Bank, announced its intention to sell down its holding to between 30-40% in order to free up capital as part of their efforts to improve their Tier 1 capital position for their banking operations.




*Source: BT Investment Management*

We elected to participate in the sell-down as not only we were buying a strong growth business at a discount but the sell down allowed BT to enter the Top 200 Index. This is often seen as a positive catalyst as it forces Index based investment managers to purchase a holding.

BT is exposed to a sector with mandated structural growth, pays a 6% forecast yield and trades at a discount to market with an FY16 price to earnings multiple of 14x.

## **Reporting Season Wrap -** *The Good, the Bad and the Ugly.*

As mentioned earlier in the newsletter, Reporting Season was disappointing, with large falls outweighing the positive surprises. This was also one our busiest months with the JMFG team seeing 10 companies in face to face meetings and another 15 on conference calls. Our direct company contact will continue throughout September as companies complete their results roadshows.

Whilst we managed to avoid a lot of the disastrous results we are not infallible and not at all our companies were winners.

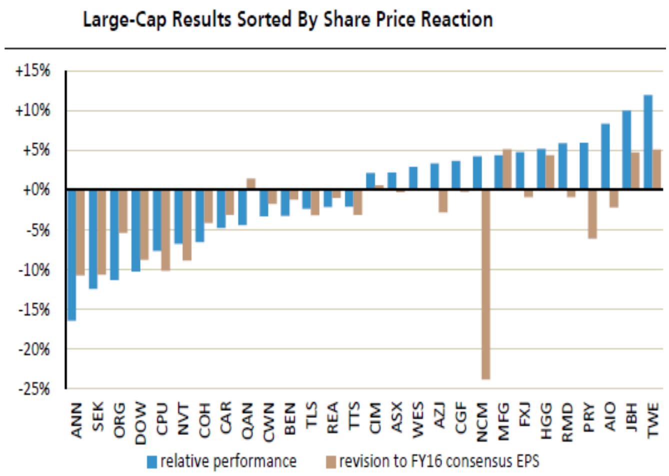
***"Predicting rain doesn't count. Building arks does." - Warren Buffett***

Below is more detail on some of the larger daily moves that occurred immediately following the release of their earnings:

Sirtex (SRX) - rose 9.7% following their results which showed a 20% growth in dose sales and a 17% increase in US hospital sites using the SIRT therapy for liver cancer patients. This was significantly higher than most broker forecasts and from our discussions with management we feel confident they can grow doses by at least the same amount next year.

Fairfax (FXJ) – gained 5% after announcing that Domain.com.au revenues had grown 30% over the year and were up 53% in the first five weeks of FY16. The growth in its online digital businesses is forecast to more than offset weakness in the regional radio and print assets.

Medibank (MPL) – after falling from its post listing highs in March, Medibank regained some of the lost ground with an 11% share price rise. Medibank beat consensus profit and dividend forecasts on the back of a significant cost reduction programme.




*Source: UBS & Factset*

Cochlear (COH) – disappointingly fell 7.1% after posting earnings 6% below consensus forecasts due to weaker hearing implant sales in the Americas and the Middle East. Although revenues were up 15% on last year the market focussed on the consensus forecast miss. Encouragingly the company regained some of the lost ground later in the month.

Origin Energy (ORG) – our decision to avoid Origin was validated when the company fell 13% after announcing it needed to invest a further $1.8bn in the next 12 months to complete its LNG project. Its total forecast capital expenditure for FY16 came in a staggering $1bn higher than market expectations.