JM Financial Group

Issue 13: May 2016

Small Companies Strategy – Investment Newsletter

Performance (As at 31st May 2016)	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	**8.97**	**9.82**	**4.97**	**28.78**	**23.10**	**52.70**
Small Ords Accum. Index	4.09	7.25	8.36	15.92	6.91	16.43
Outperformance	**4.88**	**2.57**	**-3.39**	**12.86**	**16.91**	**36.27**

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 May.*

May was another strong month for equity markets with the ASX Small Ordinaries Index finishing the month 4.09% higher. After a disappointing 2015, the Small Ordinaries Index has risen a remarkable 11.8% in the last three months with the Small Resources Index up 19% across the same period.

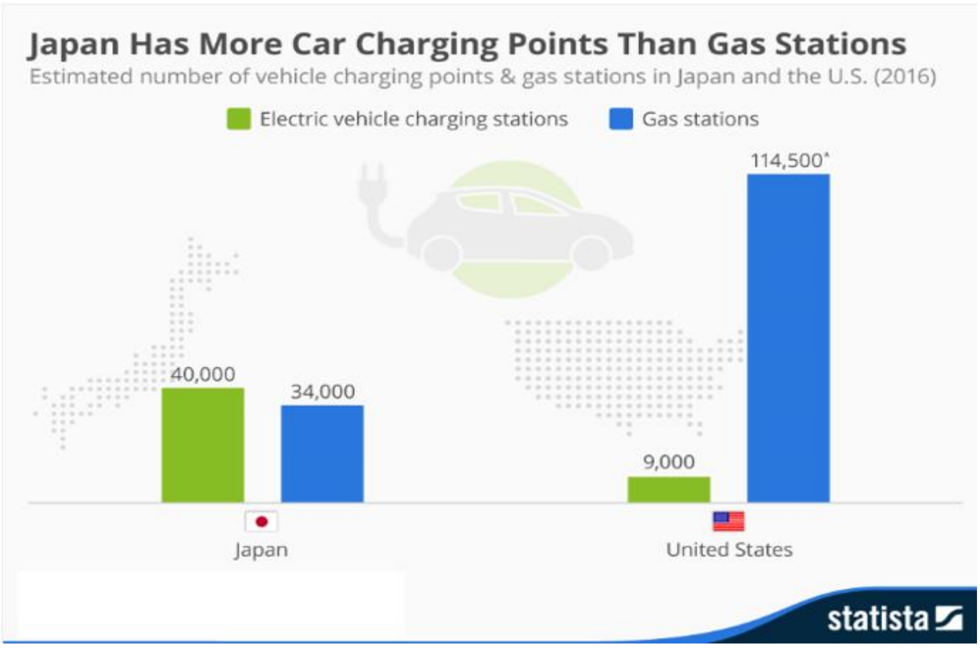
After a few months of underperformance it was encouraging to see some large bounces in a number of our stocks with two returning over 75% for the month (BSE, DTX) and a further three returning over 20% (APX, AAC, MMS).

After witnessing a number of conflicting economic reports earlier in the year it appears US equity investors are now gaining confidence that the US economy can handle further interest rate rises with Federal Reserve Chair, Janet Yellen, indicating it would be appropriate to raise rates in coming months. In very healthy signs for markets the Dow Jones rose on the back of this news and posted a positive gain for the month.

Although it appears that the US economy may finally be turning, Australia's domestic economy continued to drag with interest rates being cut by 25bp to 1.75%, a record low. This relatively un-forecasted move by the RBA took a number of commentators by surprise given the close proximity to a federal election and the announcement being made only hours before the release of the 2016/2017 fiscal budget.

The cautious views of the RBA were somewhat justified later in the month with a number of consumer facing businesses highlighting a weak operating environment. This culminated in a $1.6bn impairment of Target by Wesfarmers, an earnings downgrade from Beacon Lighting and Murray Goulburn cutting milk prices and earnings due to global dairy price weakness. After what can only be described as a disastrous start to public life Murray Goulburn's move to cut milk prices caused outrage and threw the dairy farming community into turmoil.

Chart of the Month – who killed the gasoline car?



During the month Nissan Motor Co. presented the intriguing news that there were now more electric vehicle charging stations in Japan than gasoline stations.

Although the electric numbers include personal charging stations this is a clear indication of the increasing acceptance of electric and hybrid vehicles.

Charging infrastructure has long been one of the key impediments to electric vehicle penetration and this chart further reinforces the potential for electric vehicles to gain a foothold in the market. We discuss the electric car market in more detail later in the newsletter.

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Best & Worst Performers for May 2016

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Datetix Group - DTX	Doray Minerals - DRM	Slater & Gordon - SGH	1-Page Ltd - 1PG
Base Resources - BSE	Emerchants - EML	Infigen Energy - IFN	Murray Goulburn Unit Trust - MGC
Appen Limited - APX	Maxitrans Industries - MXI	Select Harvests - SHV	Western Areas Ltd - WSA

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

Datetix Group – (up 80.5% for the month)

Online dating agency, Datetix Group rose strongly after announcing its launch into China and a 30% increase in monthly active users. Given it's very much a microcap stock, the Datetix share price experiences much higher volatility than some of the Strategy's larger businesses.

Slater & Gordon – (up 55.9% for the month). **Not held.**

After falling from $7 to 25c following its disastrous UK acquisition, SGH bounced during the month after announcing a successful refinancing of its current debt facilities. This was very much a relief bounce with the market fearing that its lenders may force the company into administration.

Doray Minerals – (down 12.1% for the month.)

The *curse of the JM newsletter* struck again with the Strategy's best performer in April falling from its recent highs. Doray, along with the larger gold sector retracted following a 5.6% fall in the gold price. Encouragingly, the company announced the first gold pour from its second operating mine.

1-Page Ltd – (down 39.3% for the month). **Not held.**

Former small cap darling, 1-Page Ltd. fell after posting weaker than expected Quarterly performance metrics. After reaching $5.50 in September, the company has fallen to 55c as its recruitment product struggles to deliver on very high market expectations.

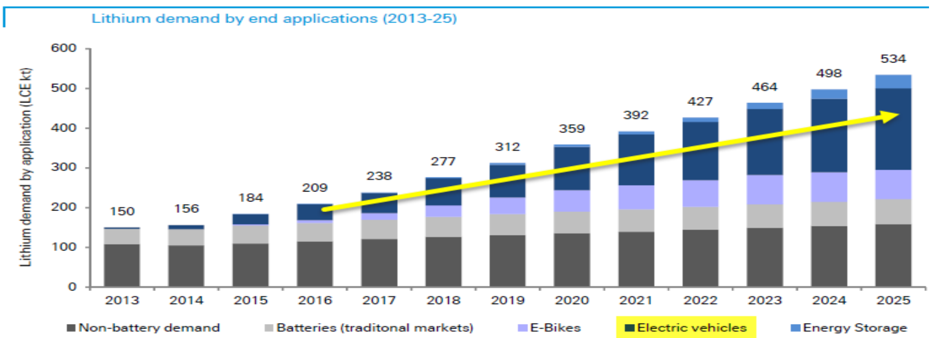
Sector Discussion – ***Lithium and the Electric Vehicle (EV) Battery***

Every so often an emerging trend takes hold in markets and provide extraordinary opportunities and returns, only to burn brightly for a period of time before dwindling as the bubble bursts. On the rare occasion an emerging trend becomes a new paradigm (think Facebook, streaming video on demand and online shopping). One of the hardest aspects is identifying what is sustainable and what is indeed a bubble.

Tesla is potentially one of these new paradigms having taken their electric car from concept to production over the last 13 years. At its most recent quarterly update, Tesla's enigmatic CEO, Elon Musk, forecast that the company would be producing 500,000 electric vehicles by 2018 and one million vehicles by 2020. To quote Musk, "In order to produce half a million cars a year…we would basically need to absorb the entire world's lithium-ion production".

As an important component of the electric battery, lithium is in high demand and Musk's comments only served to further fuel a flame under the metal, whose price had already risen 47% in the first quarter of 2016.

In fact, lithium carbonate pricing is forecast to triple from $9,000 USD/t in 2015 to $21,000 USD/t in 2016 before settling back to $10,000 USD/t in 2019 as more supply enters the market.



Despite having a third of the world's production, Australia only has one listed current producer, Orocobre (ORE), which oddly enough produces lithium from a deposit in Argentina. The other Australian companies with projects looking to commence production in the next few years are Mineral Resources (MIN) and Neometal's (NMT) Mt Marion resource, Galaxy (GXY) and General Mining's (GMM) Mt Cattlin resource and Pilbara Minerals' (PLS) Pilgangoora resource. To say we are late to the lithium story is somewhat of an understatement with GXY, GMM, NMT, PLS and ORE up 334%, 225%, 203%, 106%, and 103% respectively since January 1st this year.

The major risk for these companies is that *finding* lithium and *producing* lithium a two very different notions with deliverability being the Achilles Heel for many a resource company. At this stage we feel there are too many unforecastable variables at play to confidently invest in the Australian lithium companies but we are following the sector closely given our view that the electric car market is indeed an exciting new paradigm.