JM Financial Group

Issue 6: October 2015

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st October 2015)*	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	**8.07**	**8.07**	**24.92**	**14.47**	**31.16**	**59.14**
Small Ords Accum. Index	7.12	7.12	5.99	2.94	3.04	16.67
Outperformance	**0.95**	**0.95**	**18.93**	**11.53**	**28.12**	**42.47**

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 October.*

October was a strong month for equity markets with small resource and energy stocks rebounding strongly after months of underperformance.

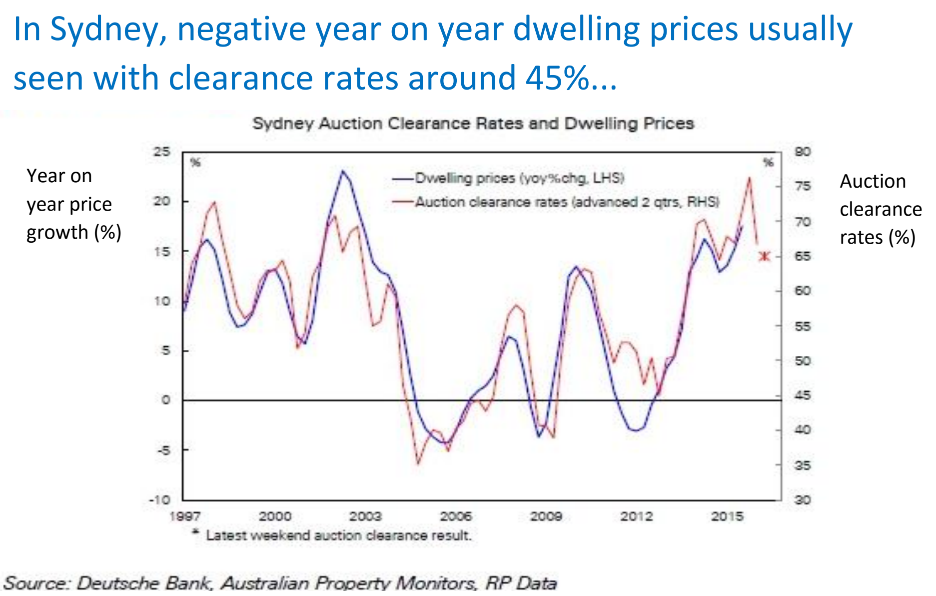
Monetary policy was again the major macroeconomic driver of our market with the world's largest economies continuing their easing bias. The US Federal Reserve again opted to hold off on raising interest rates with analysts now expecting a rate rise in December or early in 2016. The European Central bank signalled it will look to increase its economic stimulus when it meets again in December and the People's Bank of China cut rates further in an attempt to stimulate demand.

Domestically the banks were again a hot topic of discussion with Westpac announcing a capital raising and a subsequent out-of-cycle 20 basis point interest rate rise in order to compensate shareholders for the higher costs of equity now required by the recent APRA regulations. Unsurprisingly the other banks followed suit, leading many market commentators to call an end to the housing boom. Although this call has been made many times before (*and been incorrect each time*) there has been a fall in clearance rates in both Sydney and Melbourne since the interest rate moves. (This can be seen in more detail in the chart below).

On the policy front the Trans-Pacific Partnership was finalised early in the month and was applauded as a way of diversifying our economy away from mining and resources. It's still very much in its infancy but the lowering of export tariffs should be a boon for Australia's agricultural and manufacturing sectors.

At a stock level, ANZ, National Australia Bank and Woolworths all posted disappointing profit numbers and the major M&A news was an opportunistic bid for Santos from a private equity consortium for $7bn. At the smaller end, Qube made a raid on Asciano buying 19.9% of the company and potentially blocking the takeover by Brookfield. Qube has stated its desire to purchase some of Asciano's old Pacific National rail assets that were formerly run by Qube Chairman, Chris Corrigan.

Chart of the Month – *Relationship between auction clearance rates and dwelling price growth*



Source: Deutsche Bank, Australian Property Monitors, RP Data

The chart to the left highlights the high correlation between Sydney auction clearance rates (red line) and % increases in dwelling prices (blue line).

Given the recent slowdown in clearance rates in both Sydney and Melbourne it would appear inevitable that the rate of price growth (left hand axis) in the housing market will slow.

The good news for home owners though is that historically price growth has only been negative when clearance rates have fallen to 45% or lower (right hand axis).

Best & Worst Performers for October 2015

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Mainstream BPO - MAI	Alexium – AJX	Lynas Corp. - LYC	Dick Smith – DSH
MaxiTRANS - MXI	Godfreys- GFY	Drillsearch – DLS	Capitol Health – CAJ
St Barbara – SBM	Wellcom Group – WLL	Medusa Mining – MML	ERM Power - EPW

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

Mainstream BPO – (up 42% for the month)

Mainstream completed its IPO in late September and gained significant investor interest following an acquisition in Hong Kong and a greater appreciation of the fund administration sector following the successful IPO of its much larger rival, Link Administration Holdings. Mainstream offers share registry and administration services for investment managers and superannuation trustees.

Lynas Corporation – (up 81% for the month). **Not held.**

Rare earths producer, Lynas Corp., bounced strongly following a positive quarterly cash flow report and a dismissal of legal action against its Malaysian operations. Whilst this news was welcomed by the market it was somewhat of a relief bounce. LYC still only trades at 5c per share, a long way from its halcyon days of $2.50 in 2011.

Alexium International – (down 13% for the month)

Fire retardant producer, Alexium, fell from record highs during the month. However, there was some positive news with the company announcing its product had been selected by the US Department of Defence for use in its military uniforms.

Dick Smith Holdings – (down 46% for the month). **Not held.**

Dick Smith fell heavily after downgrading full year earnings by $8m due to increased competition. This was not surprising given Harvey Norman announced a 7% rise in sales across the same period the previous day. Although the offering is not identical it's clear that Dick Smith's moves to increase its range of household goods is yet to make an impact. Although we don't have a holding in either name we did exit our position in Godfreys during the month. It had become clear that a price war was occurring and Godfreys' sales were being adversely impacted.

Hitting the road – *Feedback from our October company meetings*

At JMFG we believe one of the keys to selecting good companies and good investments is to actively get out and meet with company management. In the industry it's referred to as "tyre kicking" and it forms one of the essential aspects of our due diligence process.

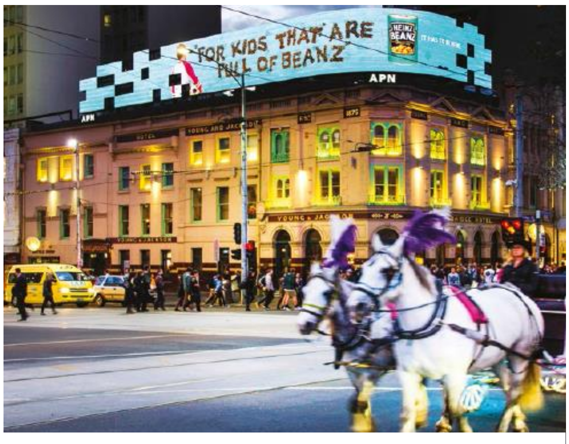
We look to catch up with the CEOs and CFOs of companies we have invested in multiple times per year as well as meeting with potential new investments, competitors, suppliers and customers and unlisted industry participants. By increasing the number of companies we see, we not only increase our chances of finding the next CSL or Wesfarmers but are able to build a large library of feedback on how the underlying economy is faring across a variety of sectors.

Throughout the month of October the JMFG team met with 21 companies face to face, attended a Microcap Conference, a Biotech Conference, an Emerging Tech conference and travelled interstate for two days for back to back meetings. We have provided feedback from some of our meetings below:

APN Outdoor (APO) and Ooh Media (OML), the two market leaders in outdoor advertising, continue to see good growth in their businesses as the amount of advertising and marketing spend dedicated to the outdoor sector grows at the expense of free to air television. This growth is further supported by static billboards being converted to digital, allowing much greater flexibility for advertisers.

Recently listed specialty retailers, Adairs (ADH) and Lovisa (LOV), continue to see strong growth in their respective sectors of homewares and fast fashion jewellery. Adairs has benefitted from the low interest rate environment and household wealth effect, with like for like sales up an incredible 20% in FY15. Lovisa has pitched itself perfectly at the 15-35 year old female market through its range of relatively inexpensive and high margin ($20 ave. price point) fast fashion jewellery. Both companies believe they can continue to grow profits in a slower housing, or higher interest rate environment.

We will keep you informed as our work on these and other potential investments progresses.



The APO digital billboard above Young and Jacksons. (Historically JMFG has done many more hours of due diligence inside the building than outside it.)