Issue 81: January 2022

JM Financial Group

Australian Equities Strategy – Investment Newsletter

Performance *(As at 31st January 2022)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Australian Equities Strategy	**-8.2**	**-5.8**	**-0.2**	**+31.3**	**+77.9**	**+7.9**
All Ords Accumulation Index	-6.6	-4.4	+9.7	+36.0	+82.4	+8.2
Outperformance	**-1.6**	**-1.4**	**-9.9**	**-4.7**	**-4.5**	**-0.3**

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 January*

For the month of January, the JMFG Australian Equities strategy fell 8.2% as the market had its softest start to the year since 2010. The strategy underperformed the All Ordinaries Accumulation Index by 1.6% for the month, after outperforming last quarter. The market volatility anticipated in the last newsletter arrived in January, along with the latest virus variant, however confidence in the continued strength of the economy remains. Following a more difficult year, the Australian Equities portfolio is positioned for a recovery in sectors such as software, health care and battery metals, some of which have suffered profit taking in recent months. We remain confident that the strong themes underpinning these positions will result in a return to outperformance as the year unfolds.

The best-performing sectors for the broader Australian market in January were Energy, which rose by a substantial 7.9%, Utilities, which rose by 3%, and Materials which rose modestly by 0.8%. Overall, the rest of the market sectors fell away significantly through the month. The weakest sectors for January were also the weakest in December – Information Technology -18%, Health Care -12%, Consumer Staples -10%. Remaining sector falls were in the range from 6.5% to 9.5%.

During January, a few adjustments were made to the portfolio. Earlier in the month, profits were taken on a couple of positions that had performed well. As the market fell quickly later in the month, the opportunity to add back some market exposure was taken, as well as rotating out of more defensive names to take advantage of some large corrections within sectors where confidence remains... Resources, Energy, Healthcare, Discretionary, and, in early February, Technology.

The strongest performers for the portfolio during the month included:

- Woodside Petroleum +14%, BHP Group +12%, Worley +9%, and Jervois Global +8%

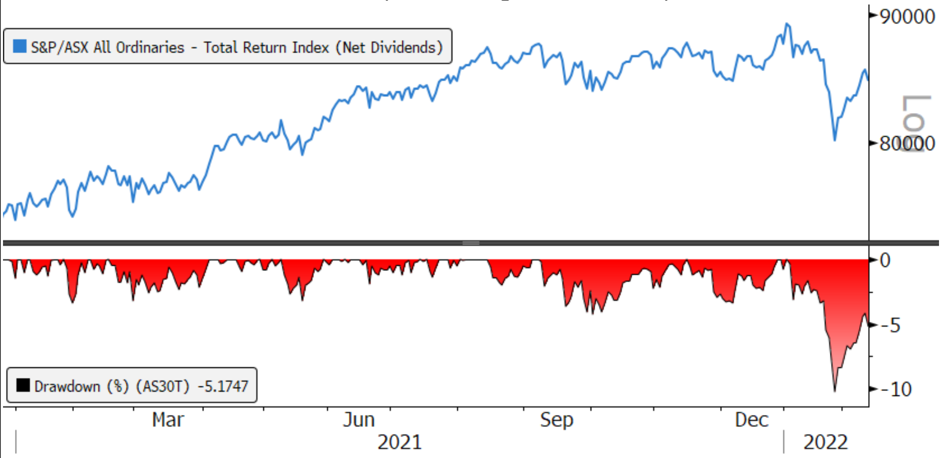
The weakest performers for the portfolio during the month included:

- Dubber Corporation -35%, Megaport -28%, Lotus Resources -21%, and Serko -20%

Chart of the Month – *January Drawdown*

Following a strong rally to all-time highs in December, the Australian market experienced its biggest fall since the March 2020 crash. The move appears to be driven by a number of factors including a pull-forward in interest rate hike expectations, rising inflation, growing geopolitical concerns with the Ukraine-Russia stand-off, the continued economic impacts of the global pandemic, and high equity valuations. The chart below shows this most recent fall and how it compares in size and speed with others over the last year.

The fall has had the biggest impact on growth companies with a low level of earnings relative to their current valuation. The suggested reason for this is that rising interest rates make these companies comparatively less attractive to value companies with a high level of current earnings relative to their valuations. However, the historic relationship between growth company valuations and interest rates is more unclear than this, with the relationship not holding across all time periods.



Source: Bloomberg Finance

Most interesting is that the recent pullback comes at a time of accelerating economic growth and broadly improving business conditions, albeit with some setbacks. In his February address, RBA Governor Philip Lowe highlighted that ***"the Omicron outbreak has affected the economy, but it has not derailed the economic recovery. The Australian economy remains resilient, and spending is expected to pick up as case numbers trend lower".***

An increasing number of attractive opportunities are appearing given the recent pullback and the strong economic backdrop. In early February, we have seen strong rallies in some names as investors are buying the dip.

JMFG Australian Equities Strategy - January		ASX All Ordinaries Index - January	
Best	**Worst**	**Best**	**Worst**
Woodside Petroleum (WPL)	Dubber Corporation (DUB)	Brainchip Holdings (BRN)	Redbubble (RBL)
BHP Group (BHP)	Megaport (MP1)	Legend Mining (LEG)	Anteotech (ADO)
Worley (WOR)	Adairs (ADH)	Champion Iron (CIA)	Dubber Corporation (DUB)

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

Woodside Petroleum (WPL) – up 14% for the month. Along with progress of its pending merger with BHP, Woodside announced 4Q results headline numbers showing production output up 2% to 22.6m BOE, sales revenue up 86% to US$2.85bn and average realised price per BOE of US$90 up 53% (vs previous quarter.) The company also noted it was withdrawing from Myanmar considering the country's deteriorating human-rights conditions since its recent military coup.

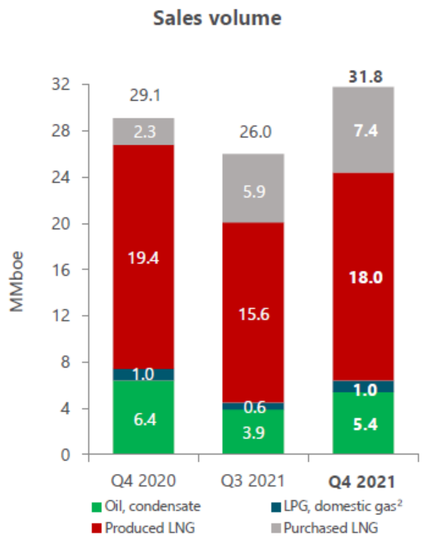
Brainchip Holdings (BRN) – up 110% for the month (Not held). Brainchip recently lodged a spate of announcements indicating its long-awaited, and potentially revolutionary, Akida Spiking Neural Network AI processing support chip was commercially available on mini-PCIe boards and in boxed kit units and was available to deliver expected high-volume orders for partners and customers to develop Next-Generation Edge-Based AI solutions.

Dubber Corporation (DUB) – down 35% for the month. Dubber reported solid growth in ARR to $52M with subscriber count now over 510,000, and significant service provider network agreements. However, a combination of overall tech sector sell-down through January and Dubber's quarterly cashflow numbers saw Dubber's share price continue to decline last month.

Redbubble (RBL) – down 46% for the month (Not held). Redbubble continues to unwind its pandemic-supported growth path, as revealed in its mid-January business update where the company lowered FY22 guidance to below FY21. Despite growing marketplace revenue and gross profit, increased underlying costs eroded EBITDA margins to negative single digits.

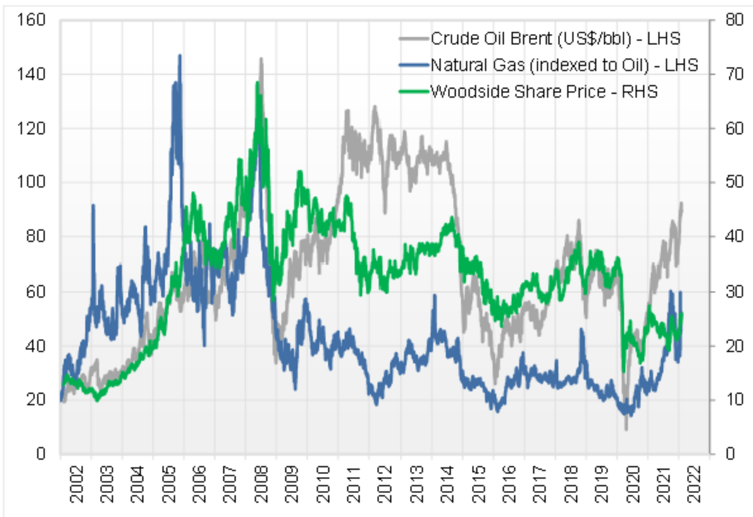
Due Diligence – *A closer look at a Company of Interest* – Woodside Petroleum Limited (ASX: WPL)

Woodside Petroleum (WPL) is a global explorer and producer of oil and gas assets and is one of the largest Australian listed energy companies, alongside Santos. WPL is finalising a merger with BHP Petroleum (expected second quarter 2022 following shareholder approval) which will increase scale and diversity, almost doubling its market cap and securing it as a top 10 global energy company. WPL has a mix of producing and exploration assets and its merger with BHP Petroleum is expected to provide over US$400m pa in synergies and allow expansion capital to be prioritised to the highest returning opportunities across the combined group assets. WPL recently approved final investment decisions for the Scarborough and Pluto Train 2 projects, significant projects that are not without risk, though have recently reduced exposure by selling a 49% non-operating interest in Pluto Train 2 to Global Infrastructure Partners. Longer term, WPL has committed to invest $5 billion in new energy products and lower-carbon services by 2030 to diversify the business into this emerging investment theme.



Source: WPL Quarterly Report

Oil and gas prices are linked to economic activity and can be volatile due to their strategic importance. Oil has spiked above US$100/barrel a handful of times in the last 150 years, linked mainly to geopolitical tensions constraining supply. The global economy's impact on demand is evident in the last two years where the COVID outbreak brought an almost immediate halt to global activity early in 2020 knocking the oil price from ~US$70 to below US$20 in the space of four months. Since then, it has trodden a steady recovery, recently trading above US$90, as central banks stimulated a strong economic recovery and global movement recommenced.



Source: FactSet, JMFG

In addition to increased demand, reduced supply has supported oil prices as i) OPEC struggled to make the promised supply increases (though it recently agreed to a 400kbpd increase at its February meeting), ii) strategic reserves have depleted, and iii) there has been a lack of investment in fossil fuels over the last decade leaving existing reserves depleted. Furthermore, there is risk of a spike in prices should the current geopolitical hotspots flare into more meaningful conflict. There is much discussion about the transition to "new" energy, to which JMFG strategies are well positioned, however there is room for "old" energy to continue to perform well in the near term as the transition plays out and the economy remains strong. Energy stocks have been left behind as oil and gas prices have rebounded strongly off lows, and the recent Omicron-induced 25% pullback in November presented an opportunity to add/top up energy exposure in various JMFG strategies.