JM Financial Group

Issue 23: March 2017

Investment Newsletter

Market Performance (As at 31st March 2017)	Month To Date (%)	Calendar YTD (%)	1 Year Rolling (%)
S&P - All Ords Accum. Index	3.16	4.50	19.49

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

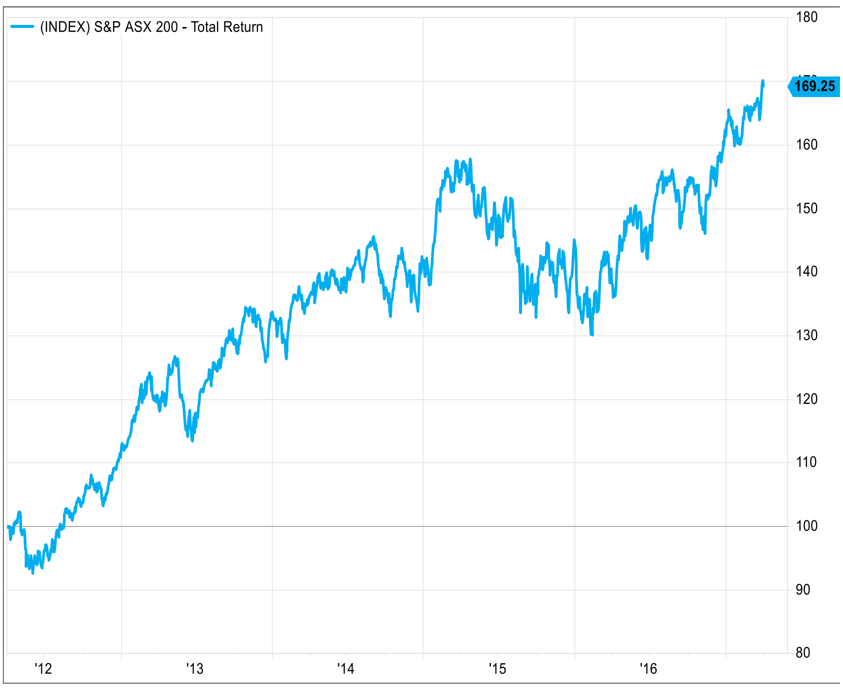
March saw a further solid rise, following on from good gains in February. The ASX 200 Accumulation Index rose 3.3% and the Small Ords Accumulation Index 2.7%. Improvements in the Australian market were achieved despite a 0.7% decline in the Dow Jones to 20,663. Leading sectors included Consumer Discretionary, Consumer Staples, Energy, Healthcare, and Utilities; each rising around 5%. Lagging sectors included Telecommunications, REITs, Materials, and Resources; the latter two declining over the month.

No clear market theme is apparent with a mix of cyclical and defensive sectors appearing both within the outperforming and underperforming categories. It would appear to be a stock pickers market for now. The yield play ran out of steam mid 2016 with broad reversals since then. However we did see stocks like Transurban (TCL) and Sydney Airport (SYD) rebound strongly in March. These stocks, whilst attractive yield plays, offer better growth characteristics than many typical defensive yield plays e.g. REITs.

We wrote about iron ore last month, highlighting risks around the commodity, in particular supply-side risks. While the iron ore price was reasonably steady over the month (down marginally), both BHP and Rio fell around 2% after adjusting for dividends paid. This may reflect the slight easing in ore price and longer term supply concerns. Commodity prices were generally weaker during the month; nickel fell 9%, giving back much of what it gained in February, copper was down 2% and oil fell 5%.

The rise in the market over the past two months would now see average Market PE multiples for FY17 above 16.5x and pushing towards 20x for non-bank Industrials. Stripping out resource related growth, we estimate growth across the broad Industrial market would be in the mid-single-digit range. We view this as a healthy level of growth in a low interest rate environment, with near term rate rises expected to be only modest.

Chart of the Month – *Prices and interest rates rises*



This month we look at the chart which is perhaps the most relevant to Australian equity investors, the ASX 200 Total Return index (assumes all dividends reinvested). For simplicity we have indexed the chart to 100 at the five year starting point. The index has risen close to 70% over the past five years, generating a very healthy return.

Having peaked in the early part of 2015 it subsequently fell in the order of 13%, reaching a low in the early part of 2016. It was dragged down during this period by the two largest sectors, Financials and Materials; the former a function of balance sheet recapitalisation, the latter a function of major declines in iron ore and coking coal prices. The Energy sector was also very weak with falling oil prices, and Telecommunications underperformed on an increasingly competitive environment.

The recovery in commodity prices and improved growth outlook for the Financials have been large drivers of the index resurgence over the past 12 months. We expect the market to continue its rise but at more moderate levels from here with the Materials space now looking more challenged.

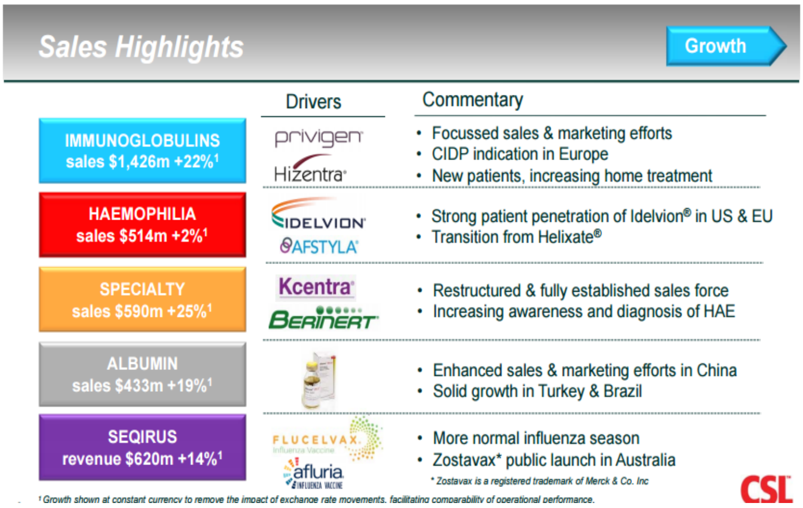
Due Diligence – *A great Australian success story*

CSL Ltd (CSL)

From its initial listing at just under $0.90 a share (adjusting for the 3 for 1 share split in 2007) in 1994 to its current price above $125, CSL has been one of the great success stories in the Australian market.

Since listing it has broadened its product range and expanded the global breadth of its operations. It now researches, develops, manufactures and markets vaccines and plasma protein biotherapies to treat and prevent human medical conditions.

Despite its long term success it continues to generate strong growth. Product sales across its portfolio grew 18% in 1H17 on a constant currency basis, with EBIT rising close to 38%. With net debt of $2.6b and annual operating cash flow in excess of $1.2b, CSL is well positioned to continue buying back its stock and growing dividends paid to shareholders.



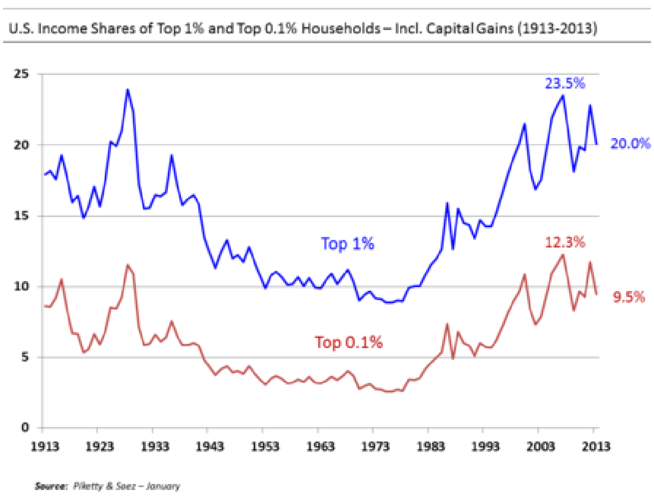
R&D investment for CSL is in excess of $600m annually with two thirds applied to new product development. The balance is applied to market development and life cycle. CSL has a range of near term products across each of its four key categories highlighted above, with potential release of products across the U.S., Europe, Japan and Australia. New products, along with a growing list of collection centres in the US Plasma business, should help to maintain above market growth. The US Plasma market has achieved compound annual growth of 8% per annum since 2012, whilst at the same time CSL has achieved 18% compound annual growth.

Making America Great Again

A nice catchphrase in an election but the reality of this slogan is much harder to achieve. To make it great again one first has to define what has gone wrong. The GFC has come and gone, unemployment levels are manageable again but there are areas of America – read the old rust belt and mid-west – that still exhibit high unemployment and income disparity levels. Income disparity, if it is allowed to extend too far, creates social unrest, breeds resentment, and can ultimately destabilise political systems and economies. The U.S. is far from this situation, but income inequality does sit around the 30th percentile globally, meaning 70% of countries have a more equal income distribution. Trump of course is pro-growth, pro-business and his rhetoric is that he wants all Americans to participate meaningfully.

Interestingly, income concentration in the US has fluctuated, reaching a low point in the mid 1970's. Since then it has all been one way. In the mid 1970's the top 1% of households generated around 9% of US income (includes capital gains). That had increased to over 20% by the early part of the new millennium and has fluctuated around that level since, with major fluctuations linked to capital value changes. The change in concentration of the top 0.1% of households has been more extreme, climbing from around 2.5% of U.S. income in the 1970's to around 10% currently. To put this data in perspective it is worth considering where income levels are for each group of US households. The bottom 50% of households generate a mean income in the order of US$30,000. The next 45% has a mean income a little under US$100,000. The top 5% has a mean income above $600,000.

A part of Trump's proposed reform involves stimulating growth through lower company taxes. This plays into the hands of the higher income groups with investment assets. Ideally the same strategy drives demand for labour and thus labour rates should rise. The key question however is whether they will rise enough to compensate for rising company profits and asset prices that the higher income groups will enjoy. Utilising trade barriers as a means of bringing jobs back to America is more problematic. The net effect of shifting jobs back into America by imposing penalties on imported product is difficult to estimate. Such policies would likely be met with counter tactics. Mexico has already voiced restrictions, should Trump take this path. We would expect other nations to adopt similar strategies. The net result could well be a triple loss situation – net loss of jobs, incomes and capital values for all demographic groups in the U.S.



Prosperity through equality…

Important Information - JM Financial Group has made every effort to ensure the accuracy of the information contained in this document. However, no warranty is made as to the accuracy and reliability of the information. Past performance is no guarantee of future performance. This report does not take into account a reader's investment objectives, particular needs or financial situation and is general information only. It should not be considered as investment advice nor be relied on as an investment recommendation. If you would like to discuss further please contact us on +61 (3) 9627 9900.