Issue 78: October 2021

JM Financial Group

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st October 2021)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	**+3.64**	**+1.27**	**+9.10**	**+71.83**	**+213.01**	**+16.85**
Small Ords Accumulation Index	+0.92	+3.68	+29.20	+48.61	+103.24	+10.16
Outperformance	**+2.72**	**-2.41**	**-20.10**	**+23.22**	**+109.77**	**+6.69**

Although the JMFG Small Companies 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 events that influenced the share market and portfolio in October*

For the month of October, the JMFG Small Companies strategy easily exceeded its benchmark, gaining 3.64% versus the Small Ordinaries Accumulation Index 0.92%. Although the strategy hasn't performed up to recent standards over the past 12 months, it still has very strong longer-term performance, averaging a positive 16.85% per annum after fees and taxes since inception over 7 years ago. Encouragingly, we are seeing continued signs of a turnaround in the relative performance of many companies in the portfolio in the early part of November.

The best-performing sector for October was Information Technology which rose by 2.0%. Other strong-performing sectors in September were Healthcare +1.0%, Financials +0.8%, and Real Estate Trusts +0.4%. Industrials was the worst-performing sector falling 3.2% on the back of a subdued global construction outlook. Other weak sectors included Energy -2.7%, Staples -2.3%, and Telecommunications -1.1%.

Trading during the month of October was minimal, with a small increase made to our holding in healthcare technology stocks. The previous month's adjustments showed some benefit to performance, hence there was no compelling reason for further adjustments. The portfolio cash position remained steady.

The strongest performers for the portfolio during the month included:

- Class +70%, Paladin Energy +28%, Aurelia Metals +27%, and Imdex +24%

The weakest performers for the portfolio during the month included:

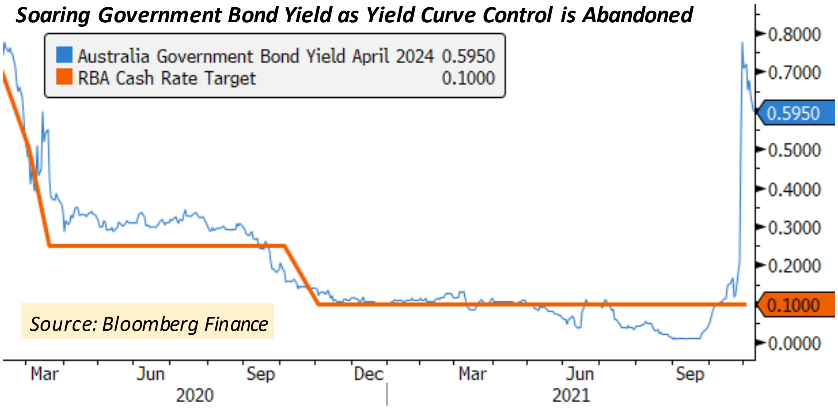
- Dubber Corporation -15%, Mineral Resources -14%, Mach7 Technologies -10%, and PolyNovo -5%

Chart of the Month – Australia's Yield Curve Control Program

Since the beginning of the pandemic the Reserve Bank of Australia has been following a yield curve control program in which the RBA has been targeting a 3-year yield of around the RBA Cash Rate. In support of this target the RBA stands ready to buy government securities to drive this yield toward this target and has been buying government securities at a rate of $4Bn a week. This strategy of yield curve control contrasts with typical cash rate targets which simply targets the overnight cash rate. The 3-year yield target aims to give the market confidence that monetary policy will remain supportive in the longer term to encourage lending activities while ensuring adequate liquidity.

However, Australia's April 2024 government bonds yields soared over 7 times the Reserve Bank's yield curve control target in the last week of October. In fact, bond markets around the world have become more volatile in response to strong inflationary data coming through for the September quarter. For example, the RBA's quarterly core inflation measure rose to 2.1 per cent on an annualised basis and similarly New Zealand's CPI increased by 2.2 per cent.

Soaring Government Bond Yield as Yield Curve Control is Abandoned



The following week, RBA's Governor Phillip Lowe confirmed that the yield curve control program had been abandoned, as the RBA would have ended up owning all April 2024 bonds on issue if it continued purchases in this market. He also stated that a late 2023 lift in the cash rate is now plausible, accelerating the previous schedule of "not before 2024." However, the market continues to doubt the credibility of the RBA's forecasts and has priced in rate hikes for 2022. Both the US Fed and Bank of England have made dovish announcements since then, with the BOE, surprisingly, keeping rates on hold for November.

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Class (CL1)	Dubber Corporation (DUB)	West African Resources (WAF)	Marley Spoon AG (MMM)
Paladin Energy (PDN)	Mineral Resources (MIN)	Liontown Resources (LTR)	EML Payments (EML)
Aurelia Metals (AMI)	Mach7 Technologies (M7T)	Nick Scali (NCK)	Infomedia (IFM)

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

Class (CL1) – up 70% for the month. After declining since 2017, Class had been recovering for the best part of the past two years. In October, Class received a strong scheme proposal for acquisition by HUB24 who will consolidate its assets and client base into HUB's platform. HUB24's offer values Class at $3.11 per share, and will be paid mostly in HUB shares with some cash and a dividend factored in.

West African Resources (WAF) – up 34% for the month (Not held). This gold, copper, and molybdenum explorer/producer had been steadily rising since the start of 2019 with a steady news-flow of improvements in production and development of new assets. The company raised $126M in the month to fund a material acquisition.

Dubber Corporation (DUB) – down 15% for the month. The voice recording services provider grew steadily through 2021 with news flow relating to ongoing growth in its service offerings and customer adoption. Given the good news flow recently, the share price slide suggests selling was due to profit-taking after the recent sustained rally.

Marley Spoon AG (MMM) – down 32% for the month (Not held). The company continued its slide following on from September's announcement that Woolworths was selling its shareholding in a block trade, despite maintaining its commercial commitments to Marley Spoon. The company's valuation is looking more realistic now, but as pandemic restrictions ease, ready-made food delivery services business such as this may continue to decline to a baseline business level before returning to growth.

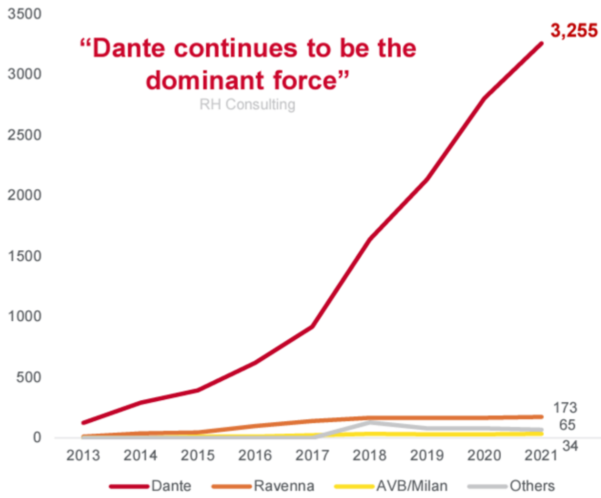
Due Diligence – *A closer look at a stock of interest*

Audinate Limited (AD8)

Audinate was founded in 2003 by a group of engineers, following the closure of Motorola factories in Australia, with a focus on improving audio networking. The company's main product *Dante* is now used at venues worldwide to better handle complex audio and visual networks. While Audinate has faced a difficult environment for the last 18 months, which may persist for some time, Audinate has a strong growth runway and continues to outperform competitors.

Dante works to replace the incumbent standard analogue network systems with digital networking whereby audio and video signals can be transmitted together over regular ethernet data cabling (AVoIP) rather than requiring hundreds of individual analogue cables to send each signal. Audinate sells Dante chips to original equipment manufacturers (OEMs) who develop the sound and stage equipment. Audinate was a major first mover in this space and, due to a mix of network effect and winning design, the Dante platform has significantly dominated its competition – as per the diagram to the right.

Total Audio Products Per Protocol



Source: Audinate 2021 AGM, RH Consulting, Networked Audio Products 2021

Audinate also sells software to sound engineers to better manage Dante audio networks. This has been a strong growth area for the business recently and grew almost 50% in FY21 to more than a quarter of revenue while hardware revenue was flat over the same time. Audinate is also developing video management software which will complement its audio networking software which is expected to launch in 2022.

Source: Audinate 2021 AGM Presentation

Audinate has faced a difficult environment over the last 2 years. Most live events were cancelled in 2020, substantially limiting sales growth. While the company is now faced with strong demand outlook in 2021, Audinate now faces supply issues due to ongoing global silicon chip shortages. At its AGM, Audinate announced that a major chip supplier could no longer guarantee delivery of parts that are key in delivering 43% of Audinate's revenue and that this would impact sales in the second half of the financial year.

While Audinate is not currently held in the portfolio, it is one we continue to monitor for a de-risking opportunity as the company continues to grow.