

SALT

Salt Long Short Fund Fact Sheet – January 2024

Manager Profile

Salt Funds Management is a boutique investment management firm wholly owned by its employees which specialises in actively seeking to maximise returns while managing the risks of the investment.

Investment Strategy

The Fund aims to deliver positive absolute returns in all market environments. In addition to holding “long-only” NZ and Australian securities, the Fund may, at our discretion, short sell shares, hold cash, lever its assets and utilise active currency management to generate returns (although generally the Fund’s assets will be fully hedged).

Fund Facts at 31 January 2024

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	\$74 million
Inception Date	1 July 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 31 January 2024

Application	2.2677
Redemption	2.2585

Investment Limits

Gross equity exposure	0% - 400%
Net equity exposure	-30% - 60%
Unlisted securities	0% - 5%
Cash or cash equivalents	0% - 100%
Maximum position size	15%

Number of Positions at 31 January 2024

Long positions	51
Short positions	35

Exposures at 31 January 2024

Long exposure	111.27%
Short exposure	65.68%
Gross equity exposure	176.95%
Net equity exposure	45.59%

Investment Risk to 31 January 2024

Fund volatility ¹	6.49%
NZ50G / ASX200AI volatility ¹	13.59%
NZ50G / ASX200AI correlation	0.069

1. Annualised standard deviation since fund inception.

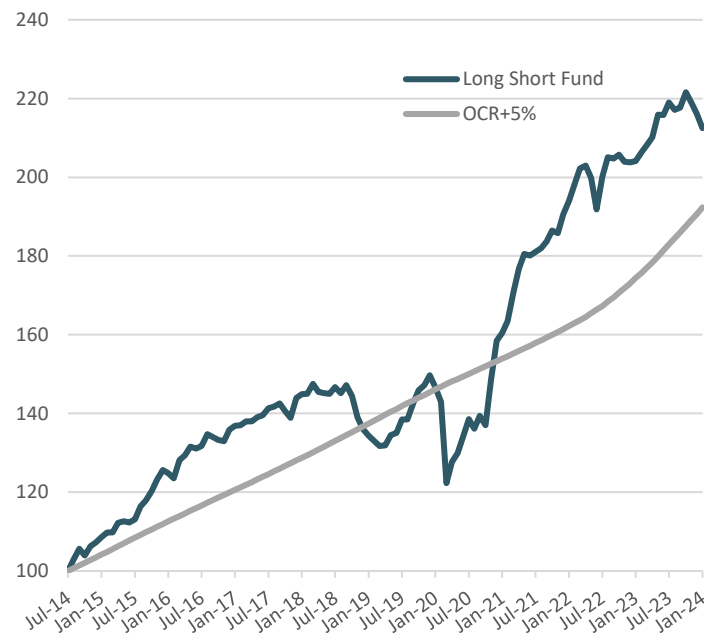
Fund Performance² to 31 January 2024

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return ³
1 month	-1.69%	0.90%	5.57%
3 months	-4.10%	2.54%	6.29%
6 months	-2.95%	5.14%	3.12%
1-year p.a.	4.09%	10.27%	6.96%
2 years p.a.	4.66%	8.88%	-0.09%
3 years p.a.	9.82%	7.71%	2.60%
5 years p.a.	9.61%	6.95%	8.76%
7 years p.a.	6.49%	6.89%	8.38%
Inception p.a.	8.87%	7.14%	8.71%

2. Fund performance is after all fees and before PIE tax.

3. NZ50G/ASX200AI is a 50/50 blend of the S&P/NZ50 Gross Index and the S&P/ASX 200 Accumulation Index and is for comparison purposes only.

Cumulative Fund Performance to 31 January 2024



Fund performance has been rebased to 100 from inception.

Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

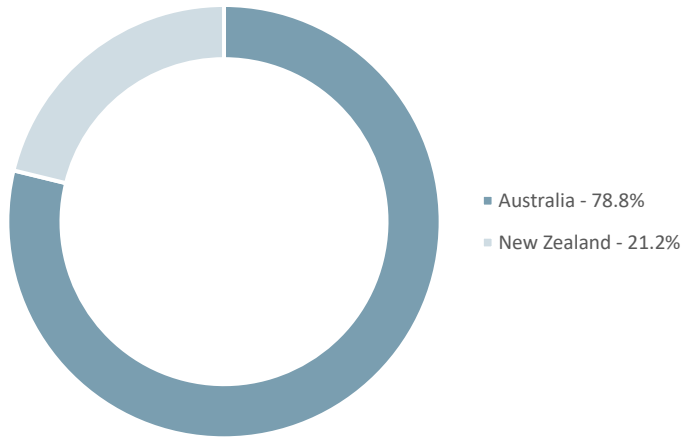
Largest Longs	Largest Shorts
Tower	Reece
GDI Property Group	Commonwealth Bank of Australia
Global Data Centre Group	Data#3
Superloop	REA Group
Lynch Group Holdings	Wesfarmers

SALT FUNDS MANAGEMENT

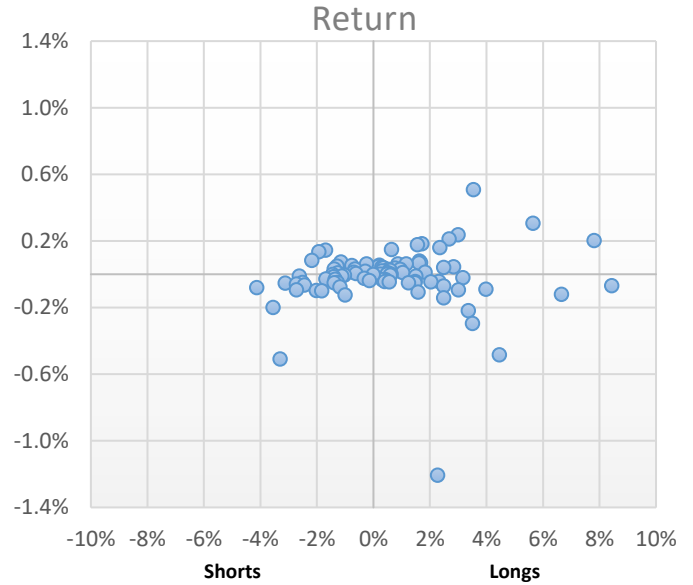
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Country Allocation at 31 January 2024 (Gross Equity Exposure)



January 2024 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

The Fund struggled to a degree during the month of January, with a return of -1.69%. It was very much a continuation of the trend from the previous couple of months, where our stock selection from the long-side was a mixed bag, while many of our very expensive shorts became even more expensive as the market computer indiscriminately said buy. It was noticeable that the Fund did very well on the one rare sharp down-day in the month but generally battled otherwise.

Markets have essentially gone all-in on sharp rate cuts despite the inflation evidence and central bank statements being rather more mixed. Moreover, the view seems to have taken hold that most countries will experience an immaculate Goldilocks-style disinflation while overall earnings forecasts hold up. Maybe this comes true but there is an awful lot of water to flow under the bridge in terms of both inflation developments and earnings outcomes.

JP Morgan research pointed out that that the +13.3% advance by Australia over the last three months was only eclipsed in the last 30 years by the sharp rolling three-month rebounds in 2009 post-GFC and in 2020 post-Covid. The last three months have not been normal. We have been a little wrong-footed in response to this group-think movement but we remain comfortable with our bottom-up holdings and overall positioning. Our longs don't necessarily work on the same

timeframe as the wider market but the Fund's solid long term track record suggests they generally get there in the end.

Markets are extremely overextended on momentum measures, with this typically being a good contrarian sell signal. We sum this up below in the CNN Greed & Fear Index, which has had an extended period in greed/extreme greed territory. This has been accompanied by Nasdaq CFTC net speculative positioning being near all-time highs, net investment newsletter optimism being at extremes and same-day call option buying exploding higher. If there is one thing that we have learned over the years, it is that extremes of optimism and pessimism tend to correct.



Certain sectors of the market have seen a return to the speculative fervour we saw in the zero-rate period post-Covid. The US market has all been about Technology and the "Magnificent 7" shooting for the stars, while other sectors

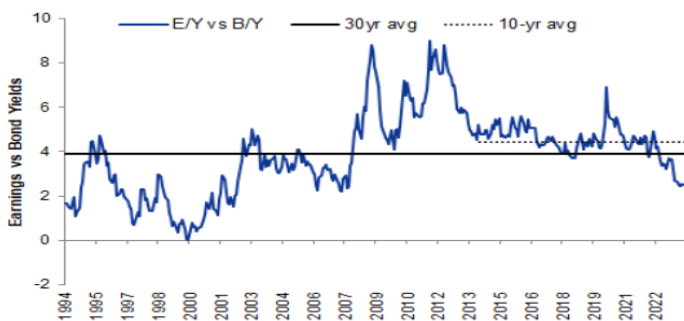
have largely tracked sideways to only slightly up thanks to earnings pressures. In some ways it feels like 1987 in NZ, with post-Covid losses seemingly not having knocked out the crowd of speculative retail investors. Australian market strength has been more broadly euphoric, while NZ equities have been stuck in something more of a rut, with our economy weak and inflation being persistent for now.

Australian performance has been broad-based, with the surging sectors there in the last three months being Healthcare +26.1%, A-REITs +24.2%, Banks +18.6% and Technology +15.4%. This has all been due to multiple expansion, with each of those leading sectors actually experiencing slight to moderate earnings downgrades over the second half of 2023.

The chart below sourced from Goldman Sachs shows how the earnings yield/bond yield ratio is at its most unattractive level in nearly 20 years despite the helpful bond yield movement of late. Worse, the overvaluation is concentrated in the largest highest multiple stocks, with median PE measures being far less egregious in both NZ and Australia.

Exhibit 4 : Equity valuations relative to bonds are at around their worst levels in 20-years.

ASX 200 24mth Forward Earnings Yield vs US 10 Bond Yield



Source: FactSet, Goldman Sachs Global Investment Research

The reasons for this large-cap multiple expansion, over and above that justified by bond yields, can only be put down to concepts such “animal spirits” and “liquidity”, with these filtering into the NZ market to a modest degree as well. This has been a real surprise given the ongoing pressure of QT, the lagged impacts of previous rate hikes and the ongoing decline in reverse repo balances at the Fed. These normally sizeable liquidity headwinds would seem to have been outweighed for now by a pick-up in the velocity of money, perhaps due to optimism about new era AI technologies coupled with aggressively priced expectations of future central bank easing.

As this piece is being written, the US market is pricing in 85bp of rates cuts by end-July and 150bp by end-Dec. This comes

the day after the Fed tried to dowse some of the rampant optimism with statements such as: *“Looking for greater confidence inflation is moving down...looking for more good data on inflation...will be appropriate to dial back at some point this year...prepared to hold rates for longer if appropriate...strongly committed to returning inflation to 2%.”*

This slight bearish tilt from Powell sparked a sell-off for all of 24 hours before normal business resumed. It is clear that the market believes that inflation is coming down quickly and that rates will fall similarly. If the market is wrong, then we are in for a period of pain. If the market is right, then the equity outlook will depend on the earnings path that lies ahead and just how material the AI thematic turns out to be.

There are sound reasons to believe that while goods inflation has plunged for now, overall inflation may prove sticky. US core CPI inflation at end-December was +3.9% YoY, comprising +0.1% for goods and +5.3% for services. Services are being driven by shelter costs, which may gradually decline, and wage inflation, which may prove sticky. Indeed, January non-farm payrolls have just delivered a shockingly strong number, with unemployment remaining at 3.7% and average hourly earnings rising by +0.6% in the month and +4.5% YoY. The Red Sea crisis may see goods inflation rise for a period from here and the January ISM Prices Paid Index rose from 45.2 to 52.9 (46.9 expected). Similarly, the ISM Services Prices Paid Index surged from 56.3 to 64.0. This does not feel like a Goldilocks-style immaculate disinflation.

The situation is similar in NZ. An RBNZ speech during the month was crystal clear that it is far too early to cut rates, with domestic non-tradeable inflation still running at nearly twice the top end of the RBNZ’s target band. Contrary to current market pricing, we still believe the first cut won’t come until November. Earlier, the CPI release for the December quarter showed tradeable inflation of -0.3% for the quarter (+3.0% YoY) but a surprisingly high non-tradeable inflation outcome of +1.1% for the quarter and +5.9% YoY. It’s a similar picture to the US but worse.

By way of contrast, Australian pressures appear to be easing a touch faster. December quarter inflation saw the trimmed mean moderate to +0.8% for the quarter and +4.2% YoY, a touch below expectations. That said, there is a similar combination of goods inflation running at +1.8% annualised, while services inflation is at +4.6% and would be even higher were it not for rent, electricity and childcare subsidies. Having

moved later and not as far, the RBA would seem to be done with hiking but any rate cuts are likely still some way off.

Put all this together and we struggle to see that Goldilocks will come true. The February results season will tell us a lot about the earnings leg of the fairy-tale but suffice it to say that we have some doubts, particularly for cyclicals, where the lagged impact of past tightening may begin to impact.

We have deeper conviction on the disinflation leg of the fairy-tale. Inflation is indeed declining but it is not happening at the rate that is priced in by financial markets, and which in our view, has led to undue strength across a range of sectors. Our stock selection from the long-side has been rather mixed in the last several months (with several blunders offsetting some great calls) but the real struggle has been from the short-side, where a number of our names have reached egregious valuations despite the earnings risks that lie ahead. We believe the Fund is now net short on a risk-adjusted basis and we think it is very well placed to perform from here.

Fund Performance in January

Returning to the Fund's performance in the month of January, our overall return of circa -1.5% pre fees and tax was made up by our long book detracting -0.4% and our short book detracting -1.1%. While many of our longs worked well, there was a size skew to several problem children. As in December, many of our shorts were again all aboard the momentum express despite there being no fundamental news to justify this. Our overall "winners to losers" ratio was again weak at only 51%, with 58% of our longs contributing but only 40% of our shorts.

Our gross exposure fell slightly over the month from a near-record 180% to 177% but remains high due to both high absolute prices as well as opportunities being created from sharp price movements. Our net length declined from 50% to 45.6% and is down a little further to 44.4% as this is being written. The outcomes of earnings season will determine how we fare this month but the low beta nature of our longs means we regard our positioning as being negatively correlated to the market on a risk-adjusted basis.

January did not quite experience the relentless strength of the prior two months but stocks did continue to drift. There were actually 10 negative days for the 50/50 index of Australia and NZ but a number of these were quite small. The average return of the market on those days was -0.38%, whereas we were up on six of them, with an average return of -0.10%.

Looking through idiosyncratic stock movements, we tended to do well on the larger down days.

The largest headwind by some distance was our mid-sized long in APM Human Services (APM, -39.6%), which delivered a further guidance downgrade following its earlier downgrade at the AGM in November. Frustratingly, we had begun to lighten in the days prior but clearly should have gone harder. Our basis for investing in APM was that it was very cheap and that it would be a countercyclical beneficiary as unemployment rose in the UK, USA and Australia. We were clearly too early and their nasty combination of relatively fixed costs and a healthy dose of debt worked against investors rather than for them. While there is still a glimmer of hope for the original investment thesis, it was clearly wrong for at least the foreseeable future and we have reduced our holding to a "lottery ticket" in terms of size.

A second key detractor was a good-sized short we have built up in Data#3 Limited (DTL, +15.9%) which continued to rise on what we can only put down to the AI thematic. We had been short DTL into its disappointing first half result last year and covered on the sharp share price weakness thereafter. There seem to be hopes that they will benefit from an "AI super-cycle", from a PC replacement cycle and from growth in their services business. Our view is that AI will take time to feed through, that there is mixed evidence on the replacement cycle and that the services business is small. The "darling stock" euphoria behind DTL has seen it reach a Jun24 PE of 33.2x and Jun25 of 29.8x – a tad high for a stock with moderate growth, gross margins of just 10% and EBIT margins of only 3%.

A third notable headwind was our long-held and rather difficult long in Lynch Group (LGL, -9.7%) which continued to weaken following their disappointing guidance at their AGM in November. Their earlier upgrade in June seems like half a lifetime ago. While Australia flower sales are travelling well and costs are falling as we had hoped, LGL has fallen victim in the short term to the weak Chinese consumer, with H1 flower sales there being disappointing. This has a levered impact on fixed cost coverage given that the key selling events are in H2 but we will just have to be patient and wait for the consumer to turn. Their balance sheet is fine and this is a high ROIC business with a strong long term growth outlook but it has fallen prey to cyclical weakness and "get me out" type selling.

Other detractors included our mid-sized long in Australian Vintage Group (AVG, -7.4%), where wider industry woes are outweighing their strong relative performance and the potential for upside if/when punitive Chinese tariffs are removed; our long in Emeco (EHL, -6.0%) where fears around nickel and lithium closures outweighed the sensible sale of their contracting business; and our large short in Commonwealth Bank (CBA, +5.1%), which at a PE of 21x in a tough margin environment can surely only now be owned by retail investors and computers.

The stand-out positive was the good-sized long we have built up in Qantm Intellectual Property (QIP, +13.5%) which delivered a solid guidance upgrade during the month. This is a name we owned some years ago but exited when they managed to wriggle out of being taken over by their larger competitor, IPH Limited. We re-entered on weakness last year. Although little followed by the sell-side, QIP is actually the quality player of the two in terms of the breadth and depth of their global client base. They have invested heavily in automation tools to ultimately lower costs and we have finally seen some signs of the benefit coming through. They have also benefitted from the weak A\$ and they have a blue-sky business in Sortify.tm, a rapidly growing AI-based trademark filing platform. QIP has potential upside if they can acquire further Asian IP firms via synergies with their globally based clients. It is on a PE of 9.1x Jun24 and 8.1 Jun25 earnings and almost no one covers it.

A second tailwind came from our large holding in Superloop (SLC, +5.2%) which ground higher on no particular new news. We believe they are continuing to grow strongly and look forward (we think) to their upcoming result.

Our medium size long in DUG Technology (DUG, +6.8%) was yet again a stand-out winner. This was also driven by no new news but just after month-end they announced a major new computing order to deal with what they described as “unprecedented demand”. Despite being a 5-bagger since we first purchased a small holding, it is still on perfectly acceptable PE multiples of 21x Jun24, 16.3x Jun25 and 12.4x Jun26.

Other more modest gains came from longs in Graincorp (GNC, +10.8%), for whom El Nino has turned out to be surprisingly damp; GDI Property (GDI, +2.3%); Monash IVF (MVF, +10.4%), with industry IVF numbers looking strong; and Kina Securities

(KSL, +7.5%) which was unaffected by the PNG riots and which will benefit from what should be strong economic growth as key resources projects finally come on-line.

Thank you for your continued support and interest in the Fund. The period since November has not been easy although the draw-down has been relatively modest and we have bounced back strongly from such periods a number of times in our history. Euphoria and liquidity are driving markets at present but the three-legged stool holding up Goldilocks is looking rather wobbly. Large cap valuations are expensive; earnings outlooks are mixed; and hopes of early, aggressive central bank easing are in the course of being dashed by stickier inflation than the market had hoped for.

We have had a good start to February in the face of market weakness, with our risk-adjusted positioning likely to work should we see more of the same. February earnings season will be an interesting test and we remain focused on our mission of delivering equity-like returns over the long run but with far less volatility and no correlation.



Matthew Goodson, CFA