JM Financial Group

Issue 75: July 2021

Australian Equities Strategy – Investment Newsletter

Performance *(As at 31th July 2021)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Australian Equities Strategy	**-1.88**	**+0.49**	**+16.35**	**+25.40**	**+83.62**	**+8.96**
All Ords Accumulation Index	+1.06	+5.67	+30.38	+33.98	+88.61	+9.38
Outperformance	**-2.94**	**-5.18**	**-14.03**	**-8.58**	**-4.99**	**-0.41**

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 July*

The JMFG Australian Equities Strategy returned negative 1.88% for the month of July, bringing the performance for the last 12 months to 16.35%. The strategy underperformed its benchmark for the month and the 12-month period. There are several reasons for this. We have continued to hold higher than usual cash weightings, noting that company valuations generally are at the higher end of what we regard as good value. We have also been underweight materials, particularly metals, as the resources sector can be quite volatile and difficult to predict. Whilst we have taken certain steps to mitigate further underperformance, we note that the strategy is nevertheless still producing high yearly returns and is well placed to handle the inevitable downturns that lie ahead. Our desire to manage risk appropriately and adopt a balanced approach in order to help preserve capital can sometimes lead to periods of underperformance in strong markets, but we factor this in when managing our strategies for the longer term.

For July, Materials were the best-performing sector of the broader market, rising 7.1%. Other strong-performing sectors of the market were Industrials +4.3%, Utilities +1.6%, Consumer Staples +1.5%, HealthCare +1.2%, and Property Trusts +0.3%. The worst-performing sector was I.T. which was down 6.9% for the month. Other weak sectors included Energy -2.5%, Financials -1.4%, Telecommunications -1.4% and Consumer Discretionary -0.5%.

Trading was active during July with several companies issuing quarterly updates and holdings changes being made ahead of reporting season in August. Overall, we increased the exposure to materials companies, particularly lithium producers, who have continued to perform strongly and now make up a more substantial portion of the index.

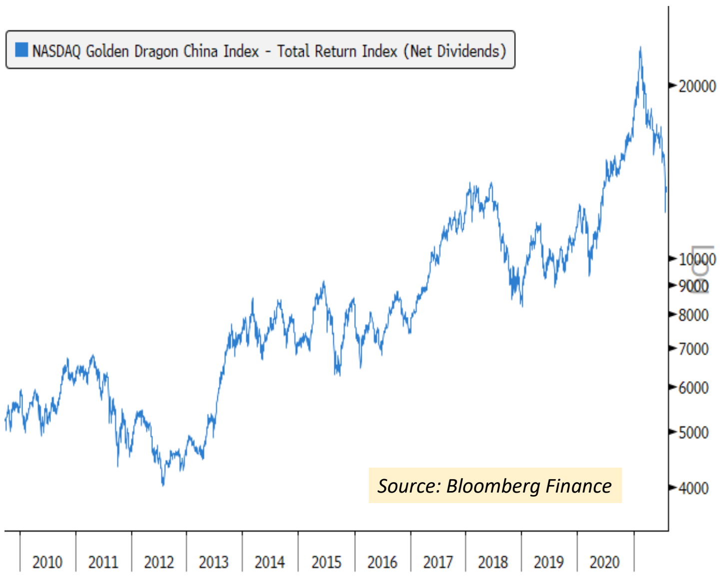
The strongest performers for the portfolio during the month included:

- BHP Group +10%, Goodman Group +7%, Fortescue Metals Group +7%, and Uniti Group +5%

The weakest performers for the portfolio during the month included:

- PolyNovo -20%, Lotus Resources -10%, Megaport -9%, and Mach7 Technologies -8%

Chart of the Month – Rout in Chinese Tech Stocks



Chinese technology companies have faced increasing uncertainty in recent months with crackdowns from Chinese regulators. This is reflected in the chart to the left which shows the performance of the NASDAQ Golden Dragon China Index over the last 10 years, which has been falling for several months and in July had its worst month since the GFC. The Golden Dragon tracks the performance of Chinese technology stocks which have a listing in the USA. Major constituents of the index include NIO, JD.com, and Alibaba. During July, Chinese regulators showed the power they have over these major technology companies – days after China-based ride-sharing company Didi Global debuted on the NYSE raising US$4.4Bn the Cyberspace Administration of China ordered DiDi be removed from App Stores in China pending an investigation. Then, in late July, China introduced massive regulations on education technology companies that included a ban on these companies making profits. This saw these Chinese EdTech companies, which had already been suffering this year, lose most of their remaining value. Examples like these make investors across all Chinese sectors wary as it highlights the vulnerability of seemingly strong companies.

JMFG Australian Equities Strategy		ASX All Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
BHP Group (BHP)	PolyNovo (PNV)	Weebit Nano (WBT)	Marley Spoon (MMM)
Goodman Group (GMG)	Lotus Resources (LOT)	Poseidon Nickel (POS)	Piedmont Lithium (PLL)
Fortescue Metals Group (FMG)	Megaport (MP1)	Envirosuite (EVS)	Crown Resorts (CWN)

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

BHP Group (BHP) – up 10% for the month. BHP continued to be supported by high iron ore prices throughout July. The company is considering exiting its oil and gas business likely due to ESG considerations and has made a cash-offer for Noront, a Canadian mining company with significant nickel assets.

Weebit Nano (WBT) – up 58% for the month (Not held). Weebit Nano is developing next-generation semiconductor memory technology called Resistive RAM (ReRAM). During the month, the company announced it had completed the final designs and verification stages of its ReRAM module. Weebit is still down 1% for 2021.

PolyNovo (PNV) – down 20% for the month. The market was disappointed with PolyNovo's FY21 BTM revenue growth of 34% given that the company indicated at the AGM last year that it was on track to double revenue. Limited access to US hospitals throughout FY21 led to difficulties in the sales team gaining access to new customers.

Marley Spoon (MMM) – down 31% for the month (Not held). Marley Spoon produces meal kits for convenient online ordering and home delivery. While the company reaffirmed FY21 revenue guidance, the quarterly business update downgraded margin guidance for the full year. Marley Spoon also continued to burn large amounts of cash despite its massive growth over the last 12 months, burning through €7.5m for the quarter. With a cash balance of just €24.1m, a cash burn like this likely makes investors wary of a potential capital raise.

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

IGO Limited (IGO)

IGO Limited has had a transformational year in which it divested its Tropicana gold asset and entered a lithium joint venture with Tianqi, one of the world's largest lithium production companies. IGO is now completely focused on clean energy metals including nickel, copper, and cobalt from its Nova Project, and lithium through its interest in the Greenbushes Lithium Mine and Kwinana Lithium Hydroxide Refinery.

Kwinana Lithium Hydroxide Refinery

Source: IGO – 4Q21 Results Presentation

Greenbushes is the world's lowest cost lithium producer and was 51% owned by Chinese company Tianqi and 49% by US company Albemarle before the investment of IGO. The mine produces spodumene concentrate that is then shipped to China where it is refined, likely into a battery-grade material such as lithium carbonate or lithium hydroxide. The joint venture with Tianqi cost IGO A$1.9Bn in December and gives IGO 24.99% interest in the Greenbushes Lithium Mine. The transition into lithium was well-timed by IGO as lithium prices have soared year to date, almost doubling over the period, based on some producers' spodumene price reports.

The joint venture also gives IGO a 49% interest in the Kwinana Lithium Hydroxide Refinery, providing the company exposure to the downstream processing market. Kwinana will likely be the first lithium hydroxide refinery operating in Australia and is expected to commence production within the next 12 months. This investment in downstream operations provides several advantages to IGO. Spodumene concentrate is expensive to ship as it is only composed of ~6% lithium oxide and 94% waste or other materials. By refining the material in Western Australia, IGO and its associates can then ship lithium hydroxide consisting of less than 1% waste. The refinery also provides geographic diversification to lithium processing exposure not previously had by Australian spodumene producers. With almost all spodumene currently shipped to China which is home to most of the world's current refining capacity. By producing battery-grade lithium hydroxide here in Australia, the joint venture can then ship into multiple overseas markets where batteries are produced or where production is coming online soon.

IGO also owns 100% of the Nova Ni-Cu-Co Operation and is its more mature operation. In FY20, the project produced over 30,0000 tonnes of nickel and generated profit before tax for IGO of A$182.2. While IGO has announced slightly lower production for FY21, prices for these commodities have soared over the past financial year to more than offset this lower production level. IGO expects to invest a further A$33m into exploration of the Nova operation and the neighbouring Fraser Range.

Outlook looks very strong for IGO following its successful transition from a diversified materials miner into a completely "battery metals" focused business. The company announced in its June activities report that Kwinana was on track to produce its first lithium hydroxide shipment by the end of the year and be fully ramped by the end of 2022. The company also provided guidance for the Nova operation in FY22, which expects cash costs to be A$2.00 – 2.40/lb of nickel, down from its FY21 guidance of A$2.40 – 2.80/lb. We see IGO as offering more conservative exposure to lithium and battery materials overall, with attractive expansion options in the battery materials space.