JM Financial Group

Issue 27: July 2017

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st July 2017)*	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	**-2.72**	**-2.72**	**-0.25**	**-2.72**	**-5.70**	**58.36**
Small Ords Accum. Index	0.34	0.34	1.45	0.34	-1.09	22.76
Outperformance	**-3.06**	**-3.06**	**-1.70**	**-3.06**	**-4.61**	**+35.60**

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 calculated on TWRR basis; non- annualised, includes fees (post 1 Jan 17) and the effects of franking credits and tax. Strategy Inception for Performance Data is July 1st 2014.

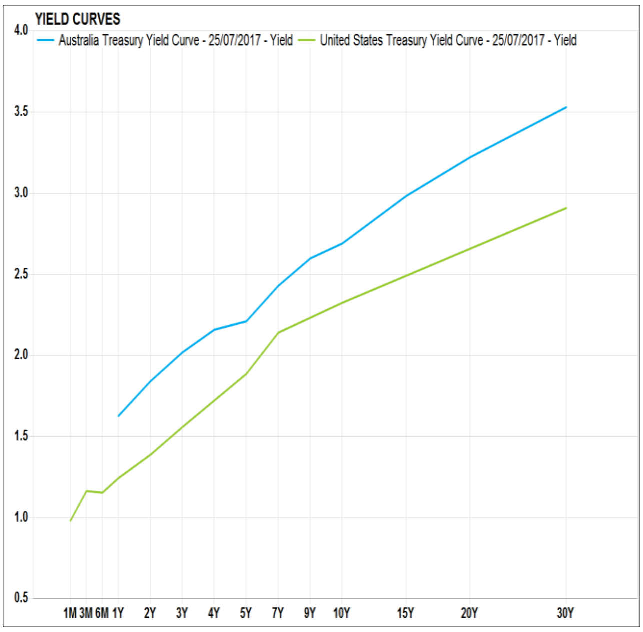
***Month in Review –** A review of events that influenced the share market in July*

The Small Ords Accumulation Index increased by a modest 0.34% for the month, marginally ahead of the All Ordinaries Accumulation Index, which increased 0.18%. Strongest sectors included Materials +3.6% and Financials +1.2%. Healthcare was the weakest sector, falling 7.5%, a function of A$ strength affecting its two largest constituents, CSL and Cochlear, both of which generate the bulk of their earnings in foreign currency. The yield unwind continued in July with Utilities falling a further 5.3%, Telecommunications down 4.3% and Industrials, which includes Transurban and Sydney Airport, down 3.1%.

The Small Companies Strategy had a poor month, underperforming its benchmark by 3.06% in July and by 4.61% over the rolling 12 month period, but outperforming its benchmark by 35.6% since inception around 3 years ago. On the positive side of the ledger, Mainstream BPO increased 29% in July and added around 100 basis points to performance, while Temple & Webster contributed around 36 basis points. However the Fund was hit by price falls in four of its investments – Catapult, Mayne Pharma, Base Resources, and St Barbara Mines – each detracting between 43-49 basis points from performance. In addition, the Small Resource component of the ASX Small Ordinaries Index, which comprises around 28% of its weight rallied 2.88% for the month, in comparison with the Industrials component which fell 1.84%. Our Small Companies Strategy is strategically underweight resources as they historically underperform the Industrials.

During the month, we trimmed Catapult, initially on strength as the price rallied toward $2.40, but at the latter end of the month on weakness as it retreated back toward $2.00. BT Investment Management was removed from the portfolio following its recent inclusion in the ASX 100, hence ineligibility to continue in the Small Companies Strategy. Integrated Research (IRI) was added to the portfolio. Through its IR Prognosis technology, IRI provides performance management and diagnostic software for business critical systems to ensure continuity and performance for a range of organisations across 75 countries and in banking, airline and telecommunication companies.

Chart of the Month – Yield Curves



Global markets have continued to rally. Despite this, the Australian market has remained stubbornly bound in a trading range. Major international equity markets are at, or near, all-time highs. Over the last 12 months the S&P 500 has risen over 16% on a total return basis, the FTSE (UK) over 15%, the CAC (Fr) and DAX (Germ) are both up c20%. Asian markets have also been strong: Hang Seng (HK) and Nikkei (Japan) over 20% and 25% respectively.

By comparison, the total return for ASX All Ordinaries is around 7% over the past 12 months. The Australian market has been in a tight trading range through CY17, ranging between 5700-6000 (All Ordinaries price index).

Earnings growth has generally been solid in foreign markets with high single/low double digit growth expectations for 2017. To this point the fundamentals for equity markets still look comfortable. Yield curves as shown in the chart opposite are normal {not inverted as is often the case when economies are at risk} and equity risk premiums are still comfortably above longer term averages, allowing for some earnings growth slippage from attractive EPS growth forecasts without necessarily damaging index levels. Overall we feel global and local factors are supportive of equity markets, excluding any left-field events.

Best & Worst Performers for July 2017

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Mainstream BPO - MAI	Catapult Group - CAT	Programmed - PRG	Doray Minerals - DRM
Temple & Webster - TPW	Mayne Pharma - MYX	Lynas Corporation - LYC	Mesoblast - MSB
AMA Group - AMA	Base Resources - BSE	Metals X - MLX	OceanaGold Corp - OGC

Hits & Misses – *A summation of the top hits and misses for the month of July*

Mainstream BPO – MAI – up 29.2% for the month

Mainstream announced its acquisition of the IRESS superannuation business, which provides services to customer-owned banks. The acquisition will see funds under administration increase by $650m. Completion is expected in early October 2017.

Programmed – **PRG** – up 59.8% for the month **(Not held)**

A Scheme Implementation Deed with PERSOL Holdings was announced, under which PERSOL proposes to acquire 100% of the issued shares of Programmed for a cash price of $3.02/share.

Catapult Group – CAT – down 13.3% for the month

Having rallied in July, Catapult on little news retreated back towards $2.00/share. The real issue for Catapult is the lack of positive news flow for a company that is supposedly in a high growth phase. Without such news flow, revenue growth could disappoint in FY18.

Doray Minerals – DRM – down 36.1% for the month (**Not held)**

Doray Minerals disappointed with its Andy Well underground mine revealing a reduction in the strike length of its ore body. The consequences are a reduction in mine life and forecast higher unit costs.

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

Integrated Research (IRI) – Performance Analytics

Integrated Research was introduced into the portfolio in July. IRI is a leading global provider of proactive technology measuring performance analytics and alerts for critical IT infrastructure, payments and unified communication systems. It essentially provides optimisation, measurement, and diagnostic tools for businesses operating complex IT systems. IRI supplies its IR Prognosis technology to more than 1,000 organisations in over 75 countries, providing critical real-time insights ensuring continuity. Solutions are provided in the cloud, on-premises, or on a hybrid basis.

In simple terms, the IR business provides performance management, network monitoring, call quality troubleshooting, call quality visualisation tools, proactive alerting, analytics and reporting, and assessment and testing. Within Unified Communications, for example, it provides tools for Skype for Business and integrates its tools with multinational groups Avaya and Cisco. Other major customers include Dell, HSBC, Ford, and Citi Group. IRI sells its products globally through direct relationships as well as reseller and system integrators. IRI generates revenue across the globe with around 65% from the US, 20% Europe and ~15% Asia Pac. Revenue grew 10% in 1H17 and profitable growth is expected to continue.

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