JM Financial Group

Issue 29: September 2017

Investment Newsletter

Market Performance (As at 30th September 2017)	Month To Date (%)	Calendar YTD (%)	1 Year Rolling (%)
S&P - All Ords Accum. Index	+0.05	+3.95	+8.53

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

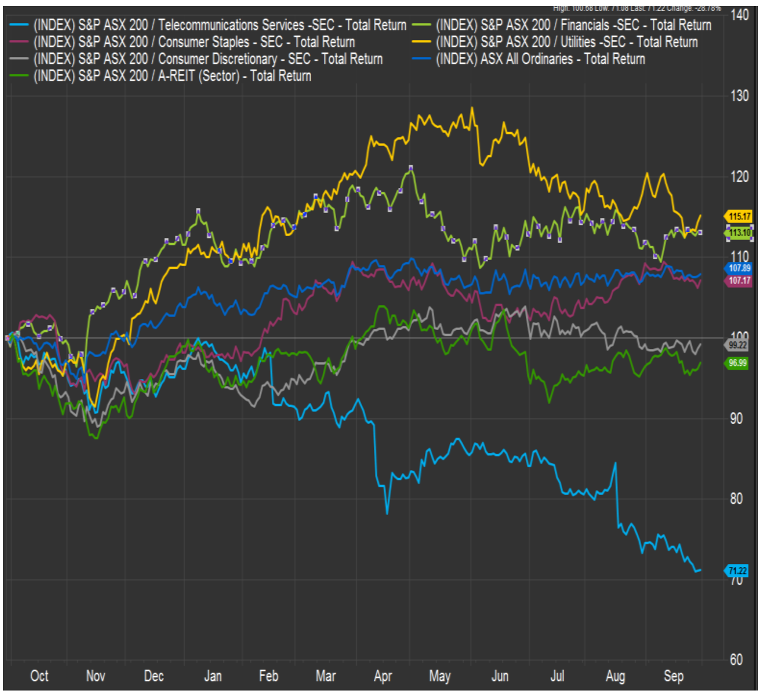
The All Ordinaries Accumulation Index increased 0.05% for the month. Large sectoral moves included Utilities and Telecommunications which fell 3.7% and 4.6% respectively on an accumulation basis. Rising global interest rates affected both sectors but in the case of Telecommunications, ongoing margin pressure in an increasingly competitive environment took its toll. The Materials sector fell 1.6% with Iron Ore falling 20% over the month, to US$61.50/t. On an accumulation basis, most other sectors either fell or rose only marginally.

While the Materials sector declined during September there were some large variations within it. BHP fell 4% on an accumulation basis and nearer 6%, excluding its dividend entitlement, accrued during the month. Rio Tinto fell by 2% and Fortescue Metals Group fell 11%. BHP and Rio dominate the weightings within the Materials sectors. On the positive side of the ledger within Materials, the metals and diversified mining stocks performed well with South 32 rising close to 15%, Syrah Resources and Orocobre +16%, and Mineral Resources +10%.

Telstra came under further pressure, falling 5% in September after its 6% fall in August. Telstra, including dividend entitlements, has fallen 27% over the past 12 months. The sector generally looks challenged with longer-dated concerns around the full financial impact of the shift to NBN and TPG's plans to launch a fourth mobile network.

Many areas of the Australian equity market look challenged. We highlight below a number of sectors which could find growth difficult for a range of different reasons, including changing competitive environment, regulation and rising interest rates. For many of these companies lower growth may be largely priced in, but even so, finding excess returns amongst them may not be easy. We suspect the best returns will come from elsewhere over the coming twelve months.

Chart of the Month – Challenged Sectors (12m Returns Indexed)



There are several challenged sectors in the Australian market - none more so than Telecommunications, which has underperformed the ASX All Ords by nearly 30% over the past year. Telstra, TPG and Vocus have all fallen dramatically. The ongoing rollout of the NBN and TPG's plans to build its own mobile network make it difficult to see a positive environment for some time.

The Consumer Discretionary & Staples sectors have underperformed. The longer term metrics for these sectors look challenging with the ongoing growth of Aldi / Costco, Amazon on its way and growth of international branded retailers. The Financials sector looks challenged with rising capital requirements and compliance costs, reduction in ATM fees and potential residential slowdown on rising global interest rates. On this latter point, yield sectors such as Utilities and REITs are also likely to face headwinds.

In total these sectors account for around 55% of the Australian market. It highlights the need to be diversified both in terms of sectors and specific stocks with a focus on small high growth stocks in I.T., Health, Materials etc.

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

Amcor (AMC)

Amcor manufactures and supplies specialised packaging products for the food, beverage, healthcare, home personal care and tobacco industries. Over the past decade it has transformed its business through innovation in packaging products providing secure and safe packaging for a range of goods.

It has also expanded into developing markets to complement its exposure in the mature North American, European and Australian markets.

Amcor operates two core divisions being Flexibles and Rigid Plastics. Within these divisions, Amcor believes growth opportunities exist through a prudent acquisition strategy and ongoing investment in research and development, to ensure it is at the forefront of innovative product solutions for its clients.

Longer-term growth: accelerating in focus segments

	Flexible Packaging Americas	Flexible Packaging Asia	Rigid Plastics specialty containers	Closures
Amcor sales[1]	US$1 billion	US$1 billion	US$750 million	US$400 million
Estimated total market[2]	US$25 billion	US$20 billion	US$15 billion	US$25 billion
Estimated Market growth[3]	3%	5%	3%	6%

Attractive fundamentals | Opportunities to differentiate | Underweight position today

Acquisition opportunities exist both in mature and developing markets. As shown in the table above, Amcor has significant market share potential improvement across all regions and segments. Amcor has had a disciplined return approach to acquisitions. This may limit opportunities from time to time but with exposure to the faster growing Asian market, even without acquisitions, Amcor should be able to grow ahead of long term Australian GDP growth. Recent strength in the A$ against the US$ has dampened the A$ share price of Amcor. Stabilisation of the A$/US$ and with stronger Euro economies, underlying earnings growth should see Amcor perform.

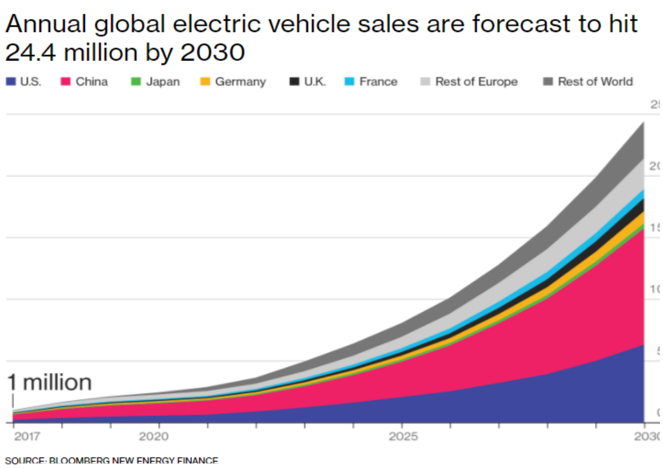
Battery Materials – Opportunities in Lithium & Cobalt

The shift toward electric vehicles and demands for energy storage in the renewable energy industry, both at a wholesale and domestic level will continue to drive battery technology and increase demand upon the materials that are used to manufacture efficient batteries. If Lithium batteries prove to be the long term solution, the world is going to need a lot more Lithium. The active materials of a Lithium Ion Battery comprise 73% Nickel, 14% Cobalt, 11% Lithium and 2% Aluminium in the Cathode, whilst the Anode comprises 100% Graphite.

Nickel and Lithium sell for around US$9,000/t and Cobalt over US$58,000/t. Annual nickel production is 2 million tonnes per annum. This compares with cobalt at about 110,000t per annum and lithium at about 600,000t per annum.

With global electric vehicle sales expected to reach 24.4m by 2030, demand for lithium, cobalt and nickel will only increase. Nickel is a more abundant metal with global ore reserves of 78mt and major producing countries including The Philippines, Australia, Russia, Canada and Indonesia. World reserves of Cobalt are estimated at 7.1mt according to the United Stated Geological Survey. Most cobalt is produced as a by- product of nickel and copper production, and over 50% of world supply comes from the Democratic Republic of Congo, Its price is often tied to the DRC's political fortunes and ethical mining can be an issue. As demand for cobalt increases it will become of greater importance to diversify world supply away from DRC.

Estimates of recoverable world lithium reserves are difficult but recent estimates are in the 14-15mt range. While lithium is present in seawater, low concentration has meant commercially viable methods of extraction are yet to be discovered. Most of the world lithium production is from South America. Chile is the leading producer followed by Argentina, but around half of world reserves are currently located in Bolivia in the Andes ranges. Lithium is typically extracted from lithium-containing brine pools where it is extracted using evaporation. This process takes 18-24 months per batch. A roasting process is then used to extract lithium metal from the concentrate.



With demand for lithium and cobalt expected to rise dramatically over the next decade, the challenge will be to find quality deposits in politically stable locations. This could create some exciting opportunities for Australian explorers.

A world of opportunity for some lesser known metals