JM Financial Group

Issue 80: December 2021

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st December 2021)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	**+1.7**	**+6.3**	**+5.1**	**+84.6**	**+221.1**	**+16.8**
Small Ords Accumulation Index	+1.4	+2.0	+16.9	+54.9	+105.5	+10.1
Outperformance	**+0.3**	**+4.3**	**-11.8**	**+29.7**	**+115.6**	**+6.7**

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 December*

For the month of December, the JMFG Small Companies strategy continued its recent positive performance, finishing up 1.7%, and has a positive return in all reported periods since inception. The strategy outperformed the Small Ordinaries Accumulation Index by 0.3% for the month, continuing the recent outperformance over the final quarter of the year. As indicated in earlier editions of this newsletter, the rewards of persisting with a growth-oriented strategy are beginning to be realised. Positive equity market performance is expected to continue in 2022 as the economy expands, but volatility is anticipated in the months ahead with rising inflation concerns, and the strategy has been set accordingly with a view to longer-term outperformance.

The best-performing sector for the broader Australian market in December was Utilities which rose by a substantial 7.9% and Materials remained strong rising 6.5%. Other sectors showing strength through December were Real Estate Trusts +4.9%, Financials +4.3%, and Industrials +4.0%. Only three sectors lost ground over the course of the month, the worst being I.T. losing 5.3%, followed by Healthcare down by 2.4% and Consumer Staples which shed 2.3%.

During December, we made a few adjustments to the portfolio, locking in profits by trimming Pilbara Minerals, topping up Dubber on price weakness in the tech sector, and adding recently floated commercial bank Judo Capital. The portfolio cash position increased to c. 6%.

The strongest performers for the portfolio during the month included:

- Mineral Resources +24%, Pilbara Minerals +23%, Appen +16%, and Centuria Industrial REIT +13%

The weakest performers for the portfolio during the month included:

- Dubber Corporation -24%, Alcidion Group -18%, Megaport -13%, and Mach7 Technologies -7%

Chart of the Month – A Decade of Asset Class Returns

The table below shows various asset class level returns for Australian investors over the last 10 years, and how they performed over each calendar year period. International companies have been the star of the last decade dominated by the US and particularly large technology companies. This trend continued in 2021 with the MSCI World ex Australia Index returning almost 30% over the last 12 months. After facing tough years during the GFC, Australian property performed well over the last decade. While the S&P/ASX 300 Real Estate Index struggled in 2020, it bounced back strongly in 2021 returning almost 25% and outperforming Australian equity markets. Large Australian companies also topped the list of asset class performance, however still returned substantially less than their international counterparts. Meanwhile, emerging markets (EM) and small companies have both underperformed equity markets broadly over the decade. Bonds and cash have underperformed equity and property for the 10 years and continued this weak performance in in 2021.

2021 proved to be much of the same as the last decade and equities are expected to continue to outperform in 2022; however, a changing economic environment makes it difficult to discern whether the future will continue to look like the recent past. Rising interest rates, rising inflation, and accelerating global economic growth each have the potential to disrupt the status quo of financial markets.

Source: Bloomberg Finance, JMFG

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total	
32.44%	48.03%	27.94%	12.66%	16.74%	27.09%	1.92%	27.97%	9.21%	29.58%	373.09%	**MSCI World ex Australia Index**
22.42%	21.54%	15.01%	11.80%	13.18%	20.00%	1.65%	23.99%	7.77%	24.97%	263.05%	**S&P/ASX 300 Real Estate Index**
21.00%	13.03%	10.37%	10.16%	12.50%	13.38%	1.52%	22.03%	5.73%	17.61%	183.70%	**S&P/ASX 100 Index**
16.74%	10.13%	6.93%	3.35%	11.72%	11.04%	0.46%	21.31%	5.09%	16.88%	140.59%	**MSCI Emerging Markets Index**
14.14%	8.67%	6.10%	2.33%	11.72%	8.54%	-2.19%	18.61%	4.62%	3.44%	115.14%	**S&P/ASX Small Ordinaries Index**
9.66%	2.87%	5.26%	2.14%	7.92%	6.90%	-2.35%	12.98%	0.77%	3.43%	113.18%	**Bloomberg Global High Yield Corporate Index**
6.53%	2.27%	2.69%	-0.87%	5.24%	3.68%	-5.10%	7.19%	0.37%	0.03%	57.38%	**Bloomberg Global-Aggregate Total Return Index**
3.97%	-0.76%	-3.80%	-4.30%	2.07%	1.75%	-8.69%	1.50%	-5.00%	-1.53%	21.23%	**BBG AUB Bank Bill**

JMFG Small Companies Strategy - December		ASX Small Ordinaries Index - December	
Best	**Worst**	**Best**	**Worst**
Mineral Resources (MIN)	Dubber Corporation (DUB)	Johns Lyng Group (JLG)	Imugene (IMU)
Pilbara Minerals (PLS)	Alcidion Group (ALC)	GrainCorp (GNC)	Sezzle (SZL)
Appen (APX)	Megaport (MP1)	Champion Iron (CIA)	Dubber Corporation (DUB)

Year In Review – *2021 Australian Market's Best and Worst*

The Australian market performed well in 2021 as it continued to recover from the March 2020 COVID drawdown. Remarkably, all major indices finished within 1% of each other with the ASX Small Ordinaries Accumulation Index (this Fund's benchmark) +16.9% at the lower end, the ASX All Ordinaries Accumulation Index +17.7% at the upper end, and the ASX top 20, 50, 100, 200 and 300 indices all in between.

The benchmark index recovered its pre-COVID high at the end of 2020 and spent the year establishing new highs in the face of the Delta and then Omicron COVID outbreaks, finishing approximately 14% above its pre-COVID high, but a couple of percentage points below its intra-year high. This sets 2022 up for another solid year in equity markets as the economy reopens and expands, though repeating the exceptional 2021 performance will be challenging and the market is expected to be more volatile as we transition to rising interest rates and as inflation threatens.

Looking closer at subsectors for 2021, it was interesting to note the divergence between the ASX Emerging Companies Index +43.8%, performing strongly due mainly to the strength of micro-cap resource stocks, and the ASX All Technology Index +3.7%, which was held back by larger capitalised tech names that de-rated as rate rise expectations were brought forward first by the market and then the respective central banks. Top-performing sectors in the ASX 200 Index were Telecommunications (+32.6%), REITs (+26.1%), Financials (+25.2%) and Consumer Discretionary (+24.3%). Middle of the pack were Materials (+13.9%), Industrials (+13.9%), Consumer Staples (+10.2%), Utilities (+9.8%), and Healthcare (+9.3%). Bringing up the rear were Energy (+0.5%) and Technology (-2.2%) which was the only negative sector this year. The best performers list in 2021 was dominated by battery metals stocks while the worst performers list was dominated by companies with stock-specific issues generally related to COVID.

Best Performers of the S&P/ASX Small Caps for 2021*

Novonix (NVX) +660% - Under new leadership, Novonix has expanded its focus into US-based advanced anode materials and now researching cathode materials, aiming to solve the inefficient and expensive 40,000km-long battery components supply chain problem currently faced by US industry.

Liontown Resources (LTR) +450% - Liontown owns the Kathleen Valley Lithium Project which it expects to develop to production by 2024 in time to meet forecast lithium supply shortages. The company expects to be a low-cost operation, targeting 6% lithium spodumene (SC6.0) production costs of US$314/dmt. Recently SC6.0 has sold for more than US$1,500/dmt, offering huge margins for Liontown if it can execute its strategy.

Imugene (IMU) +300% - Clinical stage immuno-oncology biotech company that had FDA Investigative New Drug approvals, strategic partnerships, capital raise and trial progress through the year.

Vulcan Energy (VUL) +277% - Lithium explorer in Europe and has been another major beneficiary of increasing projected demand for lithium and project development.

Pilbara Minerals (PLS) +268% - Pilbara owns the Western Australian Pilgangoora Lithium-Tantalum Project, one of the largest hard rock lithium deposits in the world and the largest pure-play lithium producer in Australia. During 2021 Pilbara announced various expansion plans for its operations. Pilbara has also run several digital auctions for excess spodumene selling 10,000dmt in October for a price of US$2,629dmt SC6.0.

Paladin Energy (PDN) +260% - Uranium miner with its existing Langer Heinrich mine on care and maintenance, but on the verge of restarting due to the rise in the Uranium price.

Johns Lyng Group (JLG) +191% - A building reconstruction firm that conducts insurance building repair work and has grown via acquisition and recently accelerated its expansion into the US via acquisition of Reconstruction Experts.

Ioneer (INR) +186% - Ioneer owns the Rhyolite Ridge Lithium Boron Project and has been another major beneficiary of increasing projected demand for lithium as the company progresses towards beginning mine construction.

Australian Ethical Investment (AEF) +176% - Listed Fund manager focusing on responsible investing which benefited from the increasing shift in funds to this theme in 2021.

Uniti Group (UWL) +160% - Uniti competes with NBN for the construction of FTTP networks and has seen strong increases in its contracted construction pipeline from which it can generate long-term ARR.

Worst Performers of the S&P/ASX Small Caps for 2021*

Nuix (NXL) -73% - Data analytics company that successfully listed late in 2020, Nuix disappointed the market, missing its prospectus forecasts at its first outing in February 2021.

Marley Spoon AG (MMM) -65% - Company lost its pandemic-boosted valuation growth with Woolworths announcing the sale of its $54M stake in the company.

PolyNovo (PNV) -61% - Unwind of high sales growth expectations for its synthetic wound care product for skin trauma (NovoSorb BTM) as sales were impacted by reduced access to hospitals during COVID. This was compounded by Hernia production delays and an unexpected CEO transition.

Electro-Optic Systems (EOS) -60% - Despite significant contract wins and news-flow before the pandemic, EOS more recently revised its guidance down, and is seeking to spin off its SpaceLink operations hoping to recover some of the sunk costs.

Appen (APX) -54% - Appen has continued to suffer alongside adverse sentiment across the high-PE end of the I.T. sector and adverse first-half headwinds which the company has assured the market will largely be remedied through its 2H order book strength.

Service Stream (SSM) -53% - Service Stream raised $185M to acquire Lendlease's Services, but otherwise revealed its business operations were not seeing growth in the current economic environment, despite contract wins, as the volume of activities per client were lower.

Kogan.Com (KGN) -53% - Online marketplace that unwound a COVID sales bump from 2020.

Mount Gibson Iron (MGX) -52% - Despite meeting production guidance, the company felt the pinch of rising costs and slumping iron ore prices.

Sezzle (SZL) -51% - Company finds itself in a now-crowded BNPL sector which is out of favour and under increased regulatory scrutiny.

Resolute Mining (RSG) -51% - Sector disinterest compounded company's issues with output shortfalls, change of MD and COO, and forecast AISC increases.

**Note - Based on Index membership on 31/12/21 – including PLS (graduated from the Index on 30/11/21). Fund holdings during the year in bold.*