

Small Companies Strategy – Investment Newsletter

Performance (As at 31 st July 2020)	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	+4.99	+22.97	+15.49	+65.65	+158.28	+16.88
Small Ords Accumulation Index	+1.39	+9.94	-8.49	+20.71	+48.17	+6.68
Outperformance	+3.60	+13.03	+23.98	+44.94	+110.11	+10.20

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.

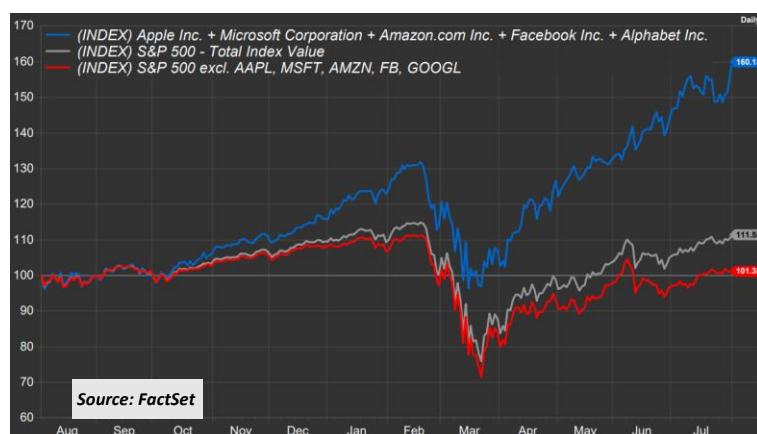
Month in Review – A review of events that influenced the share market and portfolio in July

The JMFG Small Companies Strategy had another strong month in July, rising 4.99% against its benchmark, which increased 1.39%, resulting in outperformance for the month of 3.60%. The Strategy outperformed its benchmark by 13% for the quarter and 24% for the rolling 12-month period. The annualised return since inception, over six years ago, is 16.9% p.a., compared to its benchmark return of 6.7% p.a. There has been some variation of annual returns relative to benchmark over the six year period, which is to be expected given the nature of the strategy – in two of the years we exceeded the benchmark by over 25%, in two other years we beat our benchmark by 4% and 15%, and on the two remaining periods we moderately underperformed the benchmark by 0.8% and 1.6% respectively.

The month experienced a wide divergence across sectors, with the strongest performers in the broader market including Materials +5.8%, I.T. +4.6%, Telecommunications +3.4% and Consumer Staples +3.4%. 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 0.95% for July.

Trading was relatively light during the month. We reduced holdings in Temple & Webster, Breville Group and Sezzle, all of which experienced very strong share price rallies. In the case of Sezzle, we had added to our holding through the month on an attractively priced capital raising, and subsequently reduced holdings when the stock rallied through \$8 per share later in the month. We added one new stock to the portfolio in July, Tesserent, a cyber security business which is aiming to consolidate the market in the medium enterprise and government space, to provide a one-stop shop for all major security needs – an increasingly complex requirement for all Boards and management to address. We maintained our cash exposure over the month at around 16%. Our best performing stocks over the month included Sezzle +81%, Netwealth +34%, PKS Holdings +26%, and Imdex +44%. Our worst performers included Medical Developments -16%, Polynovo -14%, and Pro Medicus Ltd -10%.

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.

Best & Worst Performers for July 2020

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	Worst	Best	Worst
Sezzle – SZL	Medical Developments – MVP	HUB24 – HUB	Avita Therapeutics – AVH
Netwealth Group – NWL	PolyNovo – PNV	Galaxy Resources – GXY	Adbri Ltd – ABC
PKS Holdings – PKS	Pro Medicus – PME	Pilbara Minerals – PLS	Phoslock Environmental – PET

Hits & Misses – A summation of the top hits and misses for the month of July

Sezzle (SZL) – up 81% for the month. Sezzle provided a very strong trading update early in the month, with June quarter merchant sales of US\$188m and an expectation of annualised merchant sales reaching US\$1b by the end of 2020. In addition, it announced that the number of active merchants using the Sezzle “buy now pay later” platform in the US had risen 27% on the prior quarter to over 16,000.

HUB24 (HUB) – up 43% for the month (Not held). HUB24 reported Funds Under Administration of \$17.2b at the end of June 20, an increase of \$4.3b or 34% for FY20 and despite a negative market impact of \$0.6b.

Medical Developments (MVP) – down 16% for the month. No particular news emerged through the month but the Health Care sector was generally weak which may have had some impact on medical device companies like MVP.

Avita Therapeutics (AVH) – down 33% for the month (Not held). A company update and fourth quarter result reported fourth quarter sales of US\$3.79m, only marginally ahead of 3rd quarter sales of US\$3.78m.

Due Diligence – A closer look at a stock of interest

Tesserent (TNT)

Tesserent is a Managed Security Service Provider (MSSP) offering services to organisations in Australia and internationally, providing monitoring and support around the clock, 365 days a year. Tesserent is targeting medium sized enterprises and government agencies with a one-stop shop approach for all cyber security requirements a business may have. With ever-increasing complexity and ongoing demand for cyber security services to ensure business integrity, continuity and protection of all data and information a business holds. The decision-making process around cyber security requirements is becoming far more critical, thereby elevating it from an IT department decision to a significant executive management and board decision.

To that end, the executive and board are more and more likely to gravitate toward a single source that can package up and deliver the best possible set of cyber security offerings available. Tesserent is aiming to achieve this by consolidating a range of companies offering a diverse set of components to comprise the overall required solution for each enterprise. The strategy involves a combination of proprietary security platforms and specialised technology from the world’s leading security vendors and overlaying them with the Tesserent management platform and local support from a team of specialist security engineers. As an example, global technology partners include Palo Alto Networks, Cisco, Nucleus Cyber, Alien Vault, Equinix, NextDC, Nextgen Group and Darktrace, to name just a handful.



Managed Firewall



Managed SIEM



Email Filtering & Security



Web Filtering & Security



Data Centre & Colocation



Threat Hunting

In summary, Tesserent will provide managed security, consultation, and connectivity with a focus on education, government, manufacturing, transport/logistics, finance, insurance and legal sectors.

Managed services include firewall supply and management, intrusion detection event monitoring and response, email filtering and encryption, web filtering and security, data centre outsourcing & colocation, threat hunting and penetration testing.

As a consolidated one-stop shop offering both proprietary and leading global solutions, along with a localised support and engineering base, Tesserent has an opportunity to deliver an efficiency to its customers facilitated by its scale, experience, and know-how. Tesserent is well positioned to be the leading provider of outsourced cyber security solutions across both Australia and into several potential international regions.