JM Financial Group

Issue 51: July 2019

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st July 2019)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	**+8.64%**	**+10.83%**	**+19.11%**	**+35.71%**	**+129.22%**
Small Ords Accumulation Index	+4.51%	+4.15%	+7.61%	+30.46%	+61.92%
Outperformance	**+4.13%**	**+6.68%**	**+11.50%**	**+5.25%**	**+67.30%**

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.

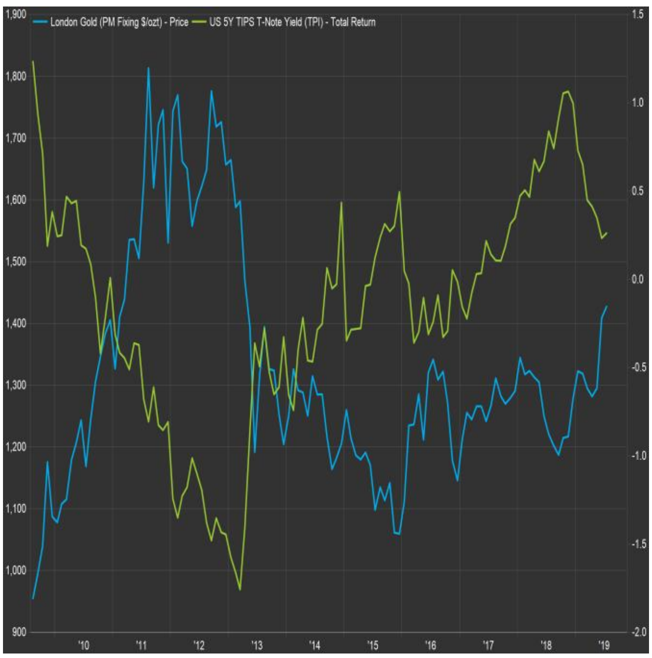
***Month in Review –** A review of events that influenced the share market and portfolio in July*

The ASX Small Ordinaries Accumulation Index had another strong month, rising 4.51%, to be up 22.08% for the calendar year to date. JMFG Small Companies portfolio performed substantially better than the Index, rising 8.64% in July and 28.75% calendar year to date. The Strategy has had a very good quarter and rolling 12 months, outperforming its benchmark by 6.68% and 11.50% respectively. Patience and remaining close to our smaller companies, ensuring their strategies are being executed as planned, has been the key to recent success, but as is often the case recent success did come with a little pain in prior periods. Strongest market sectors across the broader market included Consumer Staples +9.7%, Healthcare +5.9%, I.T. +5.0%, and Consumer Discretionary +4.9%. Weakest sectors included Materials +1.0%, Energy +1.7%, Financials +1.7%, and Utilities +1.9%.

Our best stocks for the month included: Mach7 Technologies +37%, a fourth consecutive strong month; Ioneer +37%, following a weak prior month; and Resolute Mining +33%, benefitting from a strong gold price and its recent dual listing in the U.K. A further four stocks increased between 25-28% for the month, Selfwealth, Temple & Webster, St Barbara, and Sensen Networks. Weakest stocks included Nearmap -11% after many strong months, and Auckland International Airport -4%. The ASX Small Ordinaries continues to trade near all-time high levels at 18.9x the 12-month forward PER, as per *Factset* consensus data, a 13% premium to the ASX 200 index.

We added two new stocks to the portfolio during the month, BWP Trust and Cromwell Property Group. This increased the portfolio's defensive exposure in an increasingly expensive market and was done during a capital raising process by Cromwell, which had a potentially short term dampening impact on the share price. While no stocks were sold from the portfolio during the month we lightened holdings on share price strength in APN Industria REIT, Ioneer, SelfWealth, Temple & Webster, and Appen. We also cut our holding in Netwealth ahead of the RBA interest rate cut early in the month, given its partial dependence on interest rates to generate earnings. Mid-month we added to holdings in Bravura and Webjet on price weakness. The cash holding at month end was 9.9%.

Chart/Table of the Month – Gold Price & Yield Relationship



The A$ gold price has continued to reach new all-time highs throughout calendar year 2019. This has been a function of the high US$ gold price and the depressed A$, relative to the US$. Many factors are arguably behind the recent rise in the US$ gold price, including trade wars, rising tensions in the Middle-East and the impact of Brexit. The manifestation of all of these factors could potentially have an impact on global growth and the anticipated impact on global growth is reflected in real interest rates.

The chart opposite compares the US$ gold price, in blue, against US Treasury Inflation-Protected Securities (TIPS), in green. TIPS are a good measure of real interest rates as the principal value is adjusted for inflation and they are low-risk, being backed by the US government, and interest is typically paid every six months.

Gold appears to be priced inversely to real interest rates. Gold is an asset that provides capital return potential but no yield. As yields on interest rates diminish, the opportunity cost of holding gold also diminishes. Declining real yields are typically synonymous with weak economic growth and valuation fears around economically linked assets in a weak economy drive investors into non-economically linked safe-haven assets like gold.

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Best & Worst Performers for July 2019

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Mach7 Technologies – M7T	Nearmap – NEA	Karoon Energy – KAR	Speedcast – SDA
Ioneer – INR	Auckland International Airport – AIA	Dacian Gold – DCN	Superloop – SLC
Resolute Mining – RSG	Webster – WBA	Gold Road Resources – GOR	Sundance Energy – SEA

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

Mach7 Technologies (M7T) – up 37% for the month

Mach7 announced a major new contract win in North America, with a minimum contract value of A$5.7m across a five-year term. The contract adds $550,000 to annual recurring revenue, taking total annual recurring revenue to A$8.4m. The new contract for Mach7 is significant, given the client, Aurora Health, is a top 10 not-for-profit integrated health system with 28 hospitals in the U.S.

Karoon Energy (KAR) – up 74% for the month (Not held)

Karoon announced the purchase of an operating asset in the Santos Basin, offshore Brazil, with two producing oil reservoirs. These producing fields sit alongside existing Karoon assets in the basin, which should help generate material operational and logistical synergies.

Nearmap (NEA) – down 11% for the month

Nearmap released preliminary FY19 results outlining annualised contract value of A$90m, comprising A$58m in Australia and New Zealand as well as US$23m in the U.S. While the figures resulted in a market pull-back, this did come after a period of very strong performance.

Speedcast (SDA) – down 46% for the month (Not held)

Yet another market update with a downgrade to expected EBITDA for 2019 from US$160-171m down to US$140-$150m. This comes after several previous downgrades to 2018 earnings. Along with its over-geared balance sheet, Speedcast faces some serious issues.

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

BWP Trust (BWP)

BWP is a real estate investment trust that invests in and manages commercial properties throughout Australia. The bulk of its properties are Bunnings Warehouse stores which are leased back to Bunnings Group Ltd, a part of the Wesfarmers organisation. The trust also has a small number of strategic large format retailing properties outside of the Bunnings brand. BWP offers a consistent yield, with growth above CPI. It is also exposed to a relatively safe part of the domestic retailing market, in that it does not experience the same level of online risk that many of Australia's discretionary retailers are experiencing today.

Bunnings sits somewhere between a discretionary and staple retailer. It has a large trade business and stocks many categories which are not ideally suited to online retailing, including gardening, bulky goods and small value diverse purchases. Most importantly, a large proportion of Bunnings sales are weekend purchases made by the home handyman, either as problems present themselves or as a weekend project unfolds. In other words, the items purchased are often not fully planned at the outset. Many items purchased require a degree of touch and visualisation for the inexperienced handyman. In periods of weak economic growth, renovation as opposed to new build helps keep the tills ticking over at Bunnings. In turn, this further strengthens the defensive qualities of BWP Trust.

With pricing of the broader Australian equity market quite high currently, and interest rates low and likely to remain so for some time, we see BWP as a good defensive portfolio asset for the time being, offering a c4.8% yield with CPI-type growth.