JM Financial Group

Issue 8: December 2015

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st December 2015)*	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	**0.87**	**15.60**	**34.29**	**22.69**	**34.29**	**45.47**
Small Ords Accum. Index	3.91	11.32	10.16	6.98	10.16	7.45
Outperformance	**(3.04)**	**4.28**	**24.13**	**15.71**	**24.13**	**38.02**

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 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 Small Ordinaries Accum. Index finished the month up 3.91% 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 for us 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.

Best & Worst Performers for December 2015

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
St Barbara - SBM	DateTix / Enverro - ERR	Broadspectrum – BRS	Cardno Ltd – CDD
Catapult – CAT	Temple & Webster - TPW	Orocobre – ORE	Kingsgate Consol. – KCN
Mainstream BPO - MAI	MaxiTrans - MXI	St Barbara – SBM	Sundance Energy - SEA

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

St Barbara – (up 40% for the month)

SBM continued its strong run following last month's site visit with a range of broker upgrades building further interest in the stock.

Broadspectrum – (up 64% for the month). **Not held.**

A change of name for the company formerly known as Transfield came with some good luck with Spanish firm, Ferrovial making a takeover bid for the beleaguered services business.

Temple & Webster – (down 23% for the month)

TPW was heavily sold off upon listing as the IPO market came to a grinding halt. As Australia's largest online only retailer of homewares and furniture, TPW remains well positioned to capitalise on the shift to online purchasing. Although the sell-off was disappointing the business has no debt and $30m of cash to fund its growth plans.

Cardno – (down 51% for the month). **Not held.**

Although Cardno sold a business and raised $78m in fresh capital during the month its balance sheet remains stretched and question marks remain over its ability to hit its forecast earnings guidance.

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 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