JM Financial Group

Issue 52: August 2019

Investment Newsletter

Performance (As at 31st August 2019)	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Australian Equities Strategy	**+0.14**	**+9.41**	**+10.80**	**+29.72**	**+71.78**
All Ords Accumulation Index	-2.22	+4.13	+8.58	+37.13	+55.48
Outperformance	**+2.36**	**+5.28**	**+2.22**	**-7.41**	**+16.30**

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) 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*

Despite the ASX All Ordinaries Accumulation Index declining 2.22% in August, the JMFG Australian Equities portfolio posted a positive return of 0.14%, outperforming its benchmark by 2.36% for the month. The portfolio has had a very good three months, rising 9.41% against a benchmark rise of 4.13%. Around half of the Strategy's outperformance in August came from medical device company Polynovo, which specialises in tissue regeneration scaffolding, and half of the remaining outperformance is attributable to another biotech Opthea, a newcomer to this portfolio added this month on the highly successful results of its Phase 2b clinical trial. We were able to move quickly on Opthea having followed it closely in our Small Companies portfolio since its promising Phase 2a results.

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.

During the month, in addition to Opthea, we added Infigen – a renewable energy generator that we have followed for some time and has recently traded below book value and close to net tangible asset backing. Following its FY19 result, it became sufficiently attractive for investment. We strengthened positions in Transurban on news of the M5 West project, and Appen on share price weakness. We trimmed Polynovo and St Barbara following respective rallies to realise some of the gains. We removed Bapcor and McMillan Shakespeare on concerns the results may reflect the macro pressures present in new vehicles markets. The portfolio finished the month with 12.3% cash.

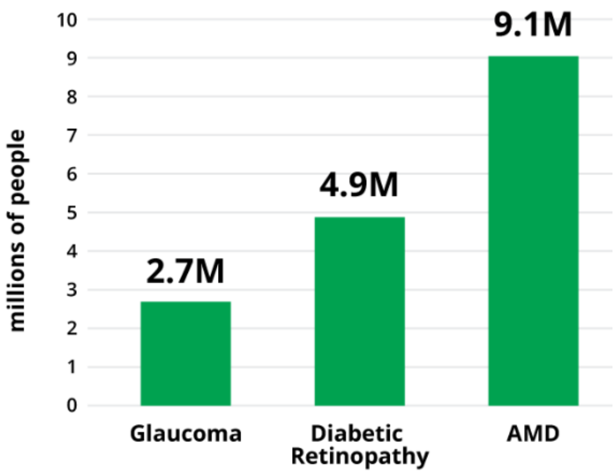
The strongest performers for the portfolio during the month included:

- Opthea +341%, Polynovo +27% and Mach7 Technologies +10%

The weaker performers for the portfolio during the month included:

- Elixinol Global -30%, Nearmap -19% and Medical Developments -16%

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



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*

Opthea (OPT)

Opthea is a biological drugs developer focusing on ophthalmic disease therapies. Its OPT-302 drug is a soluble molecule that blocks the activity of two of the Vascular Endothelial Growth Factor proteins, (VEGF-C and D) – overexpression of VEGF causes blood vessels to grow and potentially leak, and presents most prominently at the back of the retina which in turn can lead to permanent blindness. OPT-302 is used in combination with other drugs (namely Lucentis, which inhibits VEGF-A, and Eylea, which covers VEGF-A and B) to achieve a more comprehensive blockade against the proteins in the VEGF family. The combined treatment has potential to improve vision outcomes by completely inhibiting the pathways in disease progression. OPT-302 may also have applications in treating Diabetic Macular Oedema (DMO), with Phase 1b/2a trials ongoing.

Opthea's Phase 1/2a wet AMD trial results in April 2017 encouraged our initial investment in the company. This trial involved 51 patients with results suggesting improved outcomes across a range of patient groups. The Phase 2b study involved 366 patients split into a group that only received the existing standard of care, a group that received the existing standard of care plus a small-dose (0.5mg) regimen of OPT-302, and a group that received the existing standard of care and a larger dose (2.0mg) of OPT-302. This latter group achieved an average 14.2 letter gain on eye chart tests, compared with 10.8 for those receiving only the current standard of care. These results are seen as significant in the ophthalmology industry, although OPT-302 is still subject to larger Phase 3 trials. Nevertheless, the strength of the results, and the current size of the market at $10b and growing, places Opthea in an attractive position, particularly given the incumbents have much to lose as their drug technologies come off patent in the early part of the next decade.

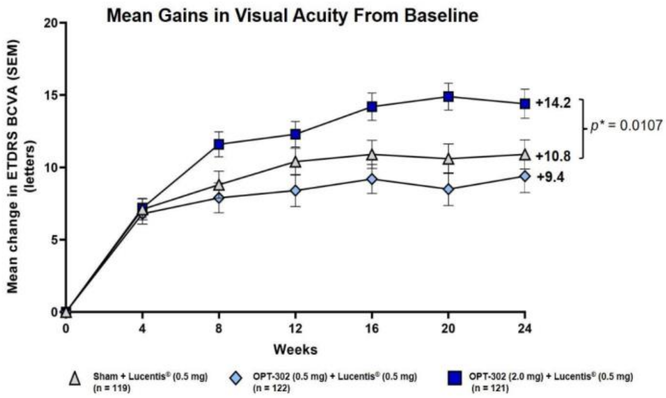
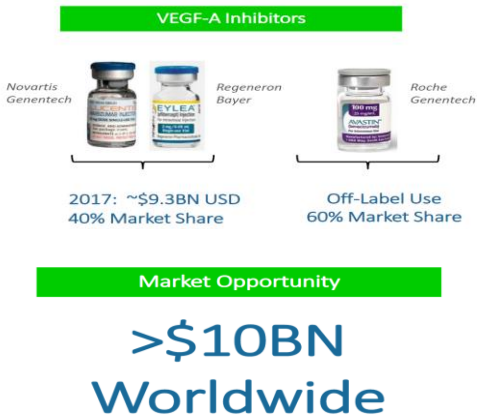


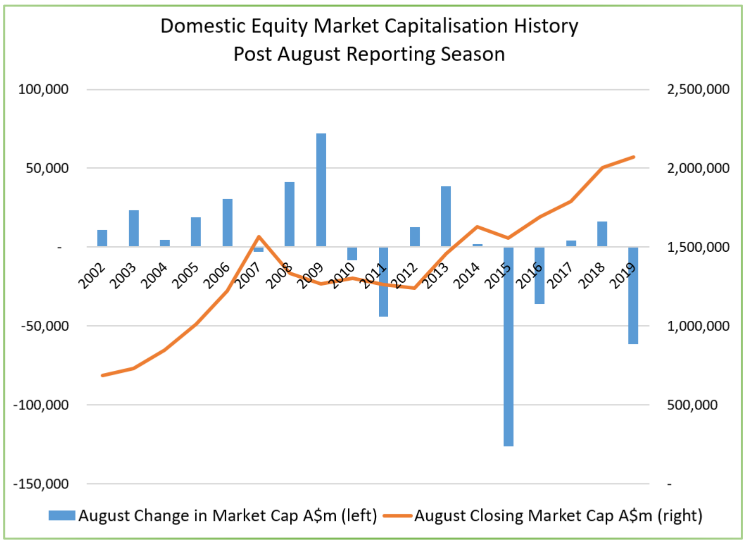
Figure 1. *OPT-302-1002 clinical trial (NCT03345082). Graph represents observed data and standard error of the mean (SEM). Modified Intent-to-treat study population. BCVA, Best Corrected Visual Acuity; ETDRS, Early Treatment Diabetic Retinopathy Study.*
** Difference in Least Square Means, using Model for Repeated Measures (MRM) analysis. Control of Type I error via the Hochberg Procedure.*



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.



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