Frame Funds.

In the Frame

Keeping you up to date with Frame Funds and financial markets.

July 2021 // Issue 6

The rise of the USD

IMPLICATIONS

REPORTING SEASON POSITIONING
Which companies saw investor flow before reporting season

US DOLLAR STRENGTH
Which ASX listed companies benefit

What I saw in June 2021

REPORTING SEASON, CHINA DELEVERAGING, NEW INTERNS

Global equity markets continued to grind higher in June, with tech stocks rotating back into favour at the expense of cyclical stocks.

The US Federal Reserve sparked a brief sell-off in global markets, as they brought forward their expectations for tapering and the increase of interest rates. The news was soon disregarded as numerous Fed speakers reiterated that increases in interest rates would not happen any time soon.

Reporting season positioning

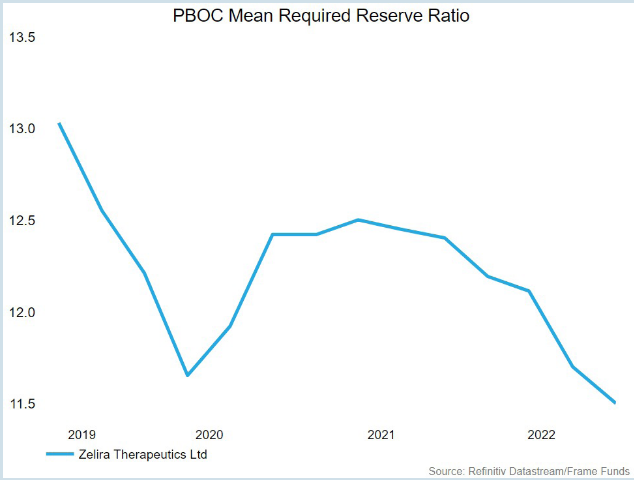
The long short Australian equity strategy finished the month up +3.51%, versus the S&P/ASX 200 (XJO) +2.11%. We saw market participants begin to position themselves for the upcoming reporting season. This resulted in our best performing investment move into extreme over-bought states.

The Global Macro strategy had a flat month, it finished +0.04%. I was happy with this performance considering the jump this strategy had over the quarter.

The long short Australian equity strategy finished the quarter +5.56% and 6-months +11.40%. The Global Macro strategy had an excellent quarter and financial year. It finished the quarter +13.27% and +30.58% for the financial year.

Chinese market deleveraging

Across the globe, central banks and governments have provided extreme levels of accommodation and stimulus to ignite growth. China on the other hand has been deleveraging. The result? The China A-50 share market is approximately 18% from recent highs, while other global markets are at all time highs. At the tail end of June, the People's Bank of China changed their tightening stance and cut their banks Required Reserve Ratio (RRR) to support growth. This change may provide a signal to the market that they will step in if Chinese and global growth slows.



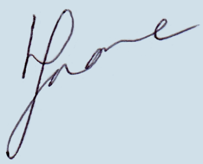
New interns

In June, we hired two high quality interns who are going to be with Frame Funds for the next 12 weeks. Sydney is in his penultimate year studying Bachelor of Commerce, majoring in Applied Mathematics and Finance, while Owen is in his second year of a Bachelor of Commerce and Advance Studies. They are both studying at the University of Sydney.

Outlook

I have written about the upcoming reporting season in the last few issues of In the Frame as it is such an important catalyst for our strategies. It is now upon us and I look forward to seeing what opportunities present themselves over the next month, as well as watching the performance of our individual investments.

If you would like to discuss any of these points, please email me at hue@framefunds.com.au or call our office on 02 8668 4877.



Hue Frame
Managing Director

The rise of the United States Dollar

WRITTEN BY HARRY HEANEY

Implications

The US Dollar (USD) is the most influential currency on earth and its relative strength or weakness has far reaching implications for the global economy. This piece will discuss why we are bullish on the USD and potential trades that may benefit as a result.

What is causing strength in the USD?

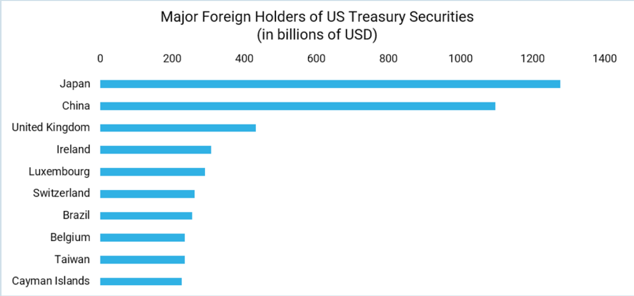
The United States economy has rapidly recovered from the COVID-19 pandemic, aided by the unprecedented level of stimulus from the US government and the Federal Reserve. Inflation and production data have continued to signal increasing strength in the US economy, which prompted the Federal Reserve to bring forward its timeline for increasing interest rates.

Money has flowed into the USD, as investors have positioned themselves in anticipation of the comparatively higher rate of return being offered sooner than expected. The Federal Reserve's tightening timeline is also shorter than its European and Japanese counterparts.

Implications of USD strength?

The US dollar is usually negatively correlated with commodity prices, meaning as the dollar increases in value, commodity prices decline. This is because commodity prices around the world are predominantly quoted in USD – a stronger USD means commodities are more expensive in terms of other currencies. This leads to lower demand and therefore lower prices. While the supply and demand for the underlying commodities have a major impact on prices, a strong dollar may put a dampener on commodity prices.

Emerging markets also suffer when the US dollar gains in value. Emerging economies like Brazil have high levels of exposure to US debt and when the Real is devalued relative to the dollar, the monetary value of debt increases. This means more money is diverted out of emerging economies to service their debt obligations, which results in slower economic growth.

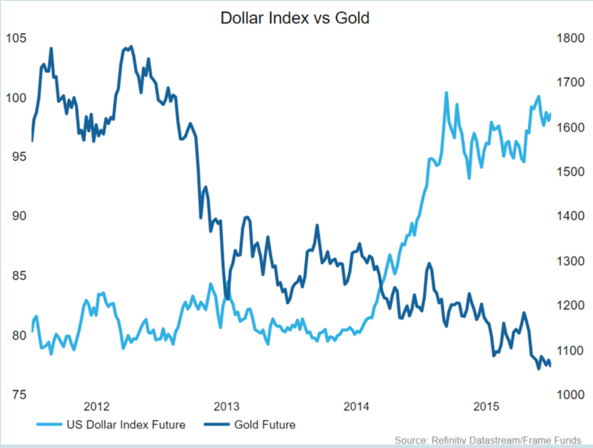


Australian exporters to the US will also be beneficiaries of a stronger USD. Their goods and services become less expensive in US dollar terms and are therefore more attractive in the US market.

Similarly, Australian based companies that have a substantial amount of business in the United States will report better in Australian Dollar terms. A weaker AUD/USD relationship will mean US based earnings are higher when converted into Australian dollars.

Trade Ideas

- Short gold – gold and the US dollar tend to have a strong negative correlation. As the US economy continues to recover and the Dollar appreciates, we would expect gold to decline in value. From September 2012 to January 2015 when the Dollar Index rose 18.71%, gold sold off 21.82%. During that time, the Federal Reserve had begun winding back its quantitative easing program that supported the economy throughout the GFC. We expect to see a similar environment in the next few years with the Fed slowly becoming more hawkish as the economy recovers.



- Short emerging markets – as debt burdens in countries like Brazil increase, we expect their economy to be adversely impacted. This should lead to slower growth and increased volatility in the benchmark Bovespa Index.

- Long ASX listed companies that do significant amounts of business in the US. James Hardie Industries (**ASX:JHX**), Mayne Pharma (**ASX:MYX**) and Aristocrat Leisure (**ASX:ALL**) generate 80%, 85% and 66% of their revenue in the United States respectively. The earnings of these companies will be inflated with a stronger US Dollar and should appreciate commensurately.

- Long exporters to the US – companies that export to the United States will have their products appear cheaper in USD terms. BlueScope Steel (**ASX:BSL**) exports steel into the United States and should see a boost in sales as their product becomes less expensive for its North American Operations.

Conclusion

As the United States economy strengthens and the recovery from the pandemic continues, we are seeing an increasing number of similarities to the post-GFC recovery which occurred during 2012.

Some of these include a more hawkish Federal Reserve, the effects of fiscal stimulus finally flowing through the economy and a stronger US dollar.

We believe the similarities from the period mentioned above are far from over, and expect the US Dollar to continue to rise in the coming months and years. This appreciation may hinder extreme commodity price rises whilst also impacting some emerging markets.

We also expect the earnings of Australian companies who do business in and export to the United States to benefit from this theme.

Global Macro

HUE FRAME
Portfolio Manager

HARRY HEANEY
Research Analyst

WRITTEN BY HUE FRAME

Frame Futures Fund

Units of the Frame Futures Fund increased by +0.04%. The core strategy detracted -0.36% to performance, whilst the trading strategy added +0.63%. Equity investments contributed +0.17%. Currency and Fixed Income investments rose by +0.32% and +0.24% respectively, while Commodity investments were lower by -0.46%.

Global equity markets continued to move higher during the month, however domestically the S&P/ASX 200 experienced a period of volatility once again. At the end of May, the index options market saw a significant spike in open interest in short-dated out-of-the-money calls with strikes at the 7300-point level. To hedge this open interest market makers must hedge their positions (by buying the index), which meant the market rose with broad sector participation. On expiry, the majority of the open interest was rolled to further out-of-the-money July and August expiries, meaning at some stage during July & August, we may see a repeat of this upside volatility.

Towards the end of the month, minutes from the May FOMC meeting sparked a brief selloff in global equity markets as the Fed brought forward its tapering expectations. The market subsequently cooled and became rangebound for the remainder of the month.

Largest contributors to the performance were our active trading strategies on the S&P/ASX 200 future contract (+2.14%), our investment in Aeris Resources Ltd (+0.61%) and our investments in rare earth and battery material businesses (+1.68%). The largest detractor to performance was our investments in the China A-50 future contract (-0.81%).

In terms of Fund activity, we continued to take advantage of the latest Australian lockdowns due to COVID-19 and accumulated investments in 're-opening' businesses, took advantage of mispricing within some junior tech companies and trimmed some global equity exposure.

At the conclusion of the month, the Fund held 30 investments.

FUND PERFORMANCE as at 30th June 2021

	1 month	3 months	6 months	1 year
Frame Futures Fund	**+0.04%**	**+13.27%**	**+7.36%**	**+30.58%**
RBA Cash Rate + 3%	+0.25%	+0.77%	+1.55%	+3.20%
Excess Return	**-0.21%**	**+12.50%**	**+5.81%**	**+27.38%**

Past performance is not an indicator for future performance. This is not intended to be financial advice and does not take into account any particular person's circumstances. Before relying on this information, please speak to an independent financial adviser.

Australian Equities

HUE FRAME
Portfolio Manager

HARRY HEANEY
Research Analyst

WRITTEN BY HARRY HEANEY

Frame Long Short Australian Equity Fund

Units of the Frame Long Short Australian Equity Fund increased +3.51% in June. Comparatively, the S&P/ASX 200 rose +2.11% for the period.

June was an interesting month for global markets as most major equity markets continued to move higher, however the divergence seen between the Dow Jones Industrial Average and the Nasdaq was significant once again. Last month, money flowed through to large cap tech stocks rather than banks and industrials, which was the opposite seen in prior months. 30-year US treasury yield continued to decline, which provided support to this trade.

Top equity contributors were Mineral Resources Limited (**ASX:MIN**), Brickworks Limited (**ASX:BKW**) and Reece Limited (**ASX:REH**) which all appeared to benefit from investors positioning before reporting season. Their approximate contributions were +1.00%, +0.96% and +0.93% respectively. Discretionary trading activity in the ASX200 SPI futures contract contributed +1.95%.

Oz Minerals Limited (**ASX:OZL**) was the weakest performer, detracting -0.65%. It experienced profit taking off the back of selling in copper. The sell-off was due to China talking about releasing their reserves to calm prices. We expect this to be a temporary measure to ease short term price concerns and remain bullish on global long-term copper demand. Nuix Limited (**ASX:NXL**) continued to be sold off as governance and legal complications persisted over its IPO. It detracted approximately -0.28%. Codan Limited (**ASX:CDA**) also detracted approximately -0.18% after one of the Directors sold down some of their holdings.

In terms of fund activity, advances in our materials names increased our weighting in the sector to 44.25%. We continue to believe companies in this sector will continue to perform well into the upcoming reporting season. Trading opportunities arose in Tesserent Limited (**ASX:TNT**) after they increased earnings guidance for the 2021 financial year. We also capitalised on broader market moves through ASX200 futures exposure.

At the conclusion of the month, the Fund held 22 investments.

FUND PERFORMANCE as at 30th June 2021

	1 month	3 months	6 months	CYTD
Frame Long Short Australian Equity Fund	**+3.51%**	**+5.56%**	**+11.40%**	**+11.40%**
RBA Cash Rate + 3%	+0.25%	+0.77%	+1.55%	+1.55%
Excess Return	**+3.25%**	**+4.78%**	**+9.85%**	**+9.85%**

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RAYMOND YIN
Equities Trader

Stocks in Play

WRITTEN BY RAYMOND YIN

Rising USD Stocks in Play

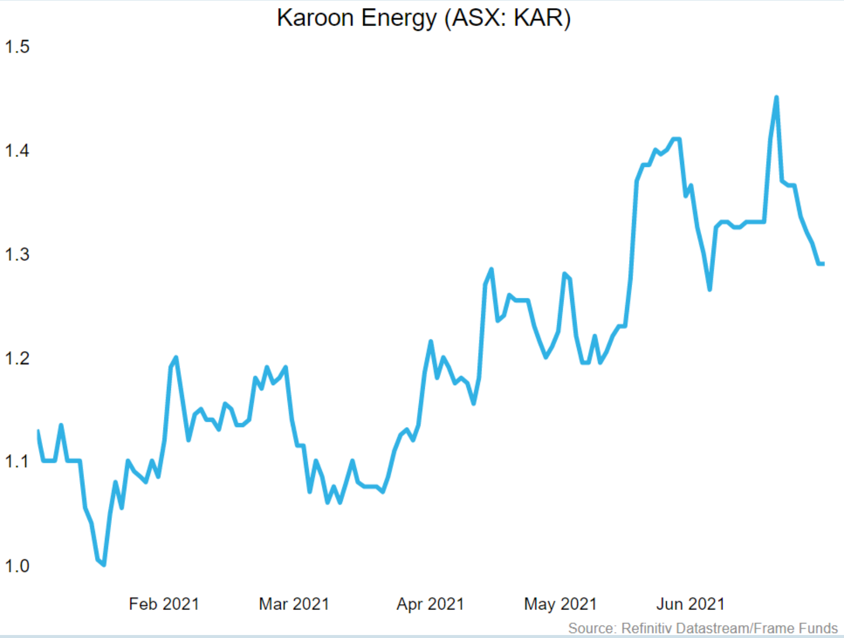
Following on from our market insight regarding the rise of the USD, we have identified several key sectors on the ASX which may benefit this theme.

Firms listed on the ASX that generate a significant portion of their earnings in the United States, will see their balance sheets grow in AUD terms. Domestic exporters to the US will also benefit as their goods and services become more affordable in USD terms. Australian commodity producers who have their underlying assets quoted in USD will also be favoured by a stronger USD.

This issue of stocks in play will focus on the latter of the identified sectors.

As the price of oil and gas is denominated in USD, local businesses that sell internationally will generally benefit from a rising USD. A stand-out in the oil and gas sector has been Karoon Energy Limited (**ASX:KAR**).

Karoon has performed strongly over recent months and has shown historically higher correlation to oil and gas prices compared to other ASX listed competitors. Since March 2020, KAR has been in a strong uptrend, which has seen seen their share price rise from lows of $0.34 to $1.33 on the 30th June.



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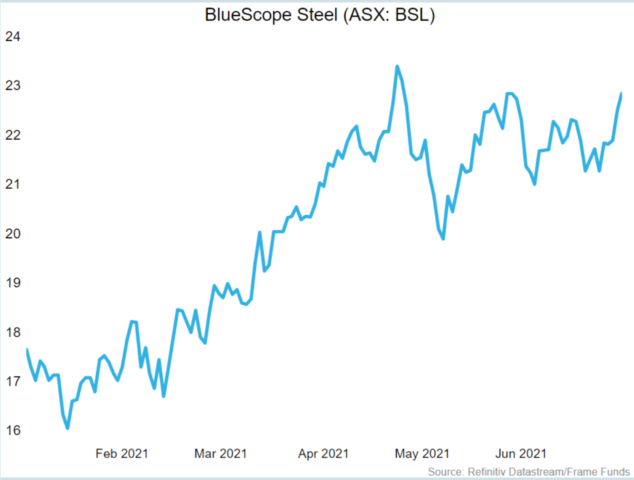
On the 8th of July Karoon changed its report currency to USD. Since KAR have an Australian dollar denominated cost base, a stronger USD will boost the value of assets in AUD terms and decrease costs for reporting purposes, thus expanding their margins. This could be a catalyst that continues to assist the share price.

Another possible stand out that may benefit from a strengthening USD is Bluescope Steel (**ASX:BSL**). Bluescope has seen a strong resurgence post the COVID-19 crash. It has risen approximately 150% since April 2020. As a big component of their business is exporting to the United States, a continued strengthening of the USD should benefit BlueScope for upcoming reporting seasons.



In their recent company update, (released April 27th 2021) earnings guidance for BSL was increased for the 2H of FY2021 from $1b to $1.08b. This increase saw their price touch $24. We expect as the USD continues to rise, the earnings of BSL will expand in AUD terms, which may act as a catalyst to drive its share price higher.

As we move out of the previous financial year and into the reporting season, the market will be flooded with financial data. With the USD continuing to strengthen, we expect to see many companies with a presence in the United States market benefit.

Frame Funds.

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