JM Financial Group

Issue 49: May 2019

Investment Newsletter

Performance *(As at 31st May 2019)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Leaders Strategy	**+0.70**	**+2.77**	**+6.15**	**+26.97**	**+45.74**
ASX 200 Accumulation Index	+1.71	+4.88	+11.08	+35.29	+47.93
Outperformance	**-1.01**	**-2.11**	**-4.93**	**-8.32**	**-2.19**

Although the JMFG Leaders 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 in May

The election produced an unusual "up" result for the ASX in May this year – JMFG's Leaders Strategy gained 0.7%, but fell short of the pace with the ASX 200 Accumulation Index rising by 1.71% for the month. Strongest sectors during the month overall included Telecommunications 7.3%, Healthcare 3.3%, and Materials 3.2%. Weakest sectors were Consumer Staples -4.2%, Information Technology - 4%, and Energy -3.8%. By comparison, international markets fell substantially – notably, the key American indices NASDAQ -6.0%, DJIA - 6.7%, and S&P500 -4.9%, and elsewhere; Japan's Nikkei 225 -5.6%, Germany's DAX -2.6%, and China's Shanghai index -5.8%.

Xero, a cloud-based accounting technology company, and Nine Entertainment were added to the portfolio during May. We increased holdings of Altium, Technology One, and WiseTech Global on price weakness across the Tech Sector, and added to Telstra to strengthen the defensive position of the portfolio on news that its competitors are unlikely to pull off a merger. We reduced our positions in Transurban, ASX, and Goodman Group to lock in profits on price strength, and sold out of WBC entirely on the post-election bank rally, taking a more conservative stance in light of equity market expectations. The portfolio cash holding at month-end was 15.5%.

The stronger performers for the portfolio during the month included:

- Nine Entertainment +19%, Northern Star +19%, and Stockland +18%

The weaker performers for the portfolio during the month included:

- BlueScope Steel -22%, Bellamy's Australia -21%, and Technology One -19%

May saw a post-election bounce led by large caps mainly in the Banking and Materials sectors. Expectation that central banks globally will keep setting rates lower for longer is now built into the market, driving the shift from momentum and growth themed stocks to quality and stable yield stocks. The shift is likely to continue through the year as economists forecast central banks will continue downward pressure on lending rates with the perceived risk of global slowdown in the second half of 2019.

Chart/Table of the Month – Global Economic Conditions

Region Economic Summary

	Real GDP	CPI	Unemployment Rate	Current Account	Govt Debt
	% vs year ago	% vs year ago	Percent	% of GDP	% of GDP
China	6.4	2.6	3.7	1.8	14.7
European Union	1.5	1.9	6.4	-	79.3
Euro Zone	1.2	1.7	7.6	2.5	84.4
France	1.2	1.3	8.7	-0.6	97.4
Germany	0.7	1.6	3.2	8.0	60.4
India	5.8	8.3	5.0	-2.5	43.6
Italy	-0.1	0.9	10.2	3.6	126.7
Japan	0.8	0.9	2.4	2.8	199.2
United Kingdom	1.8	2.1	3.8	-4.4	83.5
United States	3.2	2.0	3.6	-2.6	104.8

Source: FactSet Economics Standardized Database

We last updated the Global Economic Conditions table in November 2018. Since then, there have been minor reductions in growth rates across Europe. Real GDP growth across Europe has moderated from 1.9% to 1.5%, with France declining from 1.4% to 1.2% and Germany from 1.2% to 0.7%. However, the US and UK have had slightly stronger growth, with the US at 3.2% from 3.0% prior and the UK at 1.8% from 1.5% prior. Inflation levels have generally moderated, by around 0.5% across most regions while unemployment levels are broadly unchanged.

The measures mentioned above are historical and tell us nothing of future growth. Interest rates do however offer some insight into expectations and they have fallen quite dramatically since November. The US 30-Year Treasury Bond yield has fallen from a high of 3.4% to its current rate of 2.6%, with the 10-year falling a similar amount to 2.1%. UK 10-year treasuries have fallen from 1.7% to 0.9%, German 10-year treasuries from 0.5% to negative 0.2% and French 10-year treasuries from 0.8% to 0.2%.

Low interest rates provide valuation support for equities via lower discount rates for high growth, high PER stocks whilst making high yielding lower growth stocks an attractive alternative to low yielding bank term deposits and bonds.

JM Financial Group Level 8, 140 Bourke St, Melbourne, VIC, 3000 Web: www.jmfg.com.au
AFSL 238397 ABN 68 007 364 132 Ph: +61 3 9627 9900 Email: enquiries@jmfg.com.au

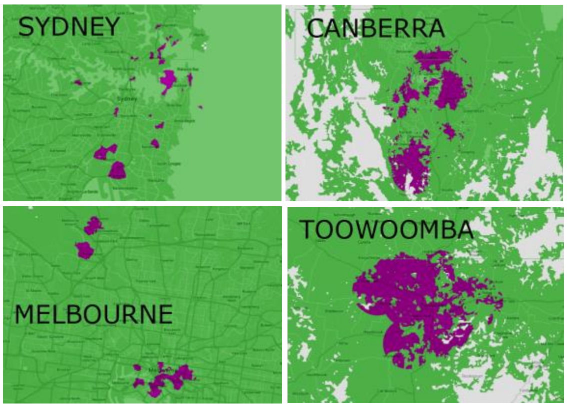
Due Diligence – *A closer look at a stock of interest*

Telstra (TLS) and the new 5G (Fifth Generation) Mobile Network

Telstra returned to the portfolio earlier this year after our assessment of its change of outlook in the competitive landscape and improved market sentiment towards the company after execution of significant cost-cutting measures and delivering on its 5G network introduction plans.

We previously cut Telstra from the portfolio in May 2017 amid its slow fall from grace that did not appear to be turning around at the time. The stock continued to slide on news of declines in profits and subsequent pruning of its dividend payment. Prior to the decline, Telstra was seen as a fairly safe 5-6% yield investment – interestingly, once the price stabilised around a $3 ballpark in 2018 with the smaller dividend, it was again yielding a payout of around 6% for new or returning investors.

The competitive environment for Telstra softened this May when regulator ACCC chose to block the attempted merger of TPG Telecom and Vodafone Hutchison – thus reducing the mid-term competitive threat to Telstra's 5G network and further entrenching the company's first-mover advantage in the next-generation technology. So, not only is it leading the transition to 5G, earlier benefits are expected to flow through to Telstra's 4G customers as it significantly improves the backbone network’s concurrent connection capacity and speed in both directions within 4G/4GX coverage areas.



“In breaking news, Australian gamers and YouTubers flock to Toowoomba to take advantage of early 5G rollout in the district!”

Right now, 4G can only operate up to 6GHz, whereas 5G will handle anywhere between 30GHz and 300GHz. 4G has a peak speed of 1GB per second; 5G is able to achieve speeds of 20GB per second. In addition, because of the way 5G uses its spectrum, it can handle up to an additional 1,000 device connections per meter.

This will bring huge improvements to mobile device use. 5G consumers will see significant speed increases, and since these radio frequencies won’t already be over-crowded with existing devices, given 5G is entirely new, there will be little contention and very low latency (data delay) in a network that can accommodate a much higher payload even when usage becomes ubiquitous. Also, as more users move to 5G, continuing 4G users will find their experience also improves with the reduced connection contention.

We see this mobile network improvement likely to win back profits and confidence for Telstra. Who knows where it will leave the NBN, however.

Global Interest Rates Pointing To Slowdown

Global interest rates have dropped quite dramatically from recent peaks reached last October/November. Rates have typically declined by 80-100 basis points toward historic lows across most developed economies. The implication is that economic growth has slowed and is continuing to slow. We highlight in our Global Economic Conditions table overleaf that a degree of slowing has already occurred, based on Real GDP growth for the last 12 months, relative to those same growth rates last November, as per *FactSet* consensus data.

The consensus forecast data for Real GDP growth also supports the view that growth will slow over calendar year 2019. UK Real GDP growth is forecast to moderate to 1.3% for 2019, from 1.8% for the prior 12 months and the U.S. from 3.2% to 2.4%. France and Germany are forecast to improve modestly but from fairly benign levels, hence not enough to offset slowdowns in the UK and USA.

FactSet consensus data is simply a collection of economic forecast data from investment banks and research houses around the globe – it may or may not prove to be accurate, but the market’s treatment of expected interest rates is certainly evidence of pricing for a slowdown.

What is interesting about the current slowdown in growth to date is that unemployment levels have not deteriorated. In fact, according to current *FactSet* data relative to last October/November, unemployment levels have actually declined further. Other than France at 8.7% (it was 9.1% last October), all of the other large developed economies are under 4.0% unemployment levels. China also is under 4%. The slowdown we are currently having is probably reflected in slow global wage growth across developed economies, but it is not reflected in unemployment. Should that continue, the impact of the slowdown is likely to be less severe on government budgets.