JM Financial Group

Issue 19: November 2016

Investment Newsletter

Market Performance (As at 30th November 2016)	November 2016 (%)	Calendar YTD (%)	1 Year Rolling (%)
S&P - All Ords Accum. Index	2.46	7.17	10.01

Month in Review *– A review of events that influenced the share market in November.*

Strange days indeed. These poignant lyrics from John Lennon somewhat encapsulate our views on the rather exceptional month that was November 2016.

After witnessing real estate baron and celebrity TV show host, Donald Trump, stun most political forecasters to win the US Election the Australian market plummeted, falling 3% intraday as the market reacted savagely to the greatest election surprise in modern history.

As investors around the world braced for the fallout, markets chose to focus on Trump's spending promises to rally 5% across the remainder of the month, with the Dow Jones and NASDAQ setting record highs. Resources were the main driver with zinc, copper, and lead all finishing up nearly 20% across the month. Domestically our market followed suit in a more muted fashion rising 2.5%.

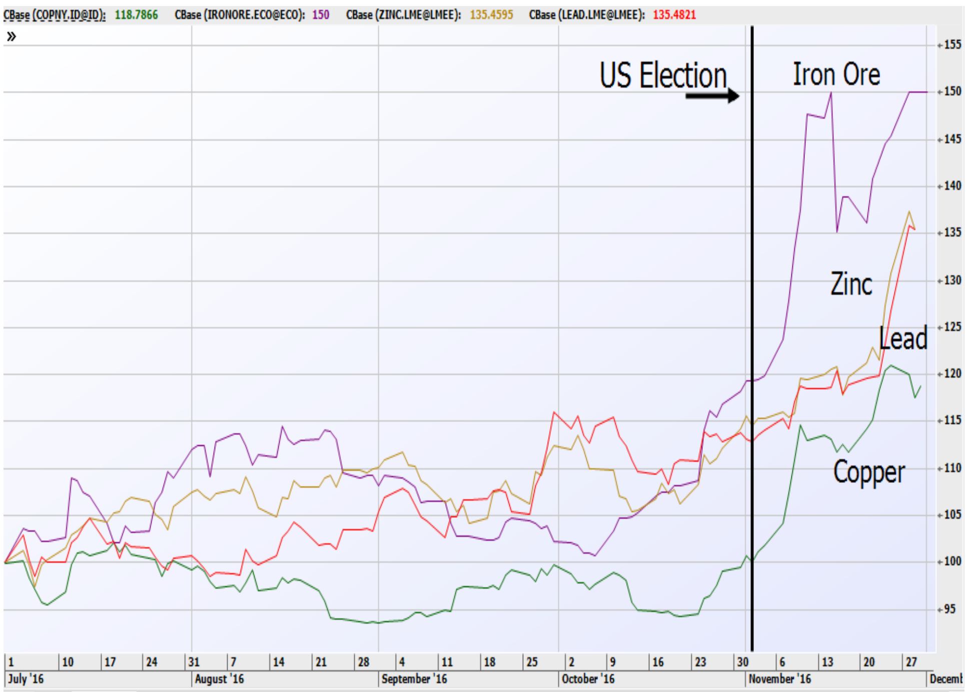
Whilst a 2.5% rise seems relatively standard the composition of this move was quite interesting with a raft of small companies announcing heavy earnings downgrades at their annual general meetings. The Small Ordinaries Index fell 1.2% with the Top 100 companies once again outperforming, returning 3.5% for the month.

To round out a very volatile and somewhat exuberant month, OPEC finally agreed to oil production cuts driving the oil price up a remarkable 8% on the last day of the month as traders took the view that days of $28/barrel of oil are well and truly behind us.

As mentioned previously our domestic market witnessed a number of high profile earnings downgrades from Adairs, Flight Centre, RealEstate.com, Isentia, CSG Group, Vocus, Virtus Health and Scottish Pacific to name a few.

In other company specific news the country's largest poultry producer, Inghams, listed on the stock exchange and building materials producer Boral announced the $2.6 billion acquisition of US peer Headwaters.

Chart of the Month – *The return of resources?*



Following President Elect Donald Trump's comments on infrastructure spending, the resources market has witnessed an incredible bounce. Investors are now betting that the associated demand for raw materials will push commodity prices out of their post GFC doldrums.

Commodities that are particularly leveraged to construction activity have been the major beneficiaries with iron ore gaining 26%, reaching a level not seen since 2014 and zinc rising 18% to a level not seen since 2008.

Whether the rally in resources can be sustained remains to be seen but with Trump not in office until January 2017 it would appear that the commodity rally could continue throughout the historically buoyant Christmas period.

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Due Diligence – *Getting it Wrong.*

Getting a stock selection wrong and losing money for clients is one of the worst errors an investment manager can make. One of the other errors is failing to own up to your mistakes.

Getting your investment thesis wrong is disappointing and particularly distressing when you do a substantial amount of work on a company including meeting with the CEO to discuss all of your concerns. This was exactly the case with Vocus (VOC), a stock we have discussed numerous times over the last two months as the business came under increasing scrutiny following rival TPG's earnings downgrade in September.

After meeting with Vocus CEO Geoff Horth, we felt that although there were some increased competitive pressures in the retail division Geoff had a good handle on the issues and the strength of the corporate and wholesale fibre division was more than enough to offset any potential retail weakness.

At Vocus' AGM late in November it became evident that there were serious issues in a range of divisions and what was particularly concerning to us was the loss of customers in the recently acquired Nextgen business. The stock fell heavily on the day of the AGM with the market surprised by the breadth of issues in the business. Although a number of research houses still have a buy or neutral outlook on Vocus we have chosen to exit the position for clients. In our opinion the issues that are impacting Vocus have no short term panacea and there is a significant chance the company could miss its revised FY17 earnings guidance.

There's an old adage "Don't let one mistake become two". When investing in companies there is always an element of risk and mistakes will happen. The key to capital preservation though is to minimise losses and know when to sell.

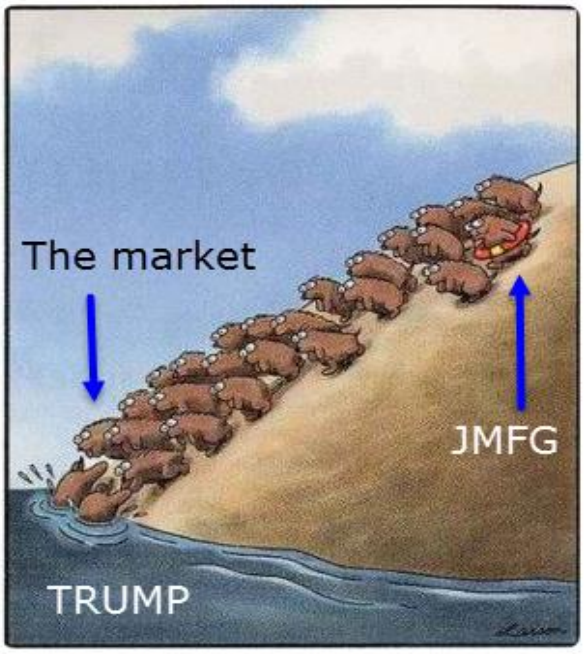
Although the majority of stocks clients own are performing well we don't like to only highlight our winners and shy away from our mistakes. As a team we learn much more from our failures than we do from our successes.

Strategy Discussion – *Donald Trump and the return of Populism*

The 2016 US election has proved to be one of the most defining moments in modern political history. A man voted into arguably the most powerful position in the world, with no political experience and only a smattering of support from his Republican Party, has redefined the entire political landscape. Trump, to his credit, was able to tap into the underlying anger and disillusionment that has been rippling through "Middle America" since the global financial crisis.

Despite winning the Electoral College vote relatively easily, Hillary Clinton won the popular vote by nearly 2.3 million voters. Never has a losing candidate won the popular vote by such a large margin.

So what does all this mean for financial markets? We have no idea. And neither do any number of financial commentators who have tried to justify the market's incredible 5% move since Trump was announced as President.



It appears that markets have been focussing on Trump's election promises to improve trade terms, "spend bigly" on infrastructure and reduce corporate taxes. Choosing to overlook the numerous misogynist, racist and offensive tweets to focus on his more reconciliatory acceptance speech.

To say we are surprised by the market's enthusiasm for President Trump is an understatement. Although he may be pro-business we have reservations on his ability to fund his election promises without further straining the US's ever burgeoning debt position. Unlike a company, a country can't claim bankruptcy and start again.

Due to our stated strategy of remaining fully invested, clients have benefitted from the "Trump rally" but we have resisted the urge to chase cyclical stocks and resources stocks, preferring to remain somewhat defensive in our stock selection due to the increased volatility a Trump presidency may bring.

Much like our friend to the left, although we are following the market lemmings over the cliff into the Trump unknown we are choosing to do so wearing a life jacket.