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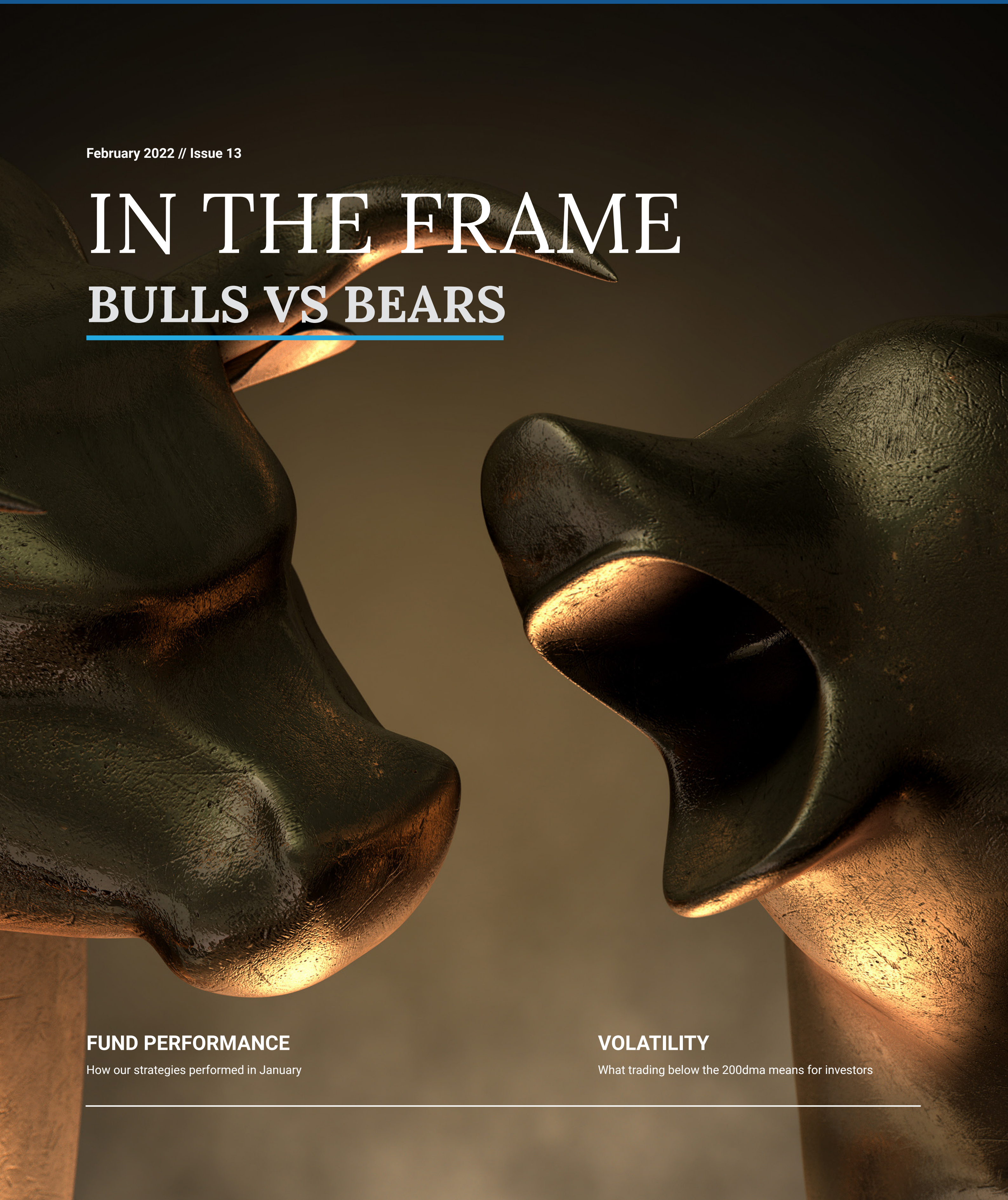


February 2022 // Issue 13

IN THE FRAME

BULLS VS BEARS

FUND PERFORMANCE

How our strategies performed in January

VOLATILITY

What trading below the 200dma means for investors

WHAT I SAW
JANUARY 2022

WRITTEN BY HUE FRAME

In this issue of 'What I saw', Hue covers the recent change in volatility, the continued market rotation, and how our strategies performed in January.

HUE FRAME
Managing Director & Portfolio Manager

2022 started off with a bang, global equity markets tumbled, as investors focused on the course of monetary policy over the next 12 months. Inflation data released from the United States showed that inflation was tracking above 7% on an annualised basis. These extreme readings caused investors to rotate out of high growth tech names and into value names.

We also saw a plethora of company earnings from the United States, which were generally viewed negatively by the market (Netflix, Facebook, Peloton Interactive). For January, the Nasdaq, S&P500 and Russell 2000 were down -8.52%, -5.26% and -9.66%. The S&P/ASX 200 performed relatively well, it declined by -6.35%.

Volatility

On the 21st of January, the S&P/ASX 200 sliced through it's 200-day moving average. This is significant because of the change in market volatility which is generally seen when this happens. When the market is trading above this level, it has an annualise standard deviation of 11.4% vs 20.4% when below. Essentially more volatility. Our market insights section covers this in more detail.

Rotation expansion

In prior months, I have written about the rotation that we have seen within global equity markets. Previously the most obvious rotation occurred between high growth/tech and value companies, however in January, this rotation spread to other assets. We saw commodities such as lumber, corn, wheat, and soybeans all accelerate to the upside, as investors priced in further demand increases. We also saw fixed income markets start to aggressively price in further rate increases.

Portfolio performance

During January, we had challenging conditions within financial markets, which resulted in underperformance for both of our strategies. Our global macro strategy dropped -7.51%, while the Long Short Australian Equity strategy declined by -11.24%.

Equity investments held within the Frame Futures Fund (FFF) declined by -7.99%, however we saw positive contributions from our Fixed Income, Commodity and Currency investments, they added +0.45%, +0.14% and +0.22% respectively.

The Frame Long Short Australian Equity Fund (FLSAEF) declined by -11.24%, as the systematic risk management of the strategy kicked into gear by selling high beta names and increasing cash levels.

Top equity contributors were Fortescue Metals Group Ltd (ASX: FMG), Seven Group Holdings Ltd (ASX: SVW) and Ampol Ltd (ASX: ALD). Largest detractors were Nine Entertainment (ASX: NEC), Sonic Healthcare (ASX: SHL) and GrainCorp (ASX: GNC).

Final thoughts

Although January was a challenging month for both strategies, I am very happy with the way the FLSAEF reduced exposure as markets fell. This proactivity, while somewhat painful in the short-term, ensures long term out-performance because it avoids large drawdowns over a full investment cycle. I am positive heading into the reporting season and look forward to seeing how our universe of companies perform.

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.

All the best.

HUE FRAME
Managing Director & Portfolio Manager

MARKET INSIGHTS
MOVING AVERAGES

WRITTEN BY HARRY HEANEY

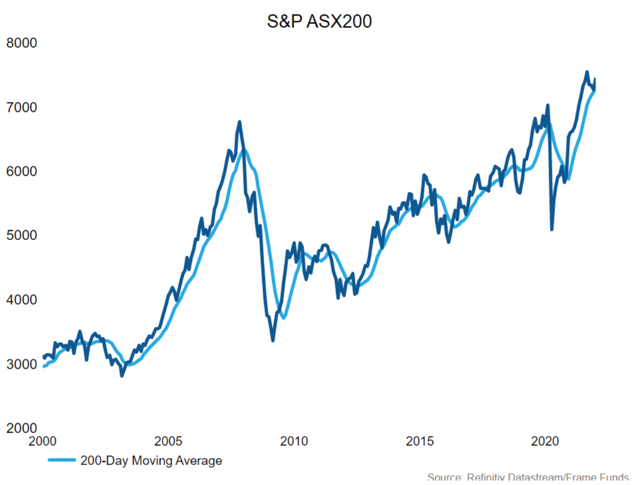
HARRY HEANEY
Co-Portfolio Manager

In this issue of 'Market Insights', Harry covers the 200-day moving average and how this indicator is used by market participants. He also gives 5 tips for portfolio management, when the index is trading below its 200-day moving average.

The moving average is one of the most popular technical indicators available to market participants. It is calculated by averaging share prices over a specific period. As new data points become available, the oldest data is dropped from the calculation. The result is a constantly updating data series, that provides directional information about recent price action. This piece will focus on the 200-day moving average, in particular the implications for investors when the market is trading beneath it.

The 200-day moving average

The 200-day moving average is seen by many as a good indicator of the strength of the trend of the overall market. Many market participants will use the 200-day moving average for directional analysis, stop loss determination and position sizing. Simply, if a stock index is trading above its 200-day moving average, the trend is bullish and the market is moving higher, whereas an index trading below its 200-day moving average is chopping lower with more volatility.



Does the market really trade differently below its 200-day moving average vs when it is trading above it? Is there an increase in volatility?

Deep dive

For our investigation, let's consider market volatility. We will use standard deviation as a measure of market volatility, with the 'market' proxy being the S&P/ASX200.

From January 1, 2000, until December 31, 2021, the annualised standard deviation of market returns is 16.1%. Now we split our standard deviation into 2 categories: a market that trades above the 200-day moving average and a market that trades below the 200-day moving average. We find the annual standard deviation of the ASX200 is 11.4% when trading above its 200-day moving average. This is compared to a standard deviation of 20.4% when trading below its 200-day moving average. While this simple calculation does have some issues*, there is clearly an expansion of volatility when the ASX200 trades below its 200-day moving average.

Because of this expansion in volatility, a self-fulfilling prophecy is created. Market participants (fund managers, professional investors, wealth managers et cetera) know there is increased risk when the market is below its 200-day moving average. As a result, most decide to decrease exposure, allocate into shorter term strategies, or increase hedging. This in turn means more selling and more volatility. Furthermore, systematic risk models such as Value at Risk (VaR) will show a portfolio carrying more risk as volatility increases. This will lead to deleveraging as theoretical risk moves outside an investors or portfolio managers risk tolerance. Again, the natural result of deleveraging is more selling pressure on the market.

Lessons

Taking all of this into consideration, here are five things' investors can do to manage a portfolio more effectively when the market is trading below its 200-day moving average:

1. *Reduce position size*

When volatility expands, smaller positions have the same profit potential as the positions which were larger when the market was trading above its 200-day moving average. For example, if the average daily trading range on a given index has doubled from 1% to 2%. Trading half the size has the same profit potential due to the increased swings in the market. It also means your downside risk has reduced by decreasing your position sizing.

2. *Adjust time frame*

It becomes more difficult to have a high conviction long term investment thesis when volatility is elevated. Even if the thesis is valid, it can be a painful ride and aggressive drawdowns may have to be endured. Shortening your trade horizon will allow more conviction behind trades.

3. *Be open to trading short (if you have the ability to)*

Taking short positions on themes that are counter-trend can be a useful way to add value in a volatile, declining market. A good example of this would be shorting airline/travel stocks during the covid crash. The travel industry was among those hit the hardest by restrictions and lockdowns, so they provided a good opportunity.

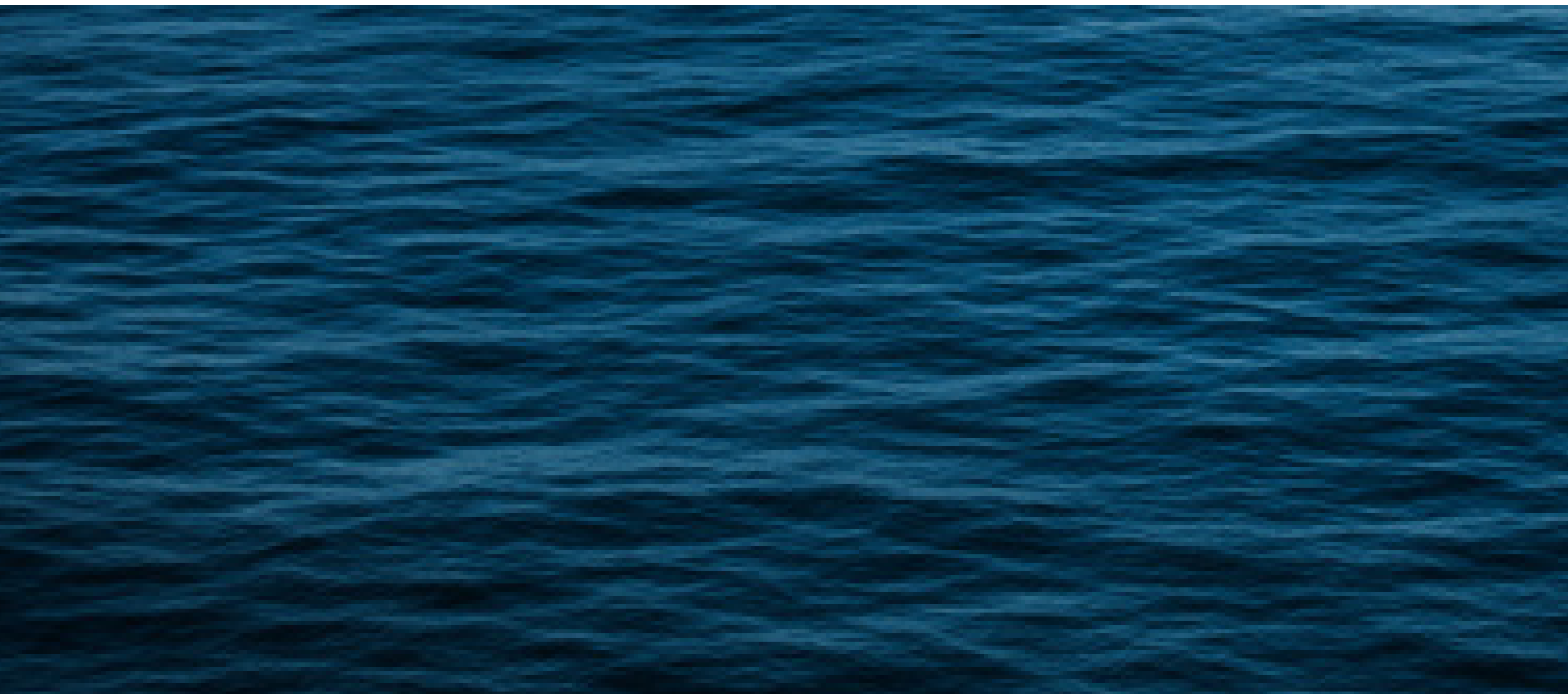
4. *Define a maximum risk level*

Before entering any trade, setting maximum risk levels will ensure excessive losses will not be suffered. Risk levels can be set at by dollar amount or by percentage of account. It is important to remember to be disciplined with this approach – once the level is hit the position must be exited.

5. *Remember markets are not linear*

All investments or trades will not be profitable and markets never go straight up or straight down. Keeping this in mind will allow investors to be in a better mental position to make clear, logical decisions when under stress.

*Since all market crashes take the index below its 200-day moving average, we are succumbing to an element of data selection bias. We are also not claiming this relationship is causal, meaning a cross below the 200-day moving average does not necessarily cause more volatility in the index.



GLOBAL MACRO

WRITTEN BY HUE FRAME

Frame Futures Fund

Units of the Frame Futures Fund declined by -7.513%. Both strategies underperformed. Trading strategies detracted by -4.46%, while the core strategy declined by -3.00%.

Equity investments underperformed, they declined by -7.99%. Currency, Fixed Income and Commodity investments were higher by +0.22%, +0.45% and +0.14% respectively.

During January, global equity markets sold off swiftly. The S&P 500, Nasdaq, Dow Jones, and Russell 2000 were down -5.26%, -8.517%, -3.535% and -9.66% respectively. The S&P/ASX 200 also declined by -6.35%. Investors continued to reposition their portfolios on anticipation of higher interest rates during 2022, with the goal of counteracting inflation. Investors aggressively sold the Nasdaq and Russell 2000, and continued to sell perceived high growth/unprofitable stocks. Investors also focussed on what the United States Federal Reserve plans to do with their balance sheet at the conclusion of their asset purchase programme. Interest rate markets have swung from overly dovish to overly hawkish within the space of the sell-off.

Markets have now priced in five rate increases by the end of the year, which in our view is overly ambitious. It is our view that on any sign of slowing growth, or a softening of the labour market, the US Federal Reserve will delay increasing rates. We also think that the current sell-off is overdone in the short term, and have accumulated investments in US equities, European equities, and the Indian equity market.

Largest contributors to performance were our investments in ASX listed fintech businesses (+1.59%) and our active trading Blackstone Minerals Ltd (+0.81%). Our trading on the S&P/ASX 200 & the Russell 2000 Future Contracts were our largest detractors.

In terms of fund activity, we took profit on some of our recently acquired Nickel exposure, accumulated the Australian Dollar at lows and traded actively out of our silver position. We also accumulated positions in US Equity Indices, after the aforementioned sell-off.

At the conclusion of the month, the Fund held 23 investments.

INVESTMENT TEAM

HUE FRAME
Portfolio Manager

HARRY HEANEY
Research Analyst

FUND PERFORMANCE as at 31st January 2022

	1 month	3 months	6 months	1 year
Frame Futures Fund	**-7.51%**	**-1.06%**	**5.04%**	**10.14%**
RBA Cash Rate + 3%	0.26%	0.78%	1.57%	3.14%
Excess Return	**-7.78%**	**-1.84%**	**3.46%**	**7.00%**

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

WRITTEN BY HARRY HEANEY

Frame Long Short Australian Equity Fund

Units of the Frame Long Short Australian Equity Fund declined -11.24% in January. Comparatively, the S&P/ASX200 fell by -6.35% over the same period.

Increasingly hawkish signals from the Federal Reserve spurred a technology driven sell-off in equity markets as yields rose aggressively. While the ASX200 technically avoided entering 'correction' territory, investors were forced to confront the possibility that the post-COVID bull run could be over. The market returned to valuations not seen since April 2021, such was the speed and severity of the sell off.

January was a challenging month for the strategy. It is worth noting that performance remains within the back-tested maximum expected drawdown. The strategy is designed to decrease exposure when the broader market loses upwards momentum. This is done by tightening stop loss levels on current positions after sustained or particularly aggressive equity sell-offs. As volatility expanded over the course of the month, the filter we use to measure market momentum was triggered and the strategy began to exit higher beta investments. While this can be painful in the short term, the ability to be defensive and protect capital in times of market stress is a key driver of expected long term outperformance on a risk adjusted basis.

The businesses that were exited spanned multiple sectors – real estate, materials, healthcare, financials and industrials. Retained positions generally exhibited more defensive characteristics. One such example was Origin Energy (ASX: ORG) as their production and sales volume continued to show promise ahead of the reporting season. We initiated an investment in Iluka Resources (ASX: ILU) to retain some exposure to commodity markets.

Top equity contributors were Fortescue Metals Group Ltd (ASX: FMG), Seven Group Holdings Ltd (ASX: SVW) and Ampol Ltd (ASX: ALD). They contributed approximately +0.15%, +0.02% and +0.01% respectively. Fortescue continued its strong recovery in line with iron ore prices, while Ampol benefitted from continued strength in crude oil.

Largest detractors were Nine Entertainment Co. Ltd (ASX: NEC), Sonic Healthcare Ltd (ASX: SHL) and GrainCorp Ltd (ASX: GNC). Sonic Healthcare noted a decrease of demand for its COVID-19 testing services, as the spread of the virus slowed. Investors looked to take profit in GrainCorp prior to their half-yearly report, while Nine Entertainment showed no signs of breaking out of its current trading range.

At the conclusion of the month the Fund held 10 equity investments and was approximately 52.6% in cash.

INVESTMENT TEAM

HARRY HEANEY
Co-Portfolio Manager

HUE FRAME
Co-Portfolio Manager

FUND PERFORMANCE as at 31st January 2022

	1 month	3 months	6 months	1 year
Frame Long Short Australian Equity Fund	**-11.24%**	**-5.63%**	**-11.68%**	**2.34%**
RBA Cash Rate + 3%	0.26%	0.78%	1.57%	3.14%
Excess Return	**-11.50%**	**-6.42%**	**-13.25%**	**-0.80%**

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