JM Financial Group

Issue 63: July 2020

Australian Equities Strategy – Investment Newsletter

Performance *(As at 31st July 2020)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Australian Equities Strategy	**+1.00**	**+12.23**	**-2.97**	**+23.49**	**+57.82**	**+7.79**
All Ords Accumulation Index	+0.95	+8.51	-9.02	+18.08	+44.66	+6.26
Outperformance	**+0.05**	**+3.72**	**+6.05**	**+5.41**	**+13.16**	**+1.53**

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 – and is after management fees, taxes (excl imp. credit benefits) and any paid or accrued performance fees. Strategy Inception for Performance Data is July 1st, 2014.

Month in Review *– A review of the share market and overview of the portfolio for July*

The JMFG Australian Equities Strategy increased 1.00% in July, modestly beating its benchmark, the All Ordinaries Accumulation Index which increased 0.95%. The Strategy outperformed its benchmark by 3.72% for the rolling quarter and by 6.05% for the rolling 12-month period. The annualised return since inception over six years ago is 7.8% p.a., compared to its benchmark return of 6.3% p.a., after all fees and taxes and excluding any imputation credit benefits.

The month experienced a wide divergence across sectors with strongest performers in the broader market including Materials +5.8%, I.T. +4.6%, Telecommunications +3.4%, and Consumer Staples +3.4%. Within the Materials space, gold stocks were particularly strong with the S&P ASX Gold Index rising over 10%, reflecting a 9.5% rise in the US$ gold price and around 5% in A$. Base metals were also strong during the month, with major metals rising between 5-10%. The weakest sectors included Energy, for a second month running, -6.6%, Industrials -3.9%, Healthcare -3.9% and Financials -1.1%. The ASX Small Ordinaries Index was marginally stronger than the broader market, rising 1.39% compared with the ASX 200, which increased 0.5% for July.

During the month, we only made modest changes to the portfolio composition. We trimmed positions in Appen and Xero on price strength, and we moderated our position in CSL early in the month – the stock underperforming along with the entire Healthcare sector as the month progressed. We also added to our position in Sezzle, the US-based “buy now pay later” operator, by participating in its capital raising through the month, aimed at progressing the pace of its rollout across the US.

The strongest performers for the portfolio during the month were: Sezzle +81.4%, Netwealth +33.9%, Universal Biosensors +27.5% and Goodman Group +14.0%.

The weaker performers for the portfolio during the month were: PolyNovo -13.8%, TPG Telecom -9.7%, Pro Medicus -9.6% and Woodside Petroleum -7.6%.

Chart of the Month – Mega Cap Performance vs Rest of the US Market

A year ago, it would have been unthinkable that the US would experience a severe recession and the highest unemployment rate since the Great Depression, while seemingly contrarily delivering significant gains for equity investors. However, over the past year, the S&P 500 Index has gained 11.58% in defiance of the economic backdrop. This rise was driven mostly by Apple, Microsoft, Amazon, Facebook and Alphabet (Google), the five largest companies in the US, which have grown their total market capitalisation by 60.13% over the 12 months. This partly demonstrates how these companies are geared to benefit from the current environment. It also displays that the share market is forward-looking and not necessarily reflective of the economy at a point in time.

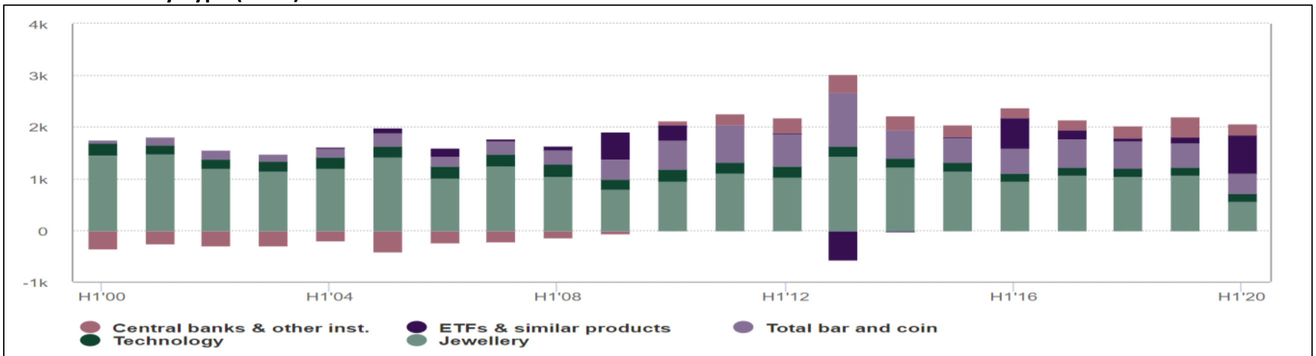
Apple Inc. (up 102% YoY) reported strong iPhone sales growth in Q2 despite overall smartphone sales declining over the same time. Microsoft Corporation (up 57% YoY) continued growth in their Intelligent Cloud segment and cloud demand was higher with customers instituting work from home arrangements. Amazon.com Inc. (up 73% YoY) reported Q2 profit growth of 97% on PCP, with strong revenue growth for their Online Stores, Subscription Services and AWS product segments. Facebook Inc. (up 33% YoY) added 128 million daily active users in the first half of 2020 and over 20% of the world population is now using the service daily. Alphabet Inc. (up 22% YoY) continued market share gains for their Google Cloud platform; however, the company recently saw its first quarterly YoY revenue decline since the company’s inception.

Due Diligence – *Gold Supply & Demand*

Gold demand in 2019 was reported to be down 1% to 4,356t. Demand fell on rising prices, with fourth quarter demand falling by 19%. Over the year, consumer demand fell in excess of 10% to around 2,978t – this was largely offset by an increase in investment demand which increased 9% to 1,272t, with central banks accounting for about half of the investment demand at 650t, down 1%. Annual gold supply increased 2% to 4,776t but this was driven by a 10% jump in recycled gold, while global mine production actually fell 1%. The rising gold price saw recycled gold grow by 16% to 335t in the fourth quarter.

The Covid-19 pandemic has undoubtedly fueled the ongoing rise in US$ gold prices through 2020. In 1H 2020, demand fell 6% to 2,076t with demand weakening through the half and down 11% in 2Q. The components of demand, however, varied wildly in 1H. Consumer demand dropped dramatically, with jewellery demand 46% lower to 572t against 1H 2019, including an over 65% decline from China. Central Bank demand declined 40% to 233t and demand for gold in the technology sector also declined, down 13% to 140t. These declines, however, were more than offset by investment demand, which increased 80% to 540t relative to 1Q 2019. Despite rising prices, supply declined 6% year on year to 2,192t, in part due to the pandemic impacting global production levels. With gold now around US$2,000/oz and recent demand largely driven by investments, given moderating consumer demand, any near-term supply recovery could see a short-term downward price risk emerge for gold.

Gold Demand by Type ('000t)



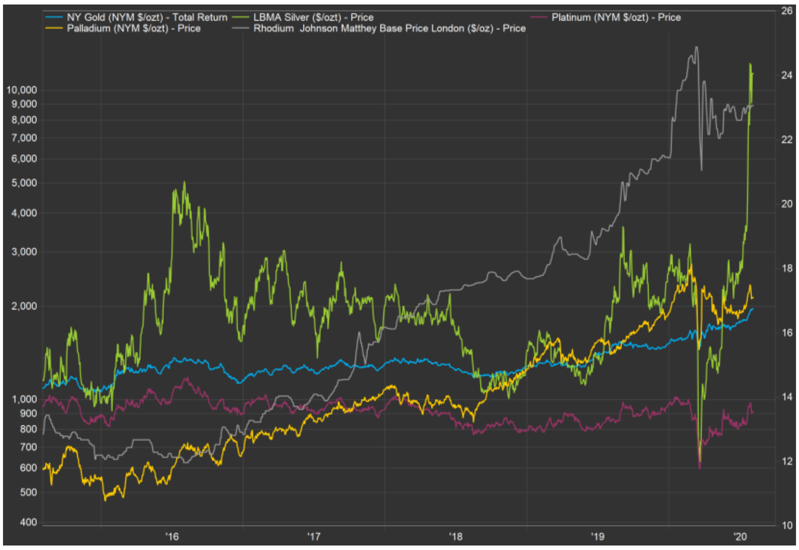
Source: Metals Focus, Refinitiv GFMS, World Gold Council

Precious Metals

The ASX 200 has a market value in the order of $1.6 trillion. The Materials component of the ASX 200 includes miners as well as construction materials, packaging materials and chemicals, and accounts for around $335b. BHP & RIO are the two largest components of the Materials sector, together comprising over 50%. Gold miners collectively make up around 3% of the ASX 200 and around 15% of the Materials sector; although it is a growing component, benefitting from rising precious metals prices, with gold the most impacting locally.

Many analysts debate the long-term value of gold, with sceptics arguing that it earns nothing, and you can't eat it, and therefore it should attract a far lower value than it currently does. The counterargument is that its visual beauty combined with its scarcity and increasing cost to produce makes it far safer than a currency, which is only as good as the economy that sits behind it. In relation to this last point, governments can pump as much or as little currency into an economy as they desire, at virtually no cost. We subscribe to the latter view and have therefore been comfortable holding gold stocks in our portfolios.

Given the current pandemic environment, we have held the view that global economic uncertainty has created an environment that is conducive to rising precious metal prices, and that is exactly what has occurred through the recent months of 2020. The five metals considered "precious" are gold, silver, palladium, platinum and rhodium. The chart shows the five metals in US$ over the past five years. With the exception of platinum, all of the precious metals have experienced strong growth in recent years. Over the calendar year, rhodium has experienced the strongest price increase, rising 47% to US$9000/oz. Silver, shown on the right hand axis, has increased 33% in US$, with gold rising 29% and palladium 12%. Platinum is the outlier, falling 6%.



Rhodium is a member of the platinum group and is extremely rare. Production is about 1% of annual gold production. Its major use is as one of the catalysts in catalytic converters in motor vehicles. It is silvery white, highly reflective and inert. Its industrial use and limited supply can make its price highly volatile at times, for example a 90% fall in the GFC.