JM Financial Group

Issue 3: July 2015

Investment Newsletter

Market Performance (As at 31st July 2015)	July 2015 (%)	Calendar YTD (%)	1 Year Rolling (%)
S&P ASX 200 Accum. Index	4.40	7.64	5.68

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

Once again financial markets were focussed on macroeconomic issues over the month of July with Greece yet again dominating the headlines. As flagged in our previous newsletter, an emphatic "No" vote was lodged with the majority of Greeks voting against the hard line austerity measures being proposed. This act of defiance against the European Union was short lived however with the Greek parliament approving sweeping austerity measures only a week later to free up much need funding from the Eurozone.

Although these measures appear to have defused the crisis in the short term, uncertainty will remain for quite some time as the ability for Greece to reform pensions, increase taxes, tighten public spending and liberalise its economy is rightly questioned.

If the Greek issues weren't troublesome enough China's yo-yoing stock market managed to consign the Greeks to page 2 of the financial papers when their equity markets plunged, wiping $4 trillion from equity values. The rout was temporarily halted in mid-July when a series of desperate measures were enacted, forcing trading halts across most of the market and imposing bans on selling by directors. This proved largely ineffective with the Shanghai Composite Index falling 8.5% in a day, the largest daily fall in the Chinese market since 2007.

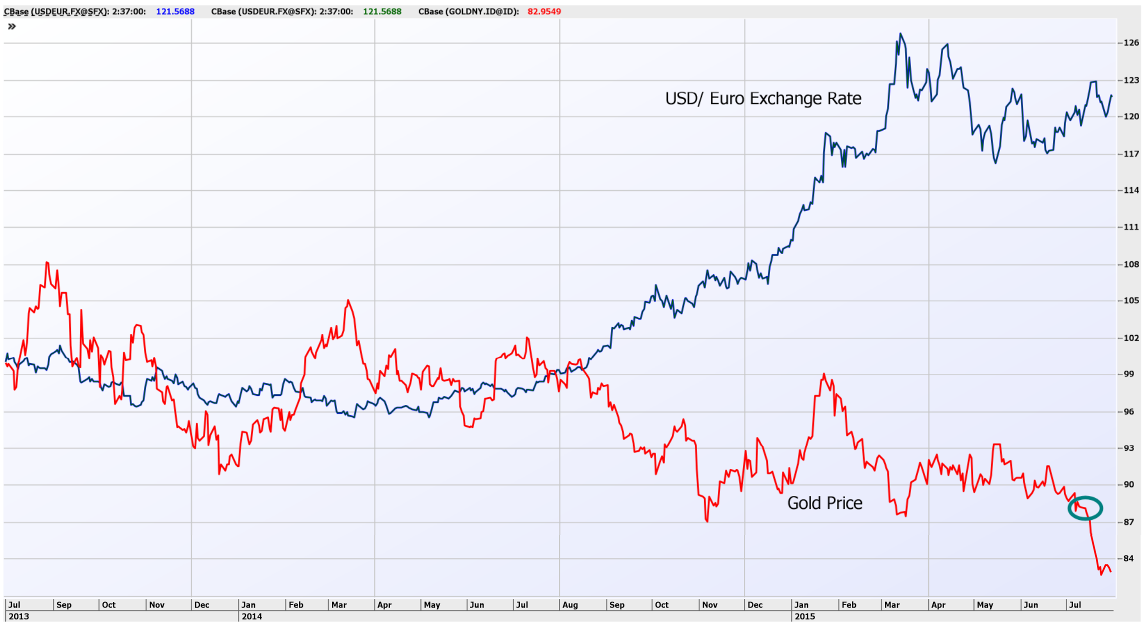
This couldn't have come at a worse time for the Chinese as they attempt to open their markets to foreign investment and develop a deeper and more sophisticated equity market. We discuss our thoughts on the ramifications of the Chinese equity market moves in more detail later in the newsletter.

As global uncertainty heightened across July, the US Dollar reconfirmed its "safe haven" status rising 5% against the Aussie Dollar and 1.6% against the Euro. The rotation into the USD gained further support when a mini 'flash crash' occurred in the gold market after 5 tonnes of bullion was unloaded on the Chinese market causing 3.5% fall in the price of gold in a matter of minutes. Although the exact cause of the fall remains unclear it appears that a combination of lower than expected Chinese Gold Reserves, the US Dollar strength and Gold Exchange Traded Fund selling may have led to the dramatic sell off.

Domestically, the start of the new financial year saw APRA finally publish its target capital ratios for the banks, which encouragingly, only require on average, 200bp of further capital to place them in the top quartile of international lenders.

Chart of the Month

USD/EUR exchange rate (blue) versus the Gold Price (red)



As we touched on earlier, the gold price plummeted in July (green circle) as a large seller flooded the market.

Although this was a severe short term move the longer term chart (left) indicates that gold has been under pressure for quite some time as it suffers from the rotation into the US Dollar.

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

CSL – A great Australian success story

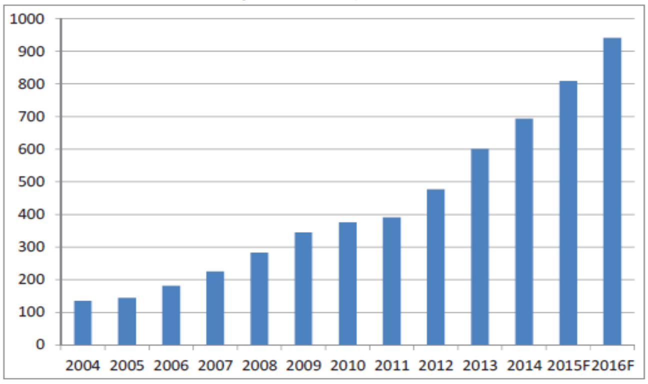
CSL (or Commonwealth Serum Laboratories as it was known upon its establishment in 1916) has grown to become one of Australia's largest and most successful companies. From humble beginnings, CSL has grown into one of the world's dominant plasma and vaccine companies with revenues in excess of $6bn annually.

Although CSL's share price rise to the $90s has been meteoric, the underlying demand for their products continues to grow with forecast demand for their main plasma products, IVIg (Intravenous immunoglobulin) and Albumin (blood proteins) growing 7-8% p.a and 16% p.a respectively.

With much of the growth in Albumin volumes coming out of China, CSL is now beginning to reap the benefits of establishing itself in the country more than 10 years ago.

Albumin a key growth driver for CSL...

CSL albumin revenue (pro-forma), USDmn



Source: Company data, Goldman Sachs Global Investment Research.

Despite the focus on the growth within emerging markets there have been early indications that the US Affordable Care Act or as it's more commonly known, "ObamaCare", is beginning to impact North American volumes. Given the Act prevents exclusion for pre-existing conditions, a large, and sadly unhealthy section of the population has now been opened up and is receiving much needed healthcare.

In fact the latest numbers from the US Department of Health indicate more than 16.5m Americans have acquired health coverage since October 2013, with the uninsurance rate falling from a staggering 20.3% to 12.3% in 18 months.

Looking past the plasma business there remains significant potential within CSL's vaccines division which is responsible for the blockbuster Gardasil HPV vaccine. CSL recently acquired the Novartis Flu business which will make it the number 2 player in the $4bn influenza vaccine market.

From an investment viewpoint, CSL is one of the very few companies in the Australian market, much like Transurban, that we characterise as *defensive growth*. A business that has strong organic growth whilst operating in a defensive and resilient industry.

China Reform – Two steps forward, one step back

As little as one month ago officials from MSCI were discussing the timeline over China's A-shares inclusion into the MSCI global indices as it was deemed a matter of 'when' not 'if' China's market would open itself to a vast array of global investors. A report from Credit Suisse forecasts Chinese stocks to grow from 1% of global indices to 9% by 2025, becoming the world's 2nd largest equity market.

Fast forward to July and the timeline is increasingly uncertain as a 32% index fall and record outflows highlight inherent problems within a market still dominated by individual investors and plagued by short term volatility and government intervention.

As the Shanghai Composite Index retreated dramatically from its highs (at one stage up 150% for the year), Chinese officials turned their back on free market reforms, intervening with a series of measures designed to stabilise the freefall.

Chinese investors watching the market in scenes reminiscent of a busy afternoon at JM.

They suspended IPOs, restricted options trading, banned directors and large shareholders from selling and halted trading in more than 1,400 companies. Whilst these measures were designed to stabilise the market, large global investors have reacted with dismay as the intervention has seemingly undermined efforts to attract foreign capital into the market.

The Chinese, to their credit, have responded to recent criticism of their actions and are looking to implement tighter controls on investing, specifically targeting online lenders that helped fuel the share rally. These lending sites reportedly offered 3.1bn yuan ($500m) of new loans for stock investing in May alone. Going forward, all client funds will need to be deposited with established banks and online lenders will need to approval from financial regulators.

Although the spill-over effects of the Chinese share market volatility cannot be dismissed, Australia's market is much more dependent on the performance of the underlying Chinese economy which continues to navigate an economic 'soft landing' as GDP growth slows to 7% this year.

Thankfully August heralds the start of company reporting season, with global macro-economic issues taking a back seat to individual company performance as the majority of ASX listed companies report their detailed FY15 financial accounts.