JM Financial Group

Issue 34: February 2018

Investment Newsletter

Performance *(As at 28th February 2018)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Australian Equities Strategy	**+1.03**	**+2.86**	**+14.43**	**+31.8**	**+49.48**
All Ords Accumulation Index	+0.18	+1.72	+10.85	+18.04	+33.47
Outperformance	**+0.85**	**+1.14**	**+3.58**	**+13.76**	**+16.01**

Although the JMFG Australian Equities 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 a TWRR basis; non-annualised, and includes fees (post 1 Jan 17) but excludes 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 February*

Despite a shaky start to the month, the All Ordinaries Accumulation Index finished modestly higher, rising 0.2% in February. The Index did particularly well compared to the S&P 500, which finished the month down 2.6%. The Australian market did not experience the same degree of volatility as the US market, falling around 4% at its lowest point, compared with the US market which fell 8.5% at its lowest point during the month.

With many companies reporting half and full year results, we entered the month with a degree of apprehension, particularly given the low number of trading updates released through January. Generally, we found company results and outlook statements a little underwhelming, although there was a smattering of surprises – both positive and negative – with corresponding sizeable share-price movements. The only sectors to show positive returns during February were Healthcare +7.0%, Consumer Staples +2.2%, and I.T. +1.3%. On the negative side of the ledger, the worst performers were Telecommunications -6.0%, Energy -3.7%, Property Trusts -3.3%, and Utilities -1.7%. The Health sector continued on from a strong month in January, with its two major stocks, CSL and Cochlear, up 11.4% and 5.9% respectively. The ASX Small Ordinaries Accumulation Index was also flat for the month.

US dollar commodity prices generally consolidated through the month, with iron ore prices a few percent higher, energy prices a few percent lower, and metals, both base and precious, in moderate trading ranges. Prices were stronger in A$, with the A$/US$ rate easing back to 78c after rallying up to 81c through January.

We remain optimistic on earnings growth for CY18, with synchronised global growth emerging. However, the underwhelming results reported in February would suggest the rate of improvement may be lower. Interestingly, only 56% of companies reported improved profits, with the balance reporting either flat or lower earnings. The consensus 12-month forward ASX All Ordinaries Price to Earnings multiple held flat at 16.1x, indicating that while earnings results were a little underwhelming, there was no major change in overall earnings forecasts for the market. Should current commodity prices hold, we would expect an earnings uplift in the Materials sector.

Table of the Month – Corruption Perceptions Index

Transparency International, a global coalition against corruption, produces an annual corruption perceptions index. The index ranks 180 countries and territories – tabling the results of surveying a combination of experts and business people, rating the countries on a scale of 0 to 100, where 0 is highly corrupt and 100 is deemed to be very clean.

More than two thirds of the 180 countries scored below 50, with the average score 43. Australia, as could be expected, ranks highly (latest score of 77), although its score has been in decline over recent years and is 12 points behind New Zealand, which sits on top of the table, with a score of 89.

A high rank would be expected of a developed economy. Perception of an economy with minimal corruption would certainly assist in attracting capital, and would be a strong indicator of market integrity. In recent times, the ASX has pushed to grow the number of listed entities on its exchange. While one benefit is a broader range of investment alternatives, it is imperative that regulators ensure market integrity is maintained. We have noticed an alarming number of quite misleading company releases over recent history.

Corruption Perceptions Index: 2017 - 2012

Country	Rank	CPI score 2017	CPI score 2016	CPI score 2015	CPI score 2014	CPI Score 2013	CPI Score 2012
New Zealand	1	89	90	91	91	91	90
Denmark	2	88	90	91	92	91	90
Finland	3	85	89	90	89	89	90
Norway	4	85	85	88	86	86	85
Switzerland	5	85	86	86	86	85	86
Singapore	6	84	84	85	84	86	87
Sweden	7	84	88	89	87	89	88
Canada	8	82	82	83	81	81	84
Luxembourg	9	82	81	85	82	80	80
Netherlands	10	82	83	84	83	83	84
United Kingdom	11	82	81	81	78	76	74
Germany	12	81	81	81	79	78	79
Australia	13	77	79	79	80	81	85
Hong Kong	14	77	77	75	74	75	77
Iceland	15	77	78	79	79	78	82
Austria	16	75	75	76	72	69	69
Belgium	17	75	77	77	76	75	75

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

St Barbara Ltd (SBM)

St Barbara has been a constant across the JM Financial Group portfolios over much of the last three years – it has been a great success story with initial purchases at less than $0.50/share. The stock price moved through $4.00/share through the latter part of February. SBM's success has largely been a function of good management, but the A$ gold price has also contributed, rising from around A$1,450/oz to A$1,700/oz.

SBM produced over 380,000oz in FY17 across its two mines, Gwalia and Simberi – up from around 250,000oz in FY14. At the same time it has managed to reduce its 'All-In Sustaining Cost' from over $1,000/oz to around A$900/oz.

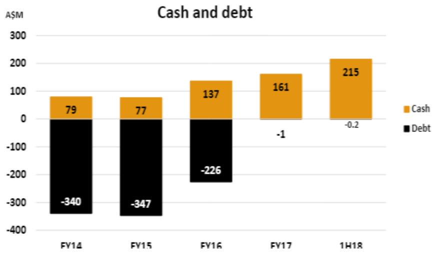
The combination of improved A$ gold price, increased production, and lower operating costs, has seen its net debt levels drop from $270m at the end of FY15 to a net cash position of $215m at the end of December 2017.

St Barbara – A Major Success

Cash balance at 31 December of $215 M[1]

Hedging in place as at 21 February 2018:

- FY18: 36 koz forward contracts at average price of A$1,728/oz deliverable February to June 2018
- FY19: 83 koz forward contracts at A$1,750/oz between July 2018 and June 2019
- FY20: 42 koz forward contracts at A$1,750/oz between July and December 2019



Another major factor in its share price improvement has been the ongoing extension of its ore resource – its total mineral resource at 30 June 2017 stood at over 9.6m oz, up from 9.2m oz at the end of FY15. While the increase is not significant as an absolute number, in the context of having mined over 750,000oz in the two years to end FY17, the upgrade represents over 1m oz of largely high grade ore. With all indications that the high grade Gwalia ore deposit continues along its strike, we expect this mine to be operating for many years, subject of course to gold prices holding up. With its strong cash-flow, St Barbara is now paying dividends (10c in total declared over the last two halves), continues to invest in ongoing mine development, and is exploring investment into new locations.

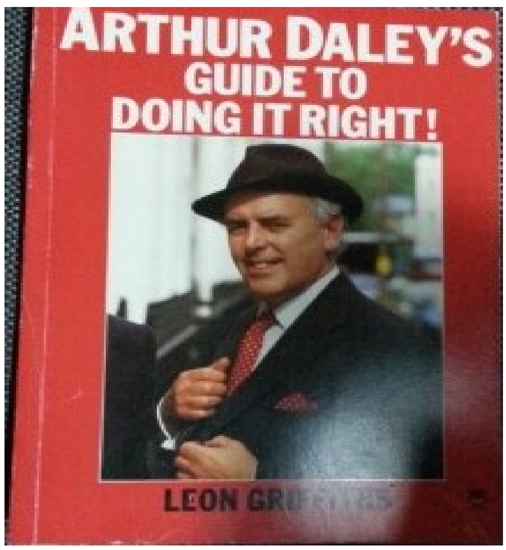
MARKET INTEGRITY AND DIRECTOR RESPONSIBILITES

Poor management and governance may not be a crime, but when it is allowed to continue, it is an indictment upon company directors that do not take the appropriate action. Negligence however is another matter and we are seeing more of it – from management actions, through to statements released to the ASX, showing, at the very least, incompetence and, at the very worst, deliberate attempts to mislead the market. Often, such statements are designed to inflate stock prices, with a clear intention to subsequently raise capital, or simply to provide an opportunity to release shares at inflated prices.

With the recent proliferation of stocks added to the ASX, there has been a corresponding increase in company directors. To put this in perspective, consider that over the past three years within the ASX technology sector alone, the market capitalisation has grown from $26b to $63b and there have been 119 new listings, comprised of 80 domestic and 39 foreign-based businesses. The listing requirements in Australia certainly make it easier to obtain a public listing than in many other jurisdictions, and the Australian market brings a degree of credibility and offers relatively high multiples for technology businesses.

We see it as imperative that the Australian market's integrity is upheld. There have been a number of recent and high-profile situations that have the potential to damage market integrity, particularly if companies can continue to go unchecked for long periods of time.

There are many examples of companies that have released information that is misleading in terms of its incompleteness – a number of these are being investigated currently. GetSwift has perhaps been the most high profile of recent examples. Companies often hide under the cloak of *confidentiality* as a reason for holding back information; we suspect this is often a convenient excuse to be deliberately opaque.



We can imagine the increase in opaque reporting, seen over the past 12 months, has in part been driven by the opportunity of a strong market and a desire to raise capital; to keep many of the cash-burning companies funded well into the future. The poor practices, however, do not stop there – dubious share trading by directors and management, through to allowing managers to hold margin loans against shareholdings in their own companies, are also affecting market credibility. Directors of listed companies have a responsibility to uphold the integrity of public markets, by applying appropriate standards to the companies of which they are the guardians. While it is desirable to have broader diversification of our highly concentrated market, regulators need to ensure it does not occur at the expense of market integrity.