JM Financial Group

Issue 69: January 2021

Leaders Strategy – Investment Newsletter

Performance *(As at 31st January 2021)*	**Month (%)**	**Rolling 3 Months (%)**	**Rolling 1yr (%)**	**Rolling 3yrs (%)**	**Inception Gross (%)**	**Inception Annualised (%pa)**
JMFG Leaders Strategy	**-1.43**	**+6.92**	**-1.63**	**+17.94**	**+52.63**	**+6.64**
ASX 200 Accumulation Index	+0.31	+11.28	-3.31	+21.74	+60.81	+7.48
Outperformance	**-1.74**	**-4.36**	**+1.68**	**-3.80**	**-8.18**	**-0.84**

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 – and is after management fees (post 1 Jan 17) and taxes (excluding imputation credit benefits). Strategy Inception for Performance Data is July 1st, 2014.

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

The JMFG Leaders Strategy had a soft start to the year, falling 1.43% against a slight rise of 0.31% for the ASX 200 Accumulation Index. The Strategy held on to its rolling 12 months lead against the benchmark, outperforming by 1.68%.

It was another month of strong rises for the consumer and financials sectors with big retailers JBH, HVN, and ARB rising between 6 - 14%, and banks ANZ, WBC, NAB, and CBA rising between 2 - 9%. Strongest sectors across the broader market included Consumer Discretionary +4.7%, Telecommunications +2.7%, Financials +2.2% and Consumer Staples +2.1%. Weakest returns came from Property Trusts -4.1%, with other weak sectors including Industrials -3.0%, HealthCare -1.9% and Materials -1.1%.

The recent rally in both precious and base metals continued into the early part of January but prices generally stabilised or weakened through the middle and latter parts of the month, which saw several resource companies also weaken in the latter half of the month. The A$/US$ relationship stabilised through the month around the 0.77 level, compared to 0.70 at the end of October 2020.

January was a quiet trading month for the Leaders Strategy. We reduced exposure to PolyNovo immediately following its trading update, which, in our view, was a touch disappointing. Our selling, however, was at substantially higher prices, ~$3.15/share, than where it ultimately settled. Also, we trimmed our holding in Pro Medicus to take some profits after a rise following news about its 7-year contract win with Intermountain Health.

The strongest performers for the portfolio during the month included:

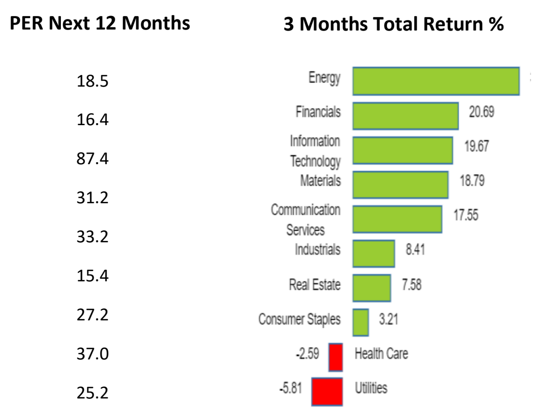
- Pro Medicus +25, Nuix +11%, Wesfarmers +8%, and Woodside Petroleum +8%

The weakest performers for the portfolio during the month included:

- PolyNovo -32%, Xero -12%, Appen -10%, and SCA Property Group -8%

Chart of the Month – Relative Index Performance for 2020

We began our discussions around de-risking portfolios several months back, slowly shifting into either lower multiple companies or into companies with more tangible growth opportunities and more sustainable business models. It is interesting to look at sector returns over the past few months as well as total market pricing. Market pricing in terms of forward PER's was expensive when we last spoke about it back in the October 2020 monthly newsletters. At that time, the market was trading on a 12-month forward PER in the order of 18X.



Source: FactSet financial data and analytics

It is now even more expensive with the ASX 200 and ASX Small Companies Indices both trading around 19X the 12-month forward PER. In the context of low interest rates and a recovering economy, some would argue the market may still be reasonable value given the alternatives in the cash and fixed interest markets. There may be some merit to that argument.

It is interesting to look at the best performing sectors over the past three months. They include the economically sensitive Energy and Materials sectors, both of which have experienced a recovery in commodity prices, as well as the Financials and Communication sectors. These four sectors all offer lower multiples and yield. The outlier is the I.T. sector where the two largest I.T. stocks have continued to rally, namely Afterpay and Zero. The remaining smaller I.T. companies have generally underperformed. The weakest sectors include those that did well in the initial pandemic period, including Consumer Staples and Healthcare. In addition, the Real Estate sector continues to suffer from the poorer performing Commercial office sector.

JM Financial Group
AFSL 238397 ABN 68 007 364 132
Level 8, 140 Bourke St, Melbourne, VIC, 3000
Ph: +61 3 9627 9900
Web: www.jmfg.com.au
Email: enquiries@jmfg.com.au

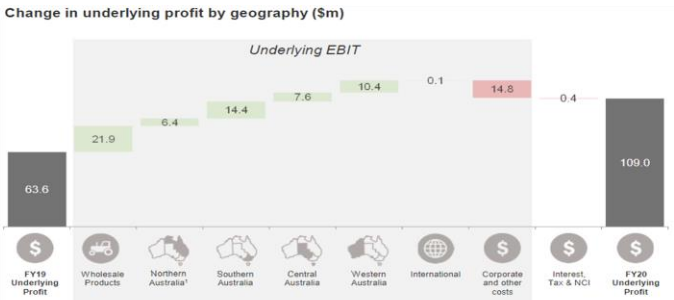
Due Diligence – *A closer look at a stock of interest*

Elders Limited (ELD)

Elders is a name that is synonymous with the Australian agricultural industry, operating since 1839 both within Australia and internationally. The company provides a range of services to primary producers including finance, banking and real estate services to wool, grain and livestock trading. Primary producers essentially work with Elders to access products, marketing services and technical advice across retail, agency, and financial products, including insurance and home loans.

After several years of drought in eastern Australia, the agricultural sector is well positioned to enjoy strong earnings with good rains through 2020 continuing into the early part of 2021. Production is forecast to grow and ongoing strength across several soft commodities should see solid earnings through 2021 and potentially into 2022. In the CEO's speech at the Elder's AGM in December, Mark Allison spoke with optimism about the coming year with an average summer crop forecast, following several below average summers. Whilst geopolitical issues are a concern to the agricultural sector in Australia, Elders believes the signing of the Regional Comprehensive Economic Partnership offers stability across export markets for ASEAN, north Asian countries and China, although the latter has proven to be a little more problematic recently.

Elders acquired Australian Independent Rural Retailers (AIRR) mid-November 2019, a national wholesale member based buying and marketing group for independent rural merchandise and pet and produce stores with eight warehouses servicing over 1,500 customers. Aside from cost synergies, access to a broader customer base and product range, the business also helps to diversify away from weather-related cycles, as well as by geography and customer type.



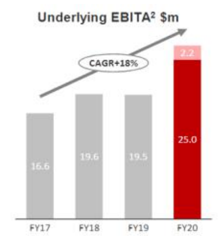
Underlying profit by geography by year ($m)

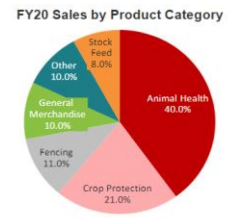
	Wholesale Products	Northern Australia	Southern Australia	Central Australia	Western Australia	International	Corporate and other costs
FY20	21.9	32.6	54.3	31.2	39.2	(1.2)	(58.5)
FY19	Nil	26.2	39.9	23.6	28.8	(1.1)	(43.7)
% change	100%	24%	36%	32%	36%	(9%)	(34%)

Source: Elders FY20 Results Presentation

AIRR was integrated into Elders Wholesale Products division through FY20 (year-end September) and was stated to be on track to deliver acquisition synergies through centralization of inventory, consolidation and streamlining procurement as well as enhanced margin management and marketing across brands and product portfolio. Other initiatives include 'own label' expansion in animal health and merchandise and a digital strategy.

AIRR Underlying EBITA **(includes $2.2m FY20 prior to acquisition)**





Changing Sector Pricing

We wrote about overall market pricing moving to around 19X its 12 month forward PER, a figure well above the long term market average of 14-15X. Much of that increase has come from a smaller part of the market. As shown in the left hand chart below the I.T. sector has experienced a dramatic increase, rising from the mid 20X range in 2015, to around 90X. The Health sector has moved from the mid 20X range toward 40X over the same time period. The Communications sector has perhaps surprisingly pushed above 30X but when considering the inclusion of higher growth Interactive Media within the sector, which includes Seek, REA Group, Carsales and Domain Holdings, the expansion is a little more understandable. The increase within the Industrial sector is more a function of the rapid Covid-19 related decline of earnings for Sydney Airport and Transurban. The chart to the right includes a collection of the more mature, lower growth sectors. Whilst Financials, Materials and Property Trusts continue to trade within more normal ranges, even these sectors are pushing toward the higher end of their long range PER bands. It is also interesting to note the expansion of the Consumer Discretionary and Consumer Staples sectors. Both of these sectors have benefited through the turbulence of Covid-19 with the aid of government support, but one has to wonder where these sectors will trade as various stimulus packages unwind.