JM Financial Group

Issue 81: January 2022

Leaders Strategy – Investment Newsletter

Performance *(As at 31st January 2022)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Leaders Strategy	**-5.4**	**-1.6**	**+7.3**	**+28.2**	**+63.8**	**+6.7**
ASX 200 Accumulation Index	-6.4	-4.3	+9.4	+32.3	+76.0	+7.7
Outperformance	**+1.0**	**+2.7**	**-2.1**	**-4.1**	**-12.2**	**-1.0**

Although the JMFG Leaders Strategy is generally representative of client portfolios, Individual performance may differ from th e 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 mana gement 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 Leaders strategy fell 5.4% as the market had its softest start to the year since 2010. The strategy outperformed the ASX 200 Accumulation Index by 1.0% for the month, continuing the recent trend which has seen outperformance in each of the last five months. The market volatility anticipated in the last newsletter arrived in January, along with the latest virus variant, however confidence in the strength of the economy remains. The portfolio is positioned to take advantage of some of the longer-term investment themes favoured by the market lately, although further volatility is expected as reporting season gets into full swing.

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 sectors 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 been performing 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, and, in early February, Technology.

The strongest performers for the portfolio during the month included:

- Woodside Petroleum +14%, BHP Group +12%, Worley +9%, and IGO +2%

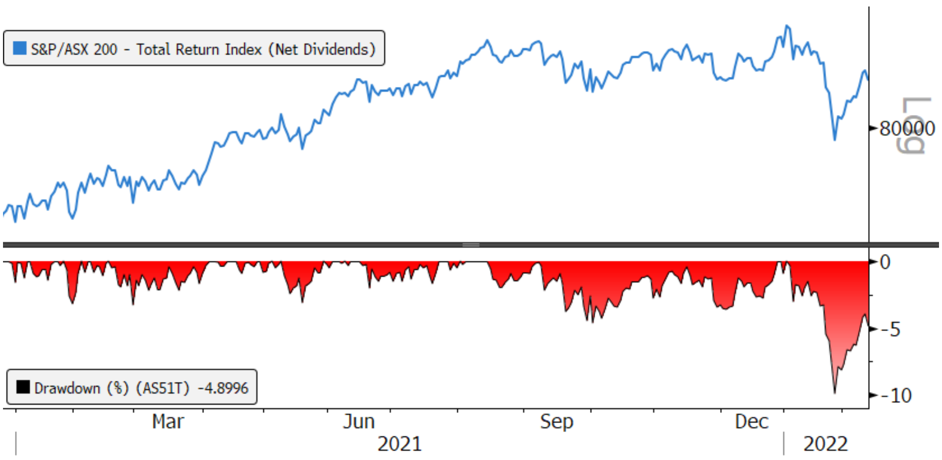
The weakest performers for the portfolio during the month included:

- Megaport -28%, Xero -20%, Goodman Group -12%, Ramsay Healthcare -12%

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 Leaders Strategy - January		S&P/ASX 200 Index - January	
Best	**Worst**	**Best**	**Worst**
Woodside Petroleum (WPL)	Megaport (MP1)	Champion Iron (CIA)	Pointsbet Holdings (PBH)
BHP Group (BHP)	Xero (XRO)	Beach Energy (BPT)	Megaport (MP1)
Worley (WOR)	Sonic Healthcare (SHL)	AGL Energy (AGL)	Pro Medicus (PME)

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.

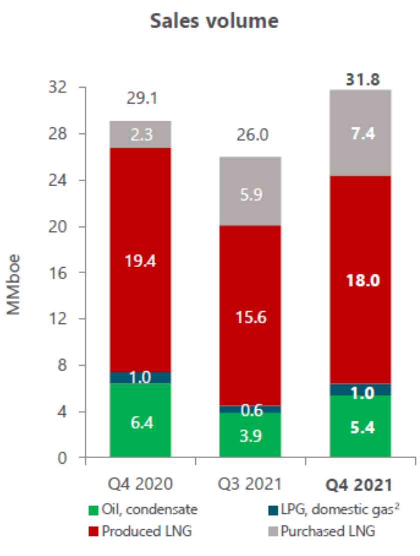
Champion Iron (CIA) – up 19% for the month (Not held). Champion reported continued strong production numbers in its results announcement, featuring Q3 iron ore concentrate production rising by over 5% to 2M tonnes, the advancing of the Bloom Lake Phase II Expansion Project, and the declaration of the company's inaugural dividend payment.

Megaport (MP1) – down 28% for the month. Part of the broader IT sector sell-off in January. Megaport shows good progress in its market penetration and expansion plans, including new entry into Mexican cloud services, however, there are some short-term management concerns illustrated by shareholders rejecting all resolutions at the recent EGM held to approve the granting of Options to Directors.

Pointsbet Holdings (PBH) – down 31% for the month (Not held). Pointsbet reported strong ongoing growth in active clients over the past twelve months, but disappointed with its disproportionate jump in expenses. High valuation IT stocks were being sold off generally through January, and this is amplified when such stocks fall short of lofty expectations.

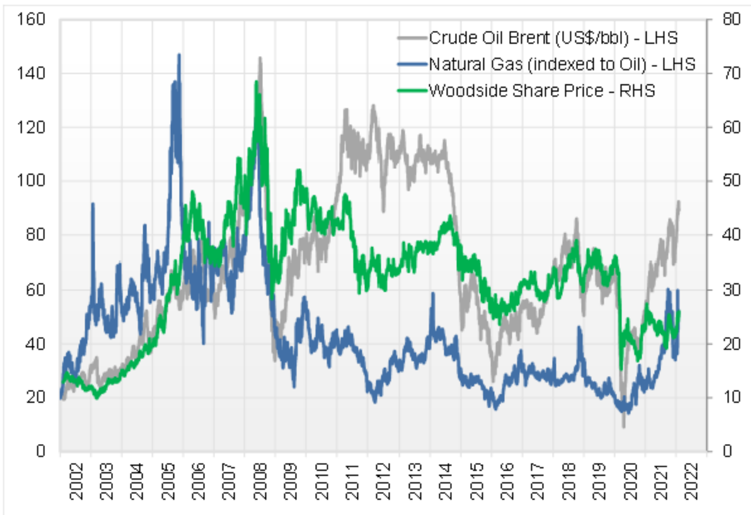
Due Diligence – *A closer look at a Company of Interest* – Woodside Petroleum Limited (ASX: WPL)

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.