JM Financial Group

Issue 21: January 2017

Investment Newsletter

Market Performance (As at 31st January 2017)	January 2016 (%)	Calendar YTD (%)	1 Year Rolling (%)
S&P - All Ords Accum. Index	-0.77	-0.77	+17.09

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

January saw the ASX 200 take a breather following Trump related strength in November/December last year. The market was strong at the start of the month but this was followed by a gradual sell off, finishing 0.77% lower at month end as presidential euphoria wore off. A number of stocks were hit by downgrades during the pre-result 'confession', including Bellamy's, Aconex, Virtus Health and Servcorp all suffering large share price falls. On the other hand Bega shares rose 20% on the news it had bought iconic Australian brand Vegemite, along with a range of cheese and grocery brands, from Mondelez International.

Resource stocks did well on the back of stronger commodity prices with 7 out of the top 10 ASX 200 moves coming from that sector. Gold reversed its recent trend rising 5.2% during the month whilst copper rose 8.7%, continuing its strong run from November. Oil was steady. Elsewhere the Dow Jones moved above 20,000 points for the first time, but receded to finish marginally ahead for the month overall.

Much has happened since the inauguration of President Trump on January 20th and uncertainties surround the extent to which protectionist philosophies will be implemented in the U.S. and subsequent reactions of other jurisdictions. How this affects world trade/growth along with any impact from U.S. infrastructure spend, defence and immigration policies is impossible to assess. Volatility would seem to be the only certainty.

With reporting season now upon us and following a market rise of 17% over the rolling year and 6% over the last 3 months, focus will be on guidance statements and continuation of growth over 2017. Market PE multiples have pushed beyond 16x in FY17 based on forecast EPS growth ~8% for FY17. This however is not expensive if market forecast growth for FY18, which at this stage is also 8%, is achieved. The major components of the forecast FY17 market PE multiple of 16x comprise non-financial Industrials ~19x, Financials ~13.5x and Metals & Mining ~15x.

Chart/Table of the Month – *Global Economic Factors*

Region Economic Summary

	Real GDP	CPI	Unemployment Rate	Current Account	Govt Debt
	% vs year ago	% vs year ago	Percent	% of GDP	% of GDP
China	6.8	2.3	4.0	2.4	13.8
European Union	1.9	1.2	8.2	-	83.7
Euro Zone	1.8	1.1	9.6	3.9	89.5
France	1.1	0.7	9.7	-1.2	97.2
Germany	1.7	1.9	3.9	7.9	69.0
India	7.3	2.6	5.0	-0.6	47.3
Italy	1.0	0.9	12.0	2.6	132.4
Japan	1.0	0.3	3.1	3.8	188.5
United Kingdom	2.2	1.6	4.8	-5.2	84.3
United States	1.9	2.1	4.8	-2.4	105.7

Source: FactSet Economics Standardized Database

Growth in the order of 7% across China and India continues to provide a good offset to modest growth across major developed economies throughout Europe, the United Kingdom and the United States.

High unemployment levels across several European economies continues to present a problem but at the same time should keep global inflation in check for some time and hence any rise in global interest rates should be on the modest side in CY17.

The rate of change in interest rates may well be the major factor in determining the success or otherwise of the Australian market in 2017.

While 8% eps growth, if achieved, provides a promising tailwind for market appreciation, any sizeable rise in interest rates and hence the cost of capital, would create a challenge for the market to overcome.

Subject to no major surprises, we generally maintain a positive bias toward the market in 2017.

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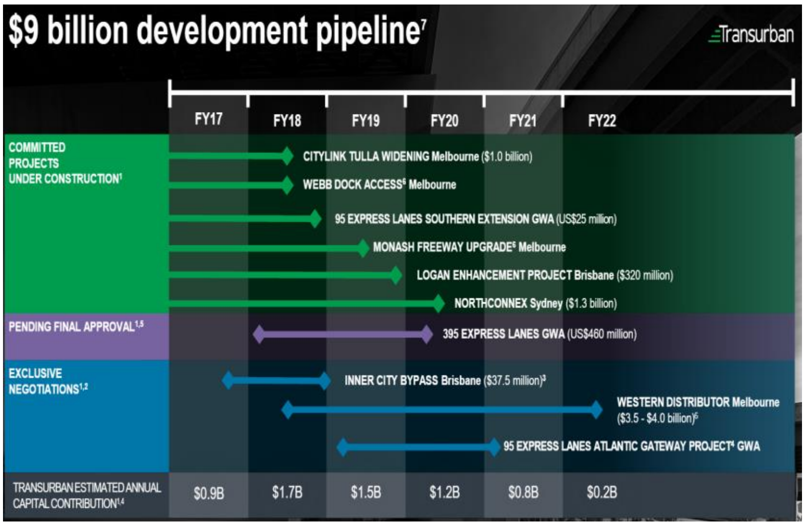
Due Diligence – *a closer look at a stock of interest*

Transurban Group (TCL)



TCL along with other high yield stocks has come under pressure recently following a strong rally during the first half of CY16. We continue to see TCL as a solid long term investment through expansion potential of existing roads in Australia and new road growth options in foreign markets.

TCL has achieved compound annual EBITDA growth in excess of 10% since FY09, excluding new road acquisitions. With mature roads typically achieving annual traffic growth of 2-4% and CPI increases in tolling charges, 5% annual long term cash-flow growth should be a given. Add to that, expansion of existing roads and potential to develop new toll roads, overall cash-flow growth should continue at or above 10%.

TCL currently has a $9b development pipeline ($6.3b TCL share) through to FY22 as shown in the graphic above. Potential other network enhancements include the M7 widening in Sydney as well as widening works in Brisbane across the Centenary/Western Motorway, Pacific Motorway, Logan Motorway and Paradise Road. Many other missing links across Sydney, Brisbane and Melbourne offer growth potential well beyond FY20.

TCL produced another solid half year result for 1H17, with distribution guidance upgraded to 51.5cps for FY17 (prior 50.5cps).

Year of the Rooster

Every 12 years there is a Rooster year, which comes after a Monkey year and before a Dog year. In Chinese astrology, each zodiac year is associated with an animal sign and one of the five elements: Gold (Metal), Wood, Water, Fire, or Earth. 2017 is a Fire Rooster year, the last being in 1957. Whether 2017 is a good or bad year, only time will tell, and with the rise of right wing politics across developed nations, how things pan out is highly uncertain – when it comes to markets, when are they not? If the market growth of 8% holds for FY17 and is achieved for the first half of FY18, we should be able to look back at the end of CY17 and conclude that it was in fact a very good year. Back to back 8% earnings growth across FY17 and FY18 would certainly satisfy the superstitious amongst us.

Planned infrastructure expenditure under a Trump presidency should provide the catalyst for continued economic/employment growth in the U.S. How the U.S. ultimately pays for this, particularly if under Trump, corporate tax rates in the U.S. are cut from the current 35% to 15% is a potential problem, but one for a later date, particularly if US growth in the near term helps to boost government revenues. We expect the private sector will need to participate in the infrastructure spend, potentially another positive for Transurban given road congestion/logistics is a major component of any efficient developed economy and their existing asset exposure in the North American market.

So long as Trump does not offend the Chinese and cordial trade relations continue between the two countries, global growth in 2017 should at least continue at levels seen in 2016. If the U.S. or Europe can improve growth rates from relatively modest levels, through expansionary policies, economic growth appears to have the potential to be a little stronger in 2017.

The hard commodity markets have been strong since mid-October 2016. Aside from the dairy industry, soft commodities continue to enjoy generally strong A$ prices and what at this stage looks to be high summer crop yields with abundant water throughout the Murray/Darling food belt and no extreme heat conditions. Many crop and grazing farmers are talking the best season in many years, providing a catalyst for growth in farm investment throughout 2017.

The Year of the Rooster has started well, and may it continue.