

Small Companies Strategy – Investment Newsletter

Performance <i>(As at 31st August 2015)</i>	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	-4.30	0.15	9.30	0.15	10.98	39.23
Small Ords Accum. Index	-4.87	-3.39	-0.52	-3.39	-9.62	9.50
Outperformance	0.57	3.54	9.82	3.54	20.6	29.73

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 August.

The ASX Small Ordinaries Accum. Index fell 4.87% in the month of August versus the ASX All Ordinaries Accum. Index falling 7.30%.

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.

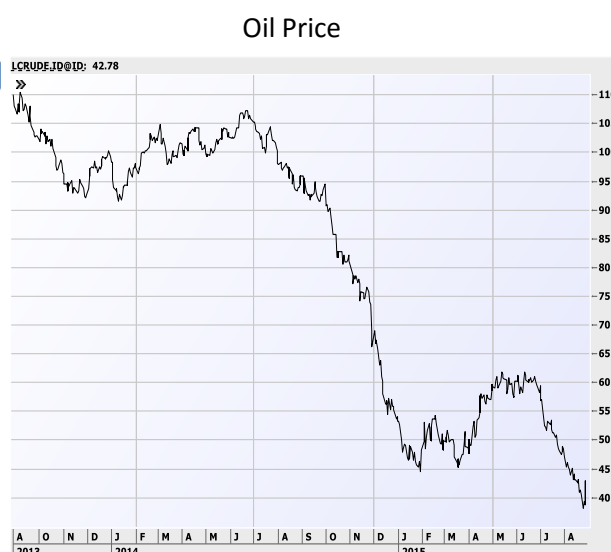
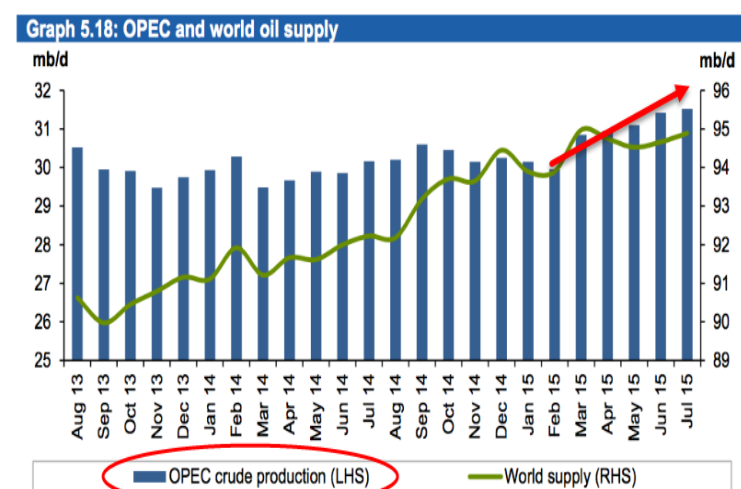
A 9% daily fall in Chinese stocks rippled through global markets with the Dow Jones falling 3.5%, the Nikkei falling 4.6% and European markets 4%. Although this was the largest daily fall in the Dow Jones since 2008 only two days later we witnessed the largest positive move in the Dow Jones across the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

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



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.

Best & Worst Performers for August 2015

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	Worst	Best	Worst
Alexium – (AJX)	Veda – (VED)	The Reject Shop - (TRS)	Cash Converters – (CCV)
Catapult – (CAT)	Webster – (WBA)	Pacific Brands – (PBG)	Atlas Iron - (AGO)
Sirtex – (SRX)	Praemium - (PPS)	SMS Management - (SMX)	Sundance Energy - (SEA)

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

Alexium – (up 35% for the month)

Alexium rose strongly after announcing a series of purchase orders from a range of textile producers. The company hosted an analyst site visit to its North Carolina operations during the month which resulted in favourable broker commentary and increased price targets. We discuss Alexium in further detail below.

The Reject Shop – (up 33% for the month). **Not held**

The Reject Shop bounced strongly after posting a solid FY15 financial result. Although this was a strong bounce, The Reject Shop is still down 11% for the year as the impact from Kmart's 'everyday low prices' strategy continues to erode margins in the discount goods sector.

Veda – (down 14% for the month)

Australia's largest provider of consumer and business credit data fell from its yearly highs during the month due to a combination of profit taking and a somewhat unexpected increase in costs forecast for FY16. Although this fall was disappointing, Veda's earnings are forecast to grow an impressive 15.5% p.a over the next four years.

Cash Converters - (down 34% for the month). **Not held**

Cash Converters fell heavily during the month due to a weaker result and the announcement that Westpac was ceasing to provide banking and financial services to Short Term Credit providers. Although Cash Converters is confident of replacing its banking provider this was a further blow to businesses that operate in the short term lending segment of the market. To make matters worse the Government has established a review of small amount credit contract (SAAC) laws which will continue until the end of 2015.

Due Diligence – Every month we will take a brief look at one of your share holdings.

Alexium (AJX) – Environmentally friendly fire retardant

Alexium is a specialty chemical company that produces a cost effective and environmentally friendly formulation for treating synthetic fabrics to make them flame retardant (FR).

Alexium operates primarily in the US and European fire retardant markets where there has been a ground swell against the use of traditional Bromine based fire retardants due to health concerns.

As one of the few companies in the world producing a non-Halogen or Bromine based product we think Alexium is well positioned to transition from an R&D company to a major commercial player in the FR market.

Having recently signed contracts with major bedding, textile and auto producers, Alexium is forecasting potential revenues of US\$10m this calendar year with significant growth forecast for CY16.

Perhaps the most exciting growth sector for Alexium though is in military uniforms with the company currently working with the US Department of Defence on their "Green Initiative" for new fire retardant uniforms. The 'Green Initiative' plan is to create a durable, halogen free, nylon-cotton (NyCo) flame resistant uniform for use across all branches of the U.S Military.

With potential revenues in this market in the range of US\$10-15m for CY16 we look forward to further announcements from the company later in the year as to whether they have been successful in their efforts. We feel any endorsement from the US Department of Defence would be a key catalyst for the stock.

Example of NyCo Alexium FR treated burn test



Source – Foster Stockbroking