JM Financial Group

Issue 12: April 2016

Small Companies Strategy – Investment Newsletter

Performance (As at 30th April 2016)	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	**0.78**	**0.78**	**-3.67**	**18.18**	**16.06**	**40.13**
Small Ords Accum. Index	3.04	3.04	4.10	11.36	5.12	11.86
Outperformance	**-2.26**	**-2.26**	**-7.77**	**6.82**	**10.94**	**28.27**

Although the JMFG Small Companies Strategy is generally representative of client portfolios, Individual performance may differ from the results above. These differences can arise due to various issues, some of which may relate to initial timing of investments and cash inflows and outflows. Performance is non-annualised, excludes fees and the effects of franking credits and tax. Strategy Inception date July 1st 2013.

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

April was a better month for equities with the Small Ords 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.

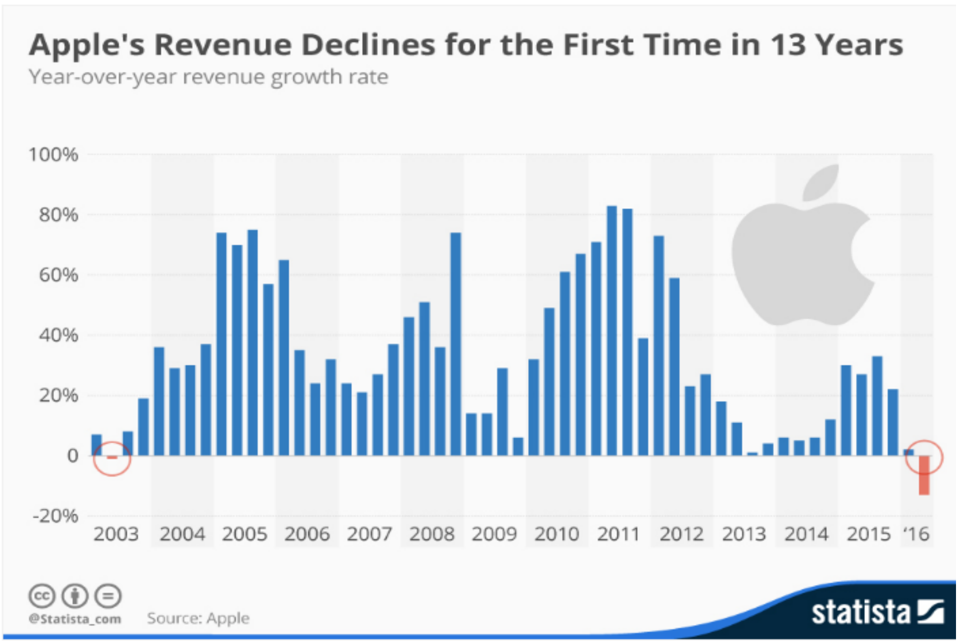
The Strategy underperformed during the month with an underweight position in resources again impacting monthly returns (Small Resources up 15% vs Small Industrials up 1%). Whilst short term underperformance is disappointing, the Strategy is managed for the long term and we continue to prefer owning companies that can grow regardless of economic cycles.

Domestically, interest rates remain a focus with recent inflation data coming in below expectation leading to an interest rate cut in May. Finally, after much speculation the first double dissolution election in thirty years looks set to be held on 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 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.

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 consumer spending put through earnings downgrades including Nine Entertainment Group, McGrath, Qantas and Murray Goulburn.

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?

Best & Worst Performers for April 2016

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Doray Minerals - DRM	Temple & Webster - TPW	Resolute Mining - RSG	Murray Goulburn Unit Trust - MGC
Catapult - CAT	McGrath - MEA	Perseus Mining - PRU	Nine Entertainment - NEC
Medical Developments - MVP	Universal Biosensors - UBI	Alacer Gold - AQG	Billabong - BBG

What We Think – *A summation of the top hits and misses for the month of April.*

Doray Minerals – (up 27% for the month)

Emerging gold producer, Doray Minerals grew strongly over the month rising in-line with the broader gold sector. We feel Doray is under appreciated by the market given the step change in earnings expected this year as its second gold mine begins contributing to production.

Resolute Mining – (up 80% for the month). **Not held.**

Gold miner, Resolute Mining was again the star performer rising a staggering 80% for the month. As has been the theme for the last 4 months, resources stocks dominated the top performers in the Small Ordinaries Index with 15 of the top 20 performers being miners or mining service companies.

Temple & Webster – (down 41% for the month.)

After rising 38% last month Temple and Webster gave it all back in April after announcing the resignation of its CEO, Brian Shanahan and a revision of revenues to $60m for the full year. This was a disappointing outcome given the amount of time we had spent with Brian over previous months understanding his growth strategy.

Murray Goulburn Unit Trust – (down 45% for the month). **Not held.**

Murray Goulburn fell heavily after revising down its previous earnings guidance from $63m to $40m due weaker dairy markets and a lack of sales in adult milk powder products in China. As a result of the disappointment MGC's CEO and CFO have both resigned their positions.

Portfolio Management – *Trim your weeds and let your roses bloom*

Over the last few months the Strategy has been reasonably active as we cut some loss making positions and reinvested the proceeds in a few exciting high growth businesses.

As most investment managers will profess one of the hardest facets of investment management is knowing when to sell. This is especially true when in investing in smaller companies where the magnitude of the rises and falls in any given month can be much higher than larger, more mature companies. Quite often the temptation can be to lock in your profits by selling successful companies whose share prices have risen and to keep buying companies that are falling in the belief that you are buying a great company cheaper. This leads to a situation where you can end up trimming your roses and letting your weeds bloom. Something we try to avoid where possible.

Although we generally adhere to our own mantra, we did make the mistake of buying small amounts of Temple & Webster (TPW) and McGrath (MEA) on the way down after being assured by management that the respective businesses were tracking to guidance.

As we have since unfortunately discovered, our confidence and management's optimism was misplaced and we have exited or are timing our exit of these positions.

Whilst we acknowledge letting one or two weeds grow for too long we have been successful in letting our roses bloom with St Barbara (SBM) and Catapult (CAT) both up over 350% since they were added to the Strategy last year.

A few future roses have been added to the Strategy in recent months and have already begun contributing to performance with Aconex (ACX) up 52%, Medical Developments (MVP) up 42% and Doray Minerals (DRM) up 22% since their addition in February and March.

In other portfolio news Qube's takeover of Asciano now puts it well into the Top 100 and out of our investable universe and A2 Milk was sold over our concerns on the implementation of the recently announced changes to cross border commerce in China.

Although we were aware the imported foods sector was undergoing regulatory change given the emergence of e-commerce, the implementation of these regulations appears somewhat messy and inconsistent.