JM Financial Group

Issue 52: August 2019

Investment Newsletter

Performance *(As at 31st August 2019)*	**Month (%)**	**Rolling 3mths (%)**	**Rolling 1yr (%)**	**Rolling 3yrs (%)**	**Inception (%)**
JMFG Leaders Strategy	**-1.89**	**+3.90**	**+3.91**	**+30.97**	**+51.45**
ASX 200 Accumulation Index	-2.36	+4.23	+9.04	+38.16	+54.19
Outperformance	**+0.47**	**-0.33**	**-5.13**	**-7.19**	**-2.74**

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 the share market and overview of the portfolio for August

The ASX 200 Accumulation Index declined 2.36% in August, with the JMFG Leaders portfolio following suit dropping 1.89%, nevertheless it managed to outperform its benchmark by 0.47% for the month. This has flowed through to steady the portfolio for the rolling three months period, where it finished only marginally behind its benchmark by 0.33%.

Strongest sectors across the broader market in August included Healthcare +3.6%, Property Trusts +1.2%, I.T. +0.3%, and Consumer Discretionary +0.2%. Weakest sectors included Materials -7.5%, Energy -5.6%, Telecommunications -3.1%, and Financials -2.6%. The ASX All Ordinaries continues to trade near all-time high levels at 17x the 12-month forward PER, as per *Factset* consensus data.

Reporting season delivered few surprise outcomes in the portfolios, but enough information and outlook adjustments to facilitate a small shuffling of stocks in the portfolio composition. During the month, we added Seven Group Holdings for its resilient income yield, and Appen and Northern Star on share price weakness – Northern Star revealed increased reserves and resources that should see a stronger 2020 after current stockpiles are cleared. We strengthened positions in Transurban on news of the M5 West project, and topped up both Bluescope Steel and BHP Group on the combination of share price weakness and a beneficial shift in the global dynamics in iron and steel supply. We trimmed Rio Tinto given its softer than expected results due to operational difficulties, weak ore grades, and adverse impact from weather at its Canadian operations. We removed ARB Corporation and McMillan Shakespeare on concerns the results may reflect the macro pressures present in the new vehicles and vehicle accessories markets. The portfolio finished the month with 12.3% cash.

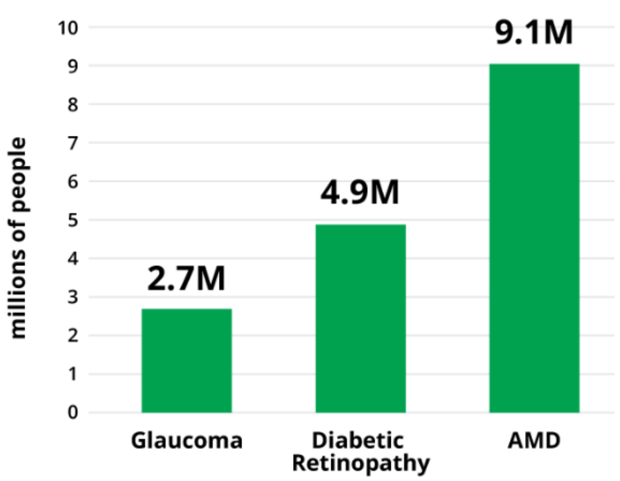
The stronger performers for the portfolio during the month included:

- Polynovo +27%, Wisetech Global +16% and SCA Property Group +7.8%

The weaker performers for the portfolio during the month included:

- Magellan Financial Group -18%, Appen -16% and Cleanaway -14%

Chart/Table of the Month – U.S. Age-Related Macular Degeneration 2010



Source: "Can optometrists help eliminate blindness caused by AMD?" (Maculogix AMD Academy, 2017)

Age-related macular degeneration (AMD) is the leading cause of vision loss and blindness in people over 50 years of age in the developed world. While dry AMD is more common, with 85-90% of people diagnosed with AMD suffering the dry form, the wet from usually leads to more serious vision loss. In 2010, there were an estimated 9.1m cases of early AMD in the U.S. and this is projected to reach close to 18m by 2050. In the developed world there are an estimated 4m+ cases of wet AMD.

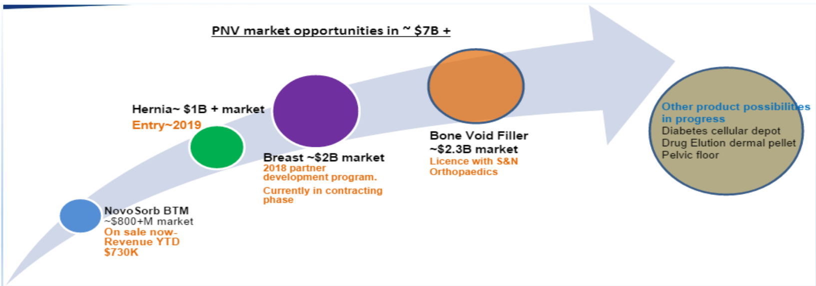
Existing patented treatments for wet AMD include both Lucentis and Eylea, with the latter more recently becoming the dominant of the two patented drugs. Eylea, distributed by Regeneron in the U.S. and Bayer in the rest of the world, had sales in 2018 of US$6.7b. Lucentis, distributed by Roche in the U.S. and Novartis in the rest of the world, had 2018 sales of US$3.9b.

In addition to Eylea and Lucentis, Avastin is being used *off-label* (not approved for this use) as a wet AMD treatment – it does benefit those suffering from the disease to some extent, so it is used as a cheaper but less effective drug. Avastin is estimated to have 60% market share and is used largely by those unable to afford health insurance.

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

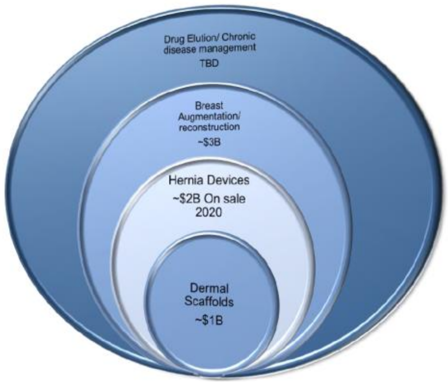
PolyNovo (PNV) – Another Australian Medical Success

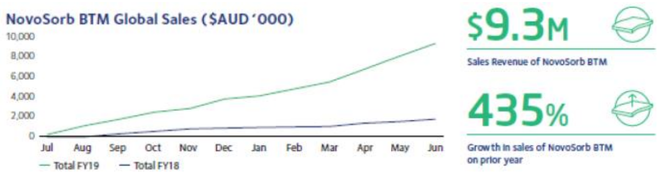
PolyNovo is an exciting Australian medical technology business we have held for some time in our more adventurous strategies, and have followed it closely through its rise from a speculative biotech to a well-executed business with a $1.5bn market capitalisation on the back of consistently growing demand for its medical problem solving technology. PolyNovo has developed NovoSorb BTM™, a biodegradable polymer technology used in the treatment of burns, surgical wounds and Negative Pressure Wound Therapy. The product is a wound dressing intended for treatment of full-thickness wounds and burns, where the dermal structure has been lost to trauma, or damaged and requiring surgical removal. Essentially, the polymer is placed in the wound, allowing the dermis layer to regenerate into the polymer, with the polymer then disintegrating over a 12-month period. After the dermis has partially regenerated, around three weeks after initial surgery, an outer skin layer is grafted over the dermis, with results showing significantly improved functional and cosmetic outcomes vs existing treatments. NovoSorb BTM is considered a disruptive product with, now, demonstrated traction globally.



US FDA approval was obtained in December 2015 for NovoSorb BTM for use in reconstructive and surgical wounds, an estimated US$800m market. The first US patient was announced in February 2017, and PolyNovo has subsequently announced several orders and reorders to major US hospitals. Since then, PolyNovo has been building and expanding its path to market, and has gained recognition worldwide.

NovoSorb BTM offers significant potential for PolyNovo, but longer-term upside could come from applications beyond dermal scaffolds; having demonstrated application of the polymer in hernia devices, further opportunities exist in breast reconstruction and bone void filler markets, and new development is underway for its use in chronic disease management through dermal drug elution and insulin secretion. PolyNovo estimates total revenue market opportunities could exceed US$7bn.





Reporting Season – Can We Really Be Surprised?

Through August reporting season – full year result for most, and first half for most of the remainder – results on balance came in slightly better than expected, with just over 55% of companies responding positively in the days after their results, and the balance either down or flat. The majority of companies over the past month however finished lower than prior to reporting season; most likely a function of weaker global markets. For example, leading global markets all fell in August, with escalation of the US/China trade war, ongoing Brexit issues and civil unrest in Hong Kong, all affecting market sentiment. The Hong Kong index fell 8% in August, the FTSE in the UK fell 5% and the Nikkei in Japan fell 3.7%. Continental European and US markets fell between 2-3%.

Against a backdrop of weak international markets, the Australian equity market did not do so badly. The ASX All Ordinaries (top 500 companies) declined by 2.22% in the month, the ASX Small Ordinaries (comprised of companies ranked from 100 to 300 by market capitalisation) declined by 3.85% and the Emerging Companies index (a selection of 200 micro-cap companies) fell a more modest 0.66%. To put this in perspective, of the top 500 listed companies in Australia, the top 10% by price movement increased between 20-330% in the month, and half of this cohort increased by more than 30%. The bottom 10% declined by 15%-40% and those that decreased by more than 30% made up only 1% of the bottom decile. The conclusion we reach is that the small end of the market in Australia is healthy, providing a good feeder to replace, over time, the more mature growth-constrained market segments.