JM Financial Group

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Investment Newsletter

Performance *(As at 29th February 2020)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Leaders Strategy	**-6.91**	**-2.65**	**+8.45**	**+27.13**	**+53.23**
ASX 200 Accumulation Index	-7.69	-5.18	+9.04	+27.82	+53.22
Outperformance	**+0.78**	**+2.53**	**-0.59**	**-0.69**	**+0.01**

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 management fees paid (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 February*

The ASX 200 Accumulation Index finished February 7.69% behind January's close. A variety of factors contributed to the slide, centring around the global economic impact of the current coronavirus epidemic. However, reporting season was slightly disappointing, particularly in relation to several of the high growth high-PER companies, with several downgrading their growth outlook. Many companies were hit by coronavirus fears – in particular, those reliant on transport, logistics, tourism, education, Chinese sourced inputs or Chinese customers. The JMFG Leaders Strategy outperformed its benchmark for the month, coming down 6.91. The Strategy, however, held onto its rolling quarter outperformance position, ending ahead of the ASX 200 Accum by 2.53% despite falling overall.

The Australian equities market experienced a "pandemic-fear-fuelled" all-segment fall through February. The best performing (i.e. least-fallen) market segments were Utilities -3.6%, Health Care -3.7%, and Property Trusts -4.9%. The weakest three sectors were Information Technology -17.3%, Energy -17.2%, and Materials -11.7%.

During the month, we exited Cleanaway on concerns around the recent SKM Recycling acquisition integration, and recent bushfires adversely impacting results. We added South32 following a large fall in base metals pricing and due to its solid yield at current prices. We added Ansell with the company seeing growing demand for its rubber-based hygiene products. We trimmed Northern Star Resources on price strength to realise some of the gains and we topped up Pro Medicus on price weakness. The portfolio finished February with 15.8% held in cash.

The stronger performers for the portfolio during the month included:

- Northern Star Resources +6.8%, SCA Property Group +4.2%, and Goodman Group +0.6%

The weaker performers for the portfolio during the month included:

- Altium -22.7%, Santos -21.4%, and Woodside Petroleum -19.6%

Chart of the Month – Changing fortunes of commodities

Indexed Commodity Price Movements – 10 years

In general, US$ industrial commodities have been in decline over the past two years, most having experienced recent peaks in the early to middle parts of 2018. Whilst all the major industrial commodities had been in decline prior to the initial widespread reports of COVID-19 into the Western world in mid-January, in most cases, declines have accelerated since then. Spot zinc has fallen in excess of 20% with spot copper and nickel falling between 10-15%. Over the same time, oil has fallen by a dramatic 45%. Interestingly, all these commodities are lower than where they were 10 years ago; with oil 67% lower, nickel 44% lower, copper 27% lower and zinc 18% lower. With global demand continuing to weaken, it is difficult to see a short-term turnaround for any major industrial commodity.

By contrast, gold, in US$ terms, is 50% higher than its spot price 10 years ago and around 8% higher than when COVID-19 was broadly reported over 6 weeks ago. Many people rubbish gold as an investment on the basis that most of it is not used but rather stored, and it cannot be eaten. However, it is a rare commodity in relation to other industrial commodities and it is becoming increasingly expensive to mine, unlike many of the industrial commodities. Gold is as tangible as a building or a piece of land, but unlike buildings and land it can be easily relocated if needed. To that extent, in a crisis, whilst it might ultimately come down in price along with other assets, it has qualities that few other assets have, which makes it enduringly desirable. We are certainly not capable of forecasting the gold price, but it does have increasing demand through crisis periods – in that regard, it does take a position in our portfolios from time to time.

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

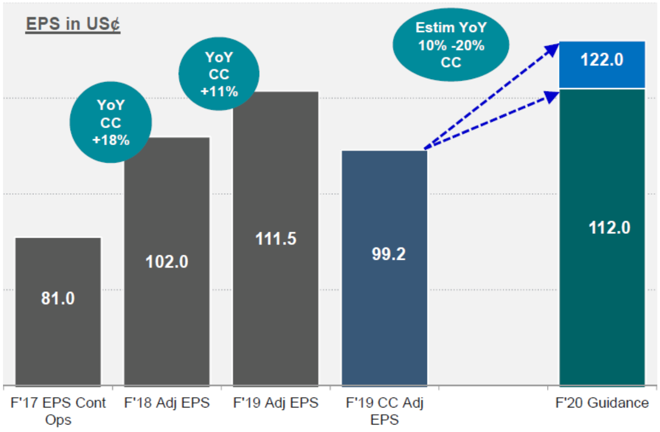
Ansell (ANN)

During a reporting season peppered heavily with warnings and earnings downgrades on the estimated global industry impact of the new coronavirus, it was interesting to see Ansell holding to its forecast earnings. Ansell reported Statutory Profit for the half US$66m, up 67% from the previous comparable period's US$40m. The company attributes its 75% growth in Statutory EPS to solid sales growth in key regions, the benefits of its "*Transformation Program*", recent strategic acquisitions, and its ongoing share buyback activity.

Ansell is well known across the world for its quality personal safety barrier technologies and products across a variety of applications – industrial hand and arm protection, full body isolation suits, healthcare specialty gloves, various life sciences applications (gloves, protective clothing, goggles and face masks), and their mechanical barrier contraception related products (i.e. condoms). Ansell also provides consulting services to help companies select the right personal protection equipment solution to improve safety, productivity and cost control measures.

In early February, Ansell completed acquisition of a 50% stake in its Malaysian-based surgical gloves supplier, Careplus. The acquisition is expected to be EPS accretive from FY21, and gives Ansell increased control over supply, and a joint partner for R&D into new products.

FY20 Guidance EPS (in Constant Currency terms)



After the half-year results released later in February, Ansell was trading on a forward PE ratio of 24.5X, which looks inexpensive in the context of a more stable growth outlook and exposure to market segments that should benefit from any health crisis.

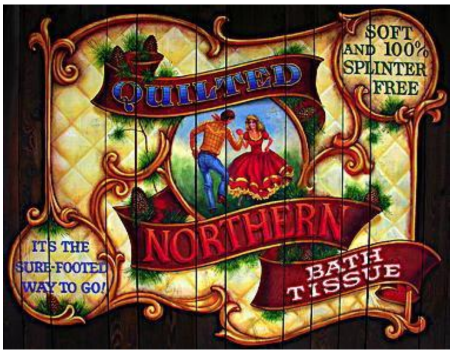
The company also reported US$48m operating cash flow with 93% cash conversion and an increased dividend per share of US21.75c, giving it its 17th year of DPS increase. At the end of February, the stock was trading at $29.60, having slid along with the rest of the market and, at this level, yields an unfranked income of 2.4%. Ansell looks well placed to weather the short-term uncertainties ahead – it provides essential goods relevant to any economy, boasts a global presence, and is not overly exposed to any single sovereignty in either its supply chain or customer base.

Where Does Australian Toilet Paper Come From?

Paraphrasing Wikipedia and other sources: One tree produces about 200 rolls (45 kg) of toilet paper and about 83 million rolls are produced per day globally – world toilet paper production consumes 27,000 trees daily. Assuming behaviour in Australia equates to American statistics, more than seven hundred million rolls of toilet paper are sold yearly in Australia alone. Australians use an average of 23.6 rolls per capita per year. The average Australian uses 23 kg of tissue paper per year which is 50% more than the average of other (non-USA) Western countries or Japan. The higher use in Australia and the United States may be explained by the absence of bidets or spray hoses typically used elsewhere. About 70% of the world does not use toilet paper at all. While paper has been used in China for hygiene since the 6th Century, the modern rolled and perforated toilet paper concept has only been around for 140 years – the technique for making *splinter-free* soft tissue was innovated in the USA in 1935, and 2-ply came in the following decade from a UK paper mill!

The majority of toilet paper produced in Australia is made from Australian-grown softwood plantation trees. Typically, purpose-grown softwood plantation trees (i.e. conifers) are chipped and shipped, often along with sawmill residues – these are exported in woodchip form factor to factories in south-east Asia where they are pulped, and that pulp is returned to Australian paper manufacturers. Toilet tissue's special requirements are met using a blend of long softwood fibres for resilience and short fibres from hardwoods for softness – different brands use varying wood composition and processes. The pulp is subjected to treatments for bleaching and for ensuring rapid solubility, so the pulp must be handled differently from pulp for other paper and tissue products.

Some companies with a focus on sustainable manufacturing practices produce competitively priced and equivalently functional toilet paper from 100% recycled post-consumer office wastepaper. This is processed locally and whitened with oxygen or peroxide treatments rather than chlorine. The technique for pulping and processing of recycled paper is different to softwood tree pulp as the fibres are already broken down, but the technology has matured over recent decades of experimentation to provide a comparable product that has gained significant acceptance. Also, as the world returns to an interest in growing hemp for fibre, there is growing interest in utilising this fast-growing plant as an alternative for trees as paper pulp feedstock.



1935 – Northern Tissue Co brought new levels of relief…