JM Financial Group

Issue 76: August 2021

Australian Equities Strategy – Investment Newsletter

Performance *(As at 31st August 2021)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Australian Equities Strategy	**+1.83**	**+1.53**	**+12.81**	**+25.99**	**+86.98**	**+9.12**
All Ords Accumulation Index	+2.60	+6.34	+29.00	+35.16	+93.53	+9.65
Outperformance	**-0.77**	**-4.81**	**-16.19**	**-9.17**	**-6.55**	**-0.53**

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 after management fees (post 1 Jan 2017), performance fees (paid or accrued), GST, and excludes the effect of franking credits. Strategy Inception for Performance Data is July 1st, 2014.

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

For the month of August, the JMFG Australian Equities Strategy rose by 1.83%, bringing the return for the last 12 months to 12.81% after fees and taxes. Although the strategy has underperformed the benchmark over the last 12 months, we feel the reasons are well understood and have been covered in recent newsletters. Many of our core stocks have performed well, resulting in overall annual gains, but perhaps not at the same level as the overall market. We have seen signs since late August that conditions overall are normalising, with the market softening through the beginning of September and the strategy outperforming its benchmark so far for the month.

August's best-performing sector of the broader market was Information Technology which rose by 17%. Other strong-performing sectors of were Consumer Staples +6.9%, Health Care +6.8%, and Property Trusts +6.3%. Only two sectors finished in the red for the month, the worst-performing being Materials which was down 7.3% for the month, followed by Energy which was down 3.9%. The other weak sectors still managed a positive result overall, including Utilities +1%, Industrials +2.7%, and Consumer Discretionary +3.4%.

Trading was subdued during August while we searched reporting season for companies significantly deviating from expectations, although most of the bad news had been announced in July. Overall, we increased portfolio exposure to under-represented medical, infrastructure, construction, insurance, and technology stocks that are strongly leveraged to anticipated pandemic recovery factors. The cash position was also reduced during the month.

The strongest performers for the portfolio during the month included:

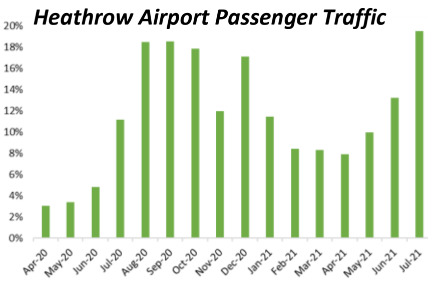
- Pilbara Minerals +26%, Uniti Group +24%, Lotus Resources +15%, and ASX +14%

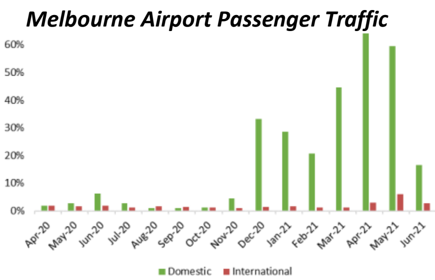
The weakest performers for the portfolio during the month included:

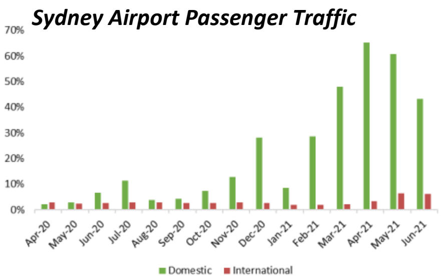
- BHP Group -15%, Mineral Resources -10%, Mach7 Technologies -5%, and Appen -5%

Chart of the Month – Airport Traffic Data as a Percentage of 2019 Levels

As developed nations hit their vaccination targets and come out of lockdown, restrictions on domestic and international travel are likely to be gradually eased. To try determining how restrictions easing will impact travel, we can examine how passenger traffic has responded since local restrictions have been eased. The charts below show airport passenger traffic from April 2020 as a percentage of the same month's traffic in 2019. Furthermore, the charts for the Australian airports separate out domestic and international travel to clearly differentiate between these categories. Towards the end of 2020, Heathrow Airport, historically one of Europe's busiest airports, saw passenger levels gradually recovering as the first wave of the pandemic began to pass. However, as cases resurged while the Delta Variant spread, Heathrow passenger traffic again slumped before once more improving as the local vaccine rollout hit its key milestones. When restrictions eased in Australia, domestic travel recovered rapidly – exceeding 60% of pre-pandemic travel traffic for Melbourne and Sydney airport – while international travel showed no signs of recovery due to international arrival quota constraints. These domestic travel numbers highlight the willingness of individuals to travel when restrictions are eased; however, this traffic is quickly extinguished by rising COVID-19 case numbers.







Source: Heathrow Traffic Statistics

Source: The Bureau of Infrastructure, Transport and Regional Economics

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JMFG Australian Equities Strategy		ASX All Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Pilbara Minerals (PLS)	BHP Group (BHP)	Novonix (NVX)	Imrico Medical Systems (IMR)
Uniti Group (UWL)	Mineral Resources (MIN)	WiseTech Global (WTC)	Mount Gibson Iron (MGX)
ASX Limited (ASX)	Mach7 Technologies (M7T)	Ardent Leisure Group (ALG)	Anteotech (ADO)

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

Pilbara Minerals (PLS) – up 26% for the month. While in a trading halt at the end of July, Pilbara reported that it had completed an online auction for 5.5% spodumene concentrate at a price of US$1,250, highlighting the short-term shortage of available spodumene. As lithium pricing is largely contract-based and without a spot market, announcements like this can substantially move share prices.

Novonix (NVX) – up 75% for the month (Not held). US-based testing services and equipment provider and synthetic graphite manufacturer for the developing battery supply chain, Novonix continued strengthening its gains after announcing Phillips 66 taking a US$150m strategic investment in the company. As part of the deal, Phillips 66 will supply specialty coke as feedstock for Novonix US-based anode production.

BHP Group (BHP) – down 15% for the month. Having put in a strong July, stock in BHP fell mid-month among various influences including: overall materials sector impact from China economic news; BHP selling its oil and gas arm to Woodside to create a new global energy company; BHP exiting London's FTSE; and litigation in Brazil against BHP and Vale to the combined value of $9.5bn.

Imricor Medical Systems (IMR) – down 32% for the month (Not held). Despite TGA approval for its cardiac device giving a small boost to valuation at the start of the month and some agreements with big players in healthcare, the company's results indicate it may still have a long road ahead to get to cashflow breakeven, let alone see return on invested capital, and is likely struggling against pandemic headwinds regarding hospital access for marketing, trials, and sales.

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

Square Inc (NYSE:SQ)

New York Stock Exchange listed Square Inc last month became particularly interesting to the Australian market, and our Australian Equities Strategy in particular, when the financial technology giant announced a court-approved takeover deal for Afterpay (ASX:APT). The US company is paying an all-stock consideration of US$27billion (~AU$39bn) for the Aussie buy now pay later (BNPL) innovator and the deal will result in current holders of APT taking an equivalent share of a 17% stake in the post-merger Square enterprise. The shares will be listed as CHESS Depository Interests (CDIs) on the ASX for local market trading, so Square will replace Afterpay in the portfolio.

Afterpay has rapidly and, at times, controversially grown its BNPL platform presence globally since merging with Touchpay in 2017, peaking at a $45bn enterprise valuation in February 2021. While that valuation was evidently inflated, Square's August offer was a ~40% premium when announced, with APT's EV having slid to AU$28bn.

Source: SquareUp.com

Square was co-founded in 2009 by its current CEO Chairman, Jack Dorsey, who is also CEO and co-founder of Twitter. Square's inception was based around the aim to "enable anyone with a mobile device to accept card payments, anywhere, anytime." When the company listed in 2015, it was generating around 95% of its revenue from payments and POS services and had begun diversifying its product and service offerings to include other commercial, financial, and marketing services to assist sellers to start, run, and grow their businesses. By 2015, the company's total net annual revenue was US$850m, off the back of processing US$24bn in gross payment volume, with 446m card payments from 144m payment cards, and 2 million sellers accepting at least 5 payments using Square. Its vendor financing operation Square Capital had advanced over $225m in its inaugural year of service since launching in 2014. The IPO valuation was US$2.9bn.

In its latest financial report, total net revenue for the half-year was US$9.7bn, gross profit US$2.1bn, and the company is presently valued at US$132bn. GPV is now at US$140bn for the latest 12 months reported. The company has added a cryptocurrency transaction platform to its repertoire, with Bitcoin revenue contributing a significant US$6.2bn to headline revenue but, at a cost of $6.1bn, it added only minimally to gross profit. Through a judicious acquisition strategy, Square also has interests in music streaming technology, banking services, workforce management, kitchen display software for restaurants, food and beverage delivery software, and inventory management software.

The two companies anticipate significant synergistic benefits from merging their complementary ecosystems as it enables cross-pollination opportunities for Square to access new customers through Afterpay's established BNPL-onboarded global merchant base, and expand commerce-enabling equipment and apps, and various transaction and feedback platforms promoted into APT's over 16-million strong customer base.