JM Financial Group

Issue 47: March 2019

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st March 2019)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	**+0.46**	**+8.46%**	**+1.60%**	**+38.97%**	**+93.11%**
Small Ords Accumulation Index	-0.12	+12.59%	+5.78%	+38.26%	+49.33%
Outperformance	**+0.58**	**-4.13%**	**-4.80%**	**+0.71%**	**+43.78%**

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 a TWRR basis; non-annualised, and includes fees (post 1 Jan 17) and taxes. Strategy Inception for Performance Data is July 1st 2014.

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

The ASX Small Ordinaries Accumulation Index had a relatively quiet month with minimal volatility. The index finished the month marginally behind, declining 0.12%. The JMFG strategy finished 0.46% ahead, outperforming by 0.58% for the month. The ASX Small Industrials rallied 0.42% while the ASX Small Resources fell 2.03%, with Energy stocks leading declines – in particular, New Hope Corporation (not held in portfolios) which fell 28% on disappointing results and outlook commentary. Strongest sectors during the month included the defensive interest rate sensitive sectors, with the Property sector rising 6.2%, Telecommunications 4.0% and Consumer Staples 3.9%. Weakest sectors included Energy -4.1%, Financials -2.7%, and Utilities +1.3%.

St Barbara, a long-term contributor to the JMFG Small Companies Strategy had its first blemish, reporting a reduction in expected gold production at its Gwalia Deeps mine, as it develops the mine to ultimately allow greater production in future periods. The stock fell 24% over the month, but its impact on the portfolio was offset elsewhere.

The ASX Small Ords 12-month forward PER, as per *Factset* consensus data, continues to trade at expensive levels, at 17.9x, aided no doubt by the low interest rate environment and an expectation that interest rates may go lower over the course of 2019. The portfolio's better performing stocks in the month included Medical Developments +21%, Base Resources +13%, Saracen Minerals +12%, and SelfWealth +10%. The worst performers included St. Barbara -24%, Webster Ltd -9%, and Bapcor -9%.

Two new stocks were added to the portfolio during the month, Auckland Airport and Rural Funds Group, both likely to be potential beneficiaries of lower interest rates, the former through ongoing low funding costs and growth in distributions, and the latter being a Property Trust in the farming space, receiving guaranteed rental income. We reduced holdings in Temple & Webster and Base Resources on price strength and we cut the holding in The Citadel Group acquired last month, following a 15% share price recovery.

Chart of the Month – Global Interest Rate Reversals

When we last wrote about 10-year interest rates in our monthly newsletters, in May 2018, rates were generally in a rising trend, from lows reached in mid-2016. Interest rates continued to rise through to October 2018, but since then, they have been in decline across major economies as well as Australia. Having peaked in the US above 3.2%, the US 10-year benchmark rate is around 2.5%. Similar rates across France, Germany, and Japan are negligible and at the same time the Australian 10-year benchmark rate has declined from 2.8% to 1.8%.

Since October 2018, a number of major economies have experienced a slowdown in economic growth. European Union real GDP growth has moderated from 1.9% to 1.4% compared with the year prior, with CPI declining from 2.2% to 1.6%. Real growth rates in Japan, the United Kingdom and the U.S. have moderated real GDP growth only by about 0.1%, but in each case, CPI has moderated by 60-100 basis points over the year.

The impact on equity markets has been greater demand for higher yielding companies as well as demand for higher quality growth assets.

Best & Worst Performers for March 2019

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Appen – APX	The Citadel Group – CGL	BWX – BWX	Blackmores – BKL
Lovisa Holdings – LOV	SRG Global – SRG	Automotive Holdings – AHG	Pact Group Holdings – PCT
Sensen Networks – SNS	Mayne Pharma – MYX	Appen – APX	Saracen Mineral Hldgs – SAR

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

Medical Developments (MVP) – up 21.5% for the month

A presentation update and global marketing appears to have raised interest in MVP with emphasis on global sales growth and opportunity for its Penthrox and respiratory devices, and product potential for its new continuous flow manufacturing facility.

Myer Holdings (MYR) – up 61.0% for the month (Not held)

Its half-year result stimulated some interest in this perennial underperformer. While sales declined 2.8%, the operating profit margin increased 99 basis points to 38.5%.

St. Barbara (SBM) – down 24.6% for the month

The Feasibility Study to increase production was seen as a disappointment, with the trucking option preferred as opposed to hydraulic hoisting – meaning future mass extraction will now be at lower levels than previously anticipated.

Eclipx Group (ECX) – down 67.6% for the month (Not held)

A poor trading update revealed a 42% decline in profit after tax for the first 5 months of FY19. On the back of this news, McMillan Shakespeare withdrew its scheme arrangement to merge with Eclipx Group.

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

Auckland Airport (AIA)

Auckland Airport owns and operates the aeronautical and non-aeronautical assets at Auckland airport and in the immediate surrounding area. In total, Auckland Airport owns over 1,500 hectares of land, including 443 hectares available for development. Auckland Airport has a diversified revenue pool with around 45% of revenue generated from aeronautical assets which receive a regulated return, ~30% from retail operations and the balance of 25% from property income, transportation, and parking. Associate interests include a 25% stake in Queenstown Airport and interests in hotel operations.

The growing travel and trade market ultimately drives the success of Auckland Airport. In this regard, the company has diversified its aeronautical market by increasing the number of direct destinations served, as well as the number of airlines operating through the facility. The number of direct destinations has increased from 55 in 2015 to 70, and the number of airlines servicing those destinations from 18 to 30. To complement traffic growth, a major international outbound terminal expansion was completed in February 2019, refurbishing or extending 36,000sqm. Along with other international terminal developments completed over the last 12 months, 55,000sqm of space has been refurbished or added. Many other developments over coming years include a second runway, new stands and taxiways, a new/expanded international arrivals area, domestic jet facility and cargo terminal. Amongst all of this there will changes to road networks, parking and pick up, drop off areas to improve flow as well as ongoing development of their large land holdings, enticing new companies to the precinct and adding to the 890+ companies already operating within the Auckland Airport precinct.

Auckland Airport Development Plans

Passenger growth has continued at around 5% p.a. for both domestic and international passengers over recent years.

Total annual passengers through the facility is nearing 21 million, a function of demand and expanding both destinations and airline alternatives.