JM Financial Group

Issue 45: January 2019

Investment Newsletter

Performance *(As at 31st January 2019)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Australian Equities Strategy	**+1.70**	**-0.43**	**-3.93**	**+20.21**	**+42.14**
All Ords Accumulation Index	+3.99	+1.20	+0.65	+33.14	+34.10
Outperformance	**-2.29**	**-1.63**	**-4.58**	**-12.93**	**+8.04**

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 events that influenced the share market in January*

JMFG's Australian Equities Strategy increased 1.70% for the month, underperforming the ASX All Ordinaries Accumulation Index by 2.29%, and by 1.63% for the rolling 3 months. The Australian market rose a modest 1.2% over the 3-month period. With the exception of the Financials Sector in January, the market rally was broadly based, with all other sectors showing solid monthly rises. Best performing sectors included Energy +11.5%, Information Technology +9.3%, Telecommunications +7.8% and Materials +7.0%. The weakest sectors included Financials -0.2%, Consumer Staples +2.8%, Industrials +3.1%, and Healthcare +3.8%.

We added three new stocks to the portfolio – Northern Star Resources, Seek, and AfterPay Touch, the latter being a smaller investment. Northern Star was added on a pullback and reduces our "underweight" exposure in the Gold Sector, and Seek was added also following a pullback, having declined from over $22 to around $17 in recent months. We sold out of Costa Group following a solid bounce in the weeks after its shock earnings downgrade. We added to our position in Netwealth on price weakness. The portfolio cash holding at month-end was largely unchanged from the prior month-end at 14.4%.

The stronger performers for the portfolio during the month included:

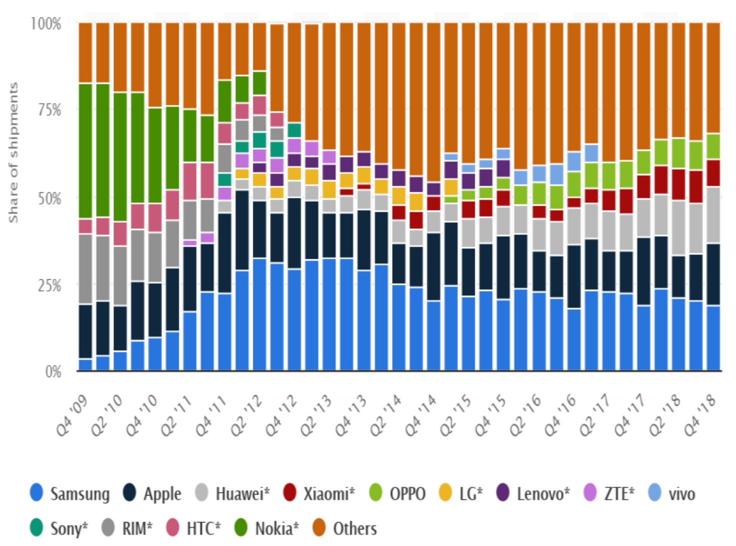
- The Citadel Group +17%, Polynovo +14%, and Echo Resources +13%

The weaker performers for the portfolio during the month included:

- Costa Group Holdings -25%, ResMed -18%, and Ioneer -12%

The ASX All Ords, despite the January rally, looks reasonably priced, with its 12-month forward PER rising from 14.3x to around 15.0x, but slightly ahead of its long-term average.

Chart/Table of the Month – The Changing World of Mobile



In 2018 Huawei sold over 200 million mobile phones, up from a little over 150 million in 2017. Only Samsung sold more phones in 2018, but Huawei is gaining ground. Apple came in third and the top 3 share of annual phone sales expanded over the course of 2018, mainly due to Huawei's growth.

The chart opposite highlights the massive change in the industry over the past 10 years. In 2009, Nokia was by far the biggest seller of phones, followed by RIM (Blackberry). At this time, Apple was just starting to make significant inroads, following the release of 3G phones in 2008. The initial iPhone was released in 2007.

Digitisation has rapidly increased business life cycles in many industries, and the chart opposite is a perfect example of how rapidly technological change can determine the fortunes of a major company inside a decade. It also highlights the need to always be on the lookout for the next big disruptor, and the incumbents that are likely to suffer from change.

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

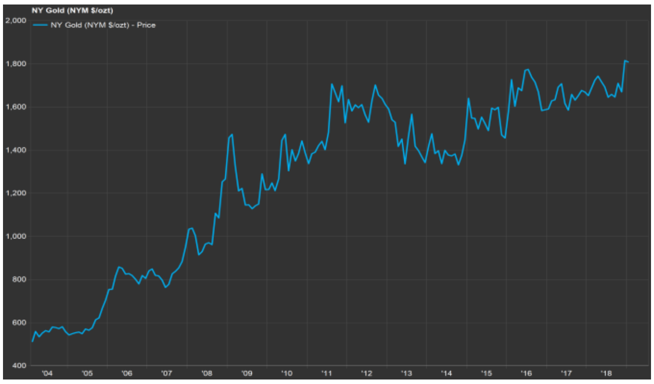
Northern Star Resources (NST)

Northern Star Resources is a global-scale gold producer with world-class assets across low sovereign risk regions of Australia (W.A.) and North America (Alaska). Its portfolio consists of relatively low-cost and high-grade underground gold mines. It has 187 million tonnes of ore resources, averaging 3.4 grams of gold per tonne of resource, including ore reserves of 32.7 million tonnes at an average grade of 3.8 grams of gold per tonne of ore. In total, NST's resource has contained metal in excess of 20 million ounces of gold. In FY19, NST expects to produce in the vicinity of 600,000-640,000 ounces from its Australian operations at an average all-in sustaining cost around A$1250/oz, attractive against the A$ gold price.

Northern Star has had incredible success over the past decade, increasing its contained gold in ore from 0.9m ounces in FY11 to 20.5m ounces currently. While the acquisition of the Pogo Gold Mine in Alaska (Sept 18) was a large part of the increase from FY18 to FY19, exploration success across several of the Western Australian gold fields has been a very significant component of that growth.

The acquisition of Pogo takes Northern Star to an annual production rate in the vicinity of 875,000 ounces per annum. The company aims to lift annual production to in excess of one million ounces per annum and maintain an all-in sustaining cost in the order of A$1,100-A$1,150 per ounce of gold produced.

A Very Healthy Gold Price - in A$



GOLD – Demand & Supply, A Difficult Asset To Value

According to the World Gold Council, total supply of gold increased 1% in 2018 to 4,490t, the slight increase being a function of increased mine production and recycled gold. Mine production comprised 3,347t of this figure. Interestingly, mine production was down across several countries. Chinese gold production declined 9%, partly due to stricter environmental regulations, which have in fact impacted production across many mineral resources produced out of China. South Africa production declined 18% with a number of deep underground loss-making mines closing in 2018. Peru also experienced a 9% production decline. On the positive side of the ledger, Russia increased production by 10% and Australia by 4%. PNG experienced growth, as did several smaller African producers.

On the demand side, the World Gold council reported a 4% production increase in 2018 to 4,345t, with Central banks accounting for 652t of that demand, an increase of 277t from the prior year. Jewellery demand continues to account for the largest component and was stable in 2018 at 2,200t. Other major areas of demand included retail investment in gold bars and coins, posting 4% growth. Coin demand accounted for 236t in 2018, while gold bar demand was 782t. Gold to back ETFs, and gold used in technology accounted for the balance of demand. It would appear that central banks are the major driver of short-term gold pricing and should they sell down reserves at any stage, this would most likely have a significant impact on price given central banks account for around 15% of annual demand.

The flow-on effect of central banks selling could also lead to reduced retail demand for gold bar, coin, and gold-backed ETFs, which, combined, accounted for around 25% of 2018 total gold demand.

While demand fluctuations will have an impact on shorter-term gold pricing, the cost to produce, and the need to generate an adequate return on investment, will likely have a larger impact on longer-term pricing. In Australia, the rough average cost of production would appear to be in the vicinity of A$1,100-A$1,300/oz and this figure generally increases. China, the biggest producing nation with about 9% of mine production (426t in 2017), has seen environmental regulations limit production growth and will most likely increase the cost of production in China. Australia sits second, at ~300t annually, with Russia not far behind. South Africa, once the top gold producers, slipped to 8th in 2017, with many of its deep mines becoming uneconomic over recent years. Rising South African costs, environmental regulations in China, and rising Australian costs should underpin long-term growth in gold prices, but buying by central banks likely holds the key to shorter term gold prices.

Top 10 Gold Producing Countries in 2017