JM Financial Group

Issue 8: December 2015

Investment Newsletter

Market Performance (As at 31st Dec 2015)	December 2015 (%)	Calendar YTD (%)	1 Year Rolling (%)
S&P ASX All Ords Accum. Index	2.65	3.78	3.78

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

After a poor start, the month of December produced a positive return for investment markets with a mid-month Santa Claus rally producing 9 consecutive days of gains. The All Ordinaries Accum. Index finished the month up 2.65%, with a strong contribution from small resources and a relief bounce in some of the year's laggards.

As flagged, the US finally raised official interest rates for the first time since 2006. The base Federal Funds rate was increased 25bp from 0.25% to 0.5% and still remains remarkably low by historical standards. Whilst this first move has seen an astounding amount of publicity, the quantum and timing of future rate rises remains unclear with commentators forecasting between 1 and 4 future rate rises in 2016.

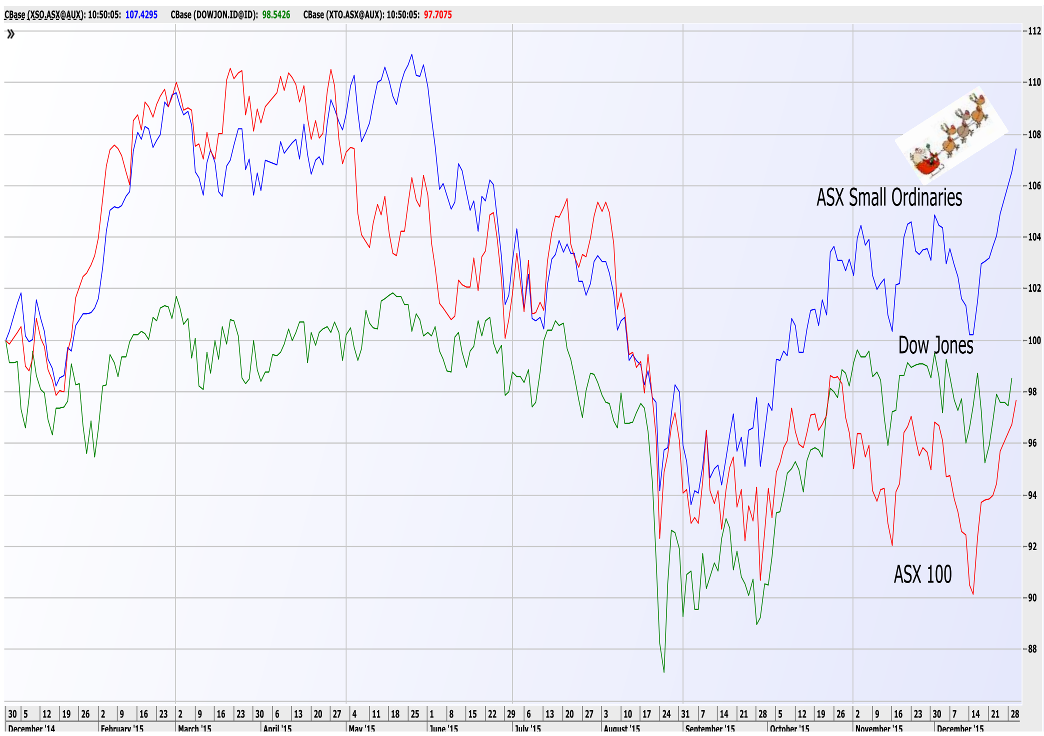
Domestically, a surprise fall in unemployment led to the RBA holding interest rates steady despite the consensus view that interest rates were going to be cut further in response to slowing growth and a record $38bn budget deficit.

At a policy level there was further negative news for the resource sector with the milestone Paris Agreement being signed during month. The Paris Agreement requires participating countries to stem their greenhouse emissions whilst increasing capital spending on green initiatives and renewable energy projects such as wind and solar.

Although December tends to be a quieter month there were some notable announcements with Suncorp posting a profit downgrade, Transurban entering exclusive negotiations with the Victorian Govt. on the proposed Western Distributor project and Woodside abandoning its proposed takeover of Oil Search.

Unfortunately the IPO market came to a grinding halt with a number of new listings performing poorly as investors seeking quick one day returns sold their allocations immediately pushing prices well below the IPO issue price.

Chart of the Month – The rise of Small Caps



2015 was the year of the Small Cap. The ASX Small Ordinaries Index outperformed both the ASX 100 and the Dow Jones by a considerable amount as shown on the chart to the left.

One of the failings of the Australian market is its concentration with the top ten stocks accounting for 45% of the ASX 200 Index. This leads to heavy weightings in banks, resources and retail.

The woes of BHP and WOW have been well documented but what the performance disparity highlights is the lack of large, innovative companies operating in high growth industries.

This was further emphasized when local internet success story, Atlassian (valued at $8bn) chose to list on the NASDAQ instead of the ASX.

The year in review – *The hits and misses of 2015*

2015 won't go down as a particularly memorable year for investors with the market posting a small loss over the calendar year. It was a year plagued by a raft of global macro-economic and political headlines with every new month seemingly throwing up another major market calamity. We have noted a small but by no means exhaustive list of macro influences from across the year below:

- The end of the commodity super cycle
- Chinese GDP slowing and the spectacular casino like movements of Chinese equity markets
- The *will they or wont they* saga of speculation around the first US rate rise since 2006
- Australia's almost annual change of Prime Minister
- War and terrorism once again impacting markets (Russia/Ukraine, ISIS)
- The Greek default – (which has barely rated a mention in the financial press in recent months)

At a stock level we saw some notable moves and trends emerging:

- The rise and rise of certain Chinese facing niche consumer stocks - Bellamy's, Blackmores
- BHP's stunning fall from grace and the demise of small miners and mining service companies
- Dick Smith's woes continuing under its new ownership
- Mergers and acquisitions returning (Toll, Asciano, Veda), and *failed acquisitions* (WPL, OSH, STO)
- Slater & Gordon's annus horribilis with another large Australian success story once again being undone by an ill-fated international acquisition.
- Small caps and industrial companies having their moment in the sun as resource stocks were all but abandoned.
- The boom and bust of the vocational education sector highlighting a range of questionable business practices and poorly constructed legislation.

From a JMFG point of view we were fortunate in that we had more winners and losers, benefitting strongly by avoiding oil stocks and large sections of the resources market. Once again the health and infrastructure sectors proved their resilience with CSL, SRX, TCL and SYD all impressive performers.

As largely bottom up stock pickers we had great success for many clients with positions in SBM, IPH and BTT posting respective gains of 241%, 106% and 63% for the year. Even though we exited SGH above $5 it was one of our poorer investments for the year along with BHP, LLC and ACL.

Looking ahead – *Themes for 2016*

Although our view at JMFG is not to be *predictors* of events but rather *observers* of events, we thought we would share with you our view on some emerging trends and themes and how they may impact investment markets across 2016.

The continued slowdown in China and the demise of bulk resources seems unlikely to reverse in 2016 with years of supply increases finally being met with slowing demand. The question of whether iron ore or oil bottoms at $30 or $20 is somewhat irrelevant with end producers struggling to make profits and fund expansions in the current environment. Although the prices of hard commodities may bottom in 2016, this does not necessarily mean the pain for companies that produce these commodities will end. There is no doubt many smaller companies and explorers will shut their doors and some larger companies will have to cut costs to repair their balance sheets.

Although the US has entered a rising rate cycle, history shows that equity markets outperform in the 12 months following the first interest rate rise. Over the last 40 years the ASX 200 has averaged a 6% rise in the first twelve months following an initial US rate rise.

Gen Y and Generation Z (or the *iGeneration*) continue to adopt technology at a rapid pace with social media, mobile phones and online businesses taking the world by storm. With Apple remaining the world's largest company on the back of a product not released until 2007 and Facebook moving from concept to the US's tenth largest company in 11 years it's a pertinent reminder of how important it is to capitalise on new and emerging trends. We think 2016 will be another year of strong growth for technology companies but given the sheer amount of new technologies and new products, investors need to be increasingly selective and discerning with their investments.

In an increasingly unsafe world, security will unfortunately be another hot topic in 2016, both in physical and cyber terms. The global cybersecurity market is forecast to be worth a staggering $170bn by 2020. We continue to look for Australian companies that are succeeding in this space.

And finally, policy change will need to be at the forefront of investors' considerations in 2016 with elections in both the USA and Australia. Invariably elections lead to changes in policy which can be either beneficial or disastrous for companies that operate in heavily regulated industries.

Performance In 12 Months Following Start of US Fed Rate Hike Cycle

start	+12 months	US Fed Funds rate	US 10 year bond yield	S&P500 price index	RBA cash rate	AU 10 year bond yield	ASX200		Resources
31-Mar-72	31-Mar-73	+275	+61	+4%	na	na	-1%		na
01-Aug-77	01-Aug-78	+300	+112	+2%	-130	-131	+17%	✓	na
21-Oct-80	21-Oct-81	+350	+370	-9%	+360	+320	-21%	✗	-41.6%
31-Mar-83	31-Mar-84	+200	+194	+4%	-223	-30	+47%	✓	+45.8%
29-Mar-84	29-Mar-85	-88	-77	+13%	+148	-30	+12%	✓	-2.5%
04-Dec-86	04-Dec-87	+94	+188	-12%	-408	-40	-10%	✗	-3.0%
04-Feb-94	04-Feb-95	+300	+168	-0%	+275	+369	-21%	✗	-23.9%
30-Jun-99	30-Jun-00	+175	+10	+8%	+125	-9	+13%	✓	+11.5%
30-Jun-04	30-Jun-05	+225	-76	+5%	+25	-75	+21%	✓	+42.8%

Source: Datastream