Frame Funds.

In the Frame

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

January 2022 // Issue 12

Inflation

ACTION NEEDED

FUND PERFORMANCE

How our strategies performed in December

TAPERING

What the US Federal Reserve is planning to do to cool inflation

What I saw in December 2021

TAPERING, US INFLATION, OMICRON

December was a month that was very typical of what had been seen over the course of the whole year. We saw periods where the market lacked direction and traded sideways. Which was soon followed by brief periods of enthusiasm, where the market rose swiftly over a short period of time. The S&P/ASX 200 finished the month up +2.6%, and a 2021 total return of +13.01%. The S&P/ASX 200 was up +10.95% by 30th June, which demonstrates this lack of trend for the second half of the year.

Omicron variant

Cases of the new COVID-19 variant, Omicron, surged globally. Cases exceeded 1m a day and since the end of December, have continued to surge. The US alone is seeing >1.3m cases a day. Within Australia, cases have continued to swell, however most states have continued to press on with their reopening plans. NSW reimposed some restrictions, however it seems that people are naturally taking additional precautions with so many cases in the community.

Tapering acceleration

Markets were volatile during the month of December as investors positioned on the uncertainty that the US Federal Reserve may or may not accelerate their bond tapering. Fed Chair Jerome Powell confirmed they would accelerate their tapering efforts, which was viewed positively by the market as it shows they are proactively attempting to control inflation.

US inflation & employment running hot

December saw the United States report Consumer Price Index (CPI) data. It showed a month to month change of 0.8%, or 6.8% year-on-year. This figure, in combination with the US labour market approaching full employment, has policy makers on their toes. At the time of writing, market expectations are for tapering to end by March, as well as three interest rate increases. We think that it seems unlikely that both of these things will happen (and stay there by the end of the year).

Portfolio performance

During December, we saw excellent performance from both our strategies. Our global macro strategy had a superb month, it rose +5.62%. The Long Short Australian Equity strategy also outperformed; it rose +7.45%.

The Frame Futures Fund (FFF) had another good month of performance. The core strategy had a solid month of performance, it generated +2.57%, while trading strategies added +2.93%.

Largest contributors to performance were our investments in listed iron ore producers (+2.64%) and our active trading strategies on the S&P / ASX 200 Future contract (+4.50%). Our investment in the China A50 was our largest detractor (-1.23%).

The three & 12-month performance of the FFF continues at a solid +13.49% and +18.08%.

The Frame Long Short Australian Equity Fund (FLSAEF) had a superb month of performance, it rose +7.45%. After consolidating near highs for the prior four months, the strategy closed the year strongly, with numerous companies within the portfolio hitting new 52-week highs.

Top equity contributors were Lynas Rare Earths Ltd (ASX: LYC), Grain Corp Ltd (ASX: GNC) and Way point REIT Ltd (ASX: WPR). They contributed +0.78%, +0.68% and +0.45% respectively. Active trading strategies generated +3.67% for the month. Largest detractors were Pilbara Minerals Ltd (ASX: PLS), Kalium Lakes Ltd (ASX: KLL) and James Hardie Industries (ASX: JHX).

The three and 12-month performance of the FLSAEF continues at a solid +5.02% and +13.13% respectively.

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

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An interview with Hue Frame

INTERVIEWED BY HARRY HEANEY

This market insight is an interview with Hue Frame, Founder of Frame Funds. He answers a selection of questions from investors, which we hope will provide further insight into 2021 and our outlook for the upcoming trading year.

1. How did 2021 compare to your expectations?

Well, we were very bullish on equity markets for 2021 and thought that it would be the year that governments and central banks attempted to 'reflate' their economies. Outside of Australia it was certainly a big year of performance, with the S&P500 rising ~27% for the year.

We did expect it to be a year that produced above average returns, but the performance of the S&P 500 exceeded our lofty expectations. The Australian market had a superb first half of the year but lacked direction in the second half which was a little unexpected.

2. What was your best and worst investment of the year for the Frame Futures Fund?

Best performer for the year for the Frame Futures Fund was by far our investments in the battery material space. Although the basket of companies we owned performed well, the outstanding performer was Liontown Resources (ASX: LTR).

The worst investment for the year was our position in the China A50 futures contract. Over the course of the year, the Chinese government adjusted regulations surrounding their share market and individual sectors within their markets (education, financial services, insurance and marketplaces, to name a few).

At the tail end of the year, they attempted to cushion the blow with a loosening of their financial conditions, however this failed to provide the catalyst needed. Their actions over the course of the year have nearly made the market infeasible as an investment.

3. What was your best and worst investment of the year for the Frame Long Short Australian Equity Fund?

I would say that our best and worst investment was Fortescue Metals Group (ASX :FMG). Fairly close to the time when we initially invested in FMG, the Chinese government started to talk down iron ore and steel prices prior to the Winter Olympics. Iron ore subsequently fell over 50%.

As a result, FMG sold off aggressively – it dropped from ~$26 to lows of ~$14. At its October lows, FMG was our worst investment of 2021. Fortunately, we added significantly to our position during October & November lows at the $14-$15 level. This meant we capitalised on a more than 35% rally throughout late November and December.

4. Biggest lesson from 2021?

That price is king. Reflecting on our investment in China for the Frame Futures Fund, we completed extensive research from both a fundamental and technical perspective, however the market just didn't want to turn. The takeaway from this is that price action is a key input to the timing of our investments and that we should always focus on price action to determine if we are on the right side of the money flow.

5. Are you bullish or bearish on equity markets for 2022?

We are net bullish for equity markets for 2022, however think there may be a lot more volatility along the way (compared to 2021). That being said, it depends on what happens with inflation globally. Our focus is on the action of central banks to slow inflation, and what impact this has on global growth.

6. You identified the battery material theme in 2019, what is your outlook for that theme now?

Well, we have continued to see demand for these components accelerate, even as supply is brought to market. Our view is that the next stage of this secular theme is the consolidation and integration, both vertically and/or horizontally across the supply chain. We saw it with the Galaxy and Orocobre merger (now named Allkem) and expect it to continue to happen this year. This is a key theme for us, and we will continue to be heavily involved in it for the foreseeable future.

7. What is your outlook for US interest rates for 2022?

Our expectations are that we may see one or two this year. Although inflation is running hot and the Fed needs to reel it in, they must be careful due to the amount of leverage in the market. The last thing they want to do is increase rates too quickly and squash growth, which has been somewhat sluggish since the GFC. US midterms in November are another consideration, so pressure from the White House will most likely be to increase rates somewhat aggressively earlier in the year but to provide accommodation around election time.

8. What do you think are the biggest risk to markets for 2022?

Inflation. Consumers expect prices will rise by 5.7% over the next 12 months. Our view is that inflation is both realised and expected. If consumers expect prices to rise at an ever-increasing rate, then they will adjust their spending habits accordingly which ultimately becomes self-fulfilling. If inflation continues to run a lot hotter than the Fed expects, they will be forced into increasing rates abruptly. The net result of this policy will be headwinds for equity markets.

HUE FRAME
Portfolio Manager

HARRY HEANEY
Research Analyst

Global Macro

WRITTEN BY HUE FRAME

Frame Futures Fund

Units of the Frame Futures Fund appreciated by +5.62%. Both strategies contributed positively. The Fund's trading strategies added +2.93%, while the core strategy added +2.57%.

Equity investments were the stand-out performer again, they contributed +7.69%. Currency and Fixed Income investments were flat, while Commodity investments detracted -1.32%.

During December, we saw two-way volatility that presented several excellent opportunities, which both strategies took advantage of. Markets swung lower at the start of the month, as investors repositioned on the uncertainty that the US Federal Reserve may or may not accelerate their bond tapering. During the FOMC meeting, Jerome Powell confirmed they would accelerate their bond tapering which was viewed positively by the market. We view an increase in the speed of their tapering as positive, as it allows them to have more control over inflation, while also providing additional ammunition if growth slows over the next 2 years. Interest rate markets are also pricing in three rate hikes during 2022, which in our view is unlikely (inflation dependent). Fixed income and currency markets continued to lack direction, while commodity markets were volatile but presented little opportunity. The number of Omicron cases exceeded 1m a day during December, however investors seem to have decided that the new strain is a blessing in disguise, as it is more transmissible and less severe.

Largest contributors to performance were our investments in listed iron ore producers (+2.64%) and our active trading strategies on the S&P/ASX 200 Future contract (+4.50%). Our investment in the China A50 was our largest detractor (-1.23%).

In terms of fund activity, we continued to add to our existing Nickel exposure, trimmed our digital currency exposure, and closed our listed iron ore producer exposure. We took advantage of two-way volatility in global equity indices near the start of December. These investments where shorter term in nature and paid off handsomely by the end of the month.

At the conclusion of the month, the Fund held 17 investments.

FUND PERFORMANCE as at 31st December2021

	1 month	3 months	6 months	1 year
Frame Futures Fund	**+5.62%**	**+13.49%**	**+9.98%**	**+18.08%**
RBA Cash Rate + 3%	+0.26%	+0.77%	+1.56%	+3.14%
Excess Return	**+5.36%**	**+12.72%**	**+8.42%**	**+14.94%**

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Australian Equities

HUE FRAME
Portfolio Manager

HARRY HEANEY
Co-Portfolio Manager

WRITTEN BY HARRY HEANEY

Frame Long Short Australian Equity Fund

Units of the Frame Long Short Australian Equity Fund increased +7.45% in December. Comparatively the S&P/ASX200 rose +2.60% for the month.

December saw the Omicron variant spread rapidly across Australia, as New South Wales, Victoria and Queensland pressed ahead with reopening plans. Markets trended higher despite this, as policy makers continued to push a 'living with the virus' mentality. RBA Governor Lowe said the central bank has adopted a 'wait and see' mindset with regard to tapering and interest rate increases. The market will have to wait until the February meeting to see if asset purchases will continue, slow or completely stop.

We began the month exiting positions in Oil Search Ltd (ASX: OSH) as the oil price fell significantly, and Pilbara Minerals (ASX: PLS) as it entered an extreme overbought state. These positions were replaced with GrainCorp Ltd (ASX: GNC) and Sonic Healthcare Ltd (ASX: SHL). Sonic was primed to benefit from increased COVID-19 cases in the community, while GrainCorp is positioned to profit from continuing supply chain squeezes. We also opened a position in James Hardie Industries (ASX: JHX) as strong demand for building materials looks set to continue.

Top equity contributors were Lynas Rare Earths Ltd (ASX: LYC), GrainCorp Ltd (ASX: GNC) and Waypoint REIT Ltd (ASX: WPR). They contributed +0.78%, +0.68% and +0.45% respectively. Lynas continued its stellar performance, confirming the rare earth theme is still very much in play. Waypoint benefited from higher inflation and interest rate expectations, while GrainCorp rose off the back of higher commodity prices caused by supply chain issues. Active trading strategies generated +3.67% for the month.

Largest detractors were Pilbara Minerals Ltd (ASX: PLS), Kalium Lakes Ltd (ASX: KLL) and James Hardie Industries (ASX: JHX) which detracted -0.48%, -0.23% and -0.15% respectively. Pilbara was caught in some volatility at the start of the month, while Kalium Lakes fell after they downgraded CY2022 harvest guidance. James Hardie continued to consolidate near highs. Materials continues to be the highest weighted sector at 23.67% with utilities the only sector where we have no exposure.

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

FUND PERFORMANCE as at 31st December 2021

	1 month	3 months	6 months	1 year
Frame Long Short Australian Equity Fund	**+7.45%**	**+5.02%**	**+1.56%**	**+13.13%**
RBA Cash Rate + 3%	+0.26%	+0.78%	+1.57%	+3.14%
Excess Return	**+7.19%**	**+4.24%**	**-0.02%**	**+9.99%**

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HARRY HEANEY
Co-Portfolio Manager

Stocks in Play

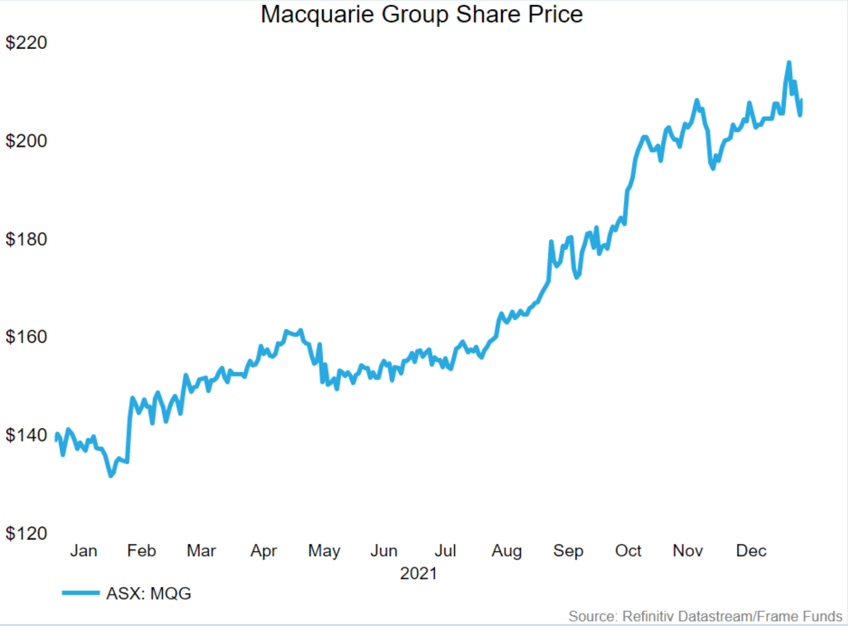
WRITTEN BY HARRY HEANEY

Over the second half of 2021, the Frame Long Short Australian Equity Fund core portfolio underwent a significant reorientation. The systematic system exited positions in materials businesses in response to the Chinese economic slowdown and has since become a more diversified portfolio. The new investment themes the Fund has allocated into include high inflation/rising interest rates, supply chain stress and rare earth/battery metal undersupply. Below is a selection of companies which the Fund has purchased to capture the themes mentioned above.

Macquarie Group (ASX: MQG)

Macquarie has been a standout of the Australian financial sector in FY22. After logging solid 2021 financial year and 2022 half year interim reports, they raised $1.5 billion to fund further growth. With new investments on the horizon and higher interest rates expected soon, Macquarie seems to be perfectly poised for further growth. Their Banking and Financial Services lines of business should experience margin growth, while their Commodities/Global Markets business should profit from the extra cash available for investment.

Macquarie's upcoming HY22 results presentation will provide the company with a good opportunity to announce new investments and projects, especially in the green energy space.

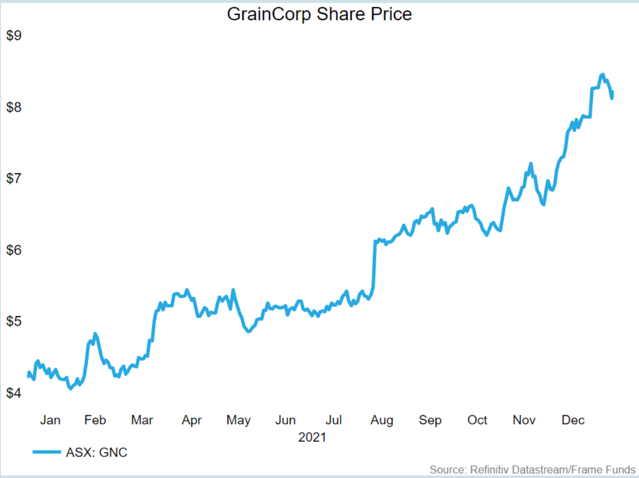


GrainCorp (ASX: GNC)

GrainCorp provides grain storage, handling, processing, and supply services to customers in over 50 countries. The efficiency of their end-to-end supply chain infrastructure assets in the face of difficult conditions, saw the value of the company almost double over the course of 2021.

In addition to strong supply chain management, solid harvest numbers and some favourable weather has meant their grain storage business continues to flourish.

Their FY21 report released in November also pointed towards profitable conditions continuing for the 2022 financial year. This included sustained strong demand for Australian grain, and the ability to store more product with their 'flex' sites. The next catalyst will come at GrainCorp's AGM in February where they will provide FY22 guidance.



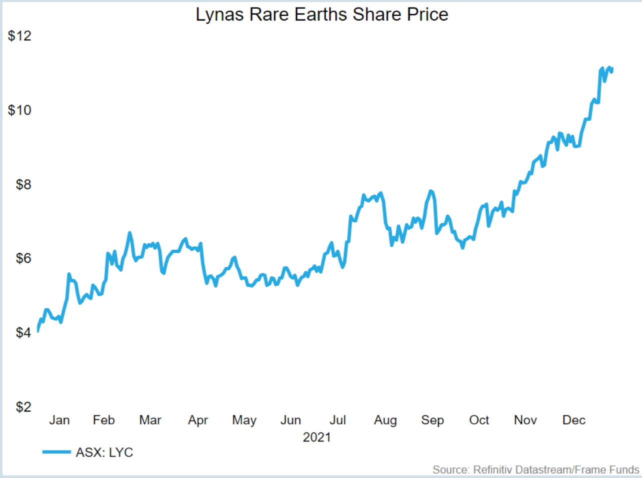
Lynas Rare Earths (ASX: LYC)

Lynas is a miner and producer of rare earth elements and is the world's only significant producer of separated rare-earth materials outside of China. There are multiple tailwinds at play that have resulted in the value of the company increasing in excess of 150% in 2021.

Firstly, there is a global shortage of rare earth elements. These elements are key inputs in the manufacture of future technologies like wind turbines and electric vehicles – areas of the economy where demand is increasing rapidly. This supply/demand imbalance has made Lynas's Mt Weld rare earth deposit significantly more valuable.

Another factor playing in Lynas's favour is increasing tension between Western nations and China. China currently provides more than 85% of the world's rare earth elements, so the globe is heavily reliant on a benevolent China to sustain rare earth supply. As trade wars play out and the possibility of conflict over Taiwan continues to mount, many Western countries have attempted to decrease reliance on China. As Lynas is the only significant rare earth producer outside of China, they have a monopoly on the supply of these critical minerals.

We expect both of these factors to continue to develop and Lynas to appreciate as a result.



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