SALT

Salt Long Short Fund Fact Sheet – June 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 July, 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 30 June 2024

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$86 million
Inception Date	1 July 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 30 June 2024

Application	2.6665
Redemption	2.6557

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 30 June 2024

Long positions	56
Short positions	34

Exposures at 30 June 2024

Long exposure	103.88%
Short exposure	55.82%
Gross equity exposure	159.70%
Net equity exposure	48.06%

Investment Risk to 30 June 2024

Fund volatility[1]	6.56%
NZ50G / ASX200AI volatility[1]	13.49%
NZ50G / ASX200AI correlation	0.056

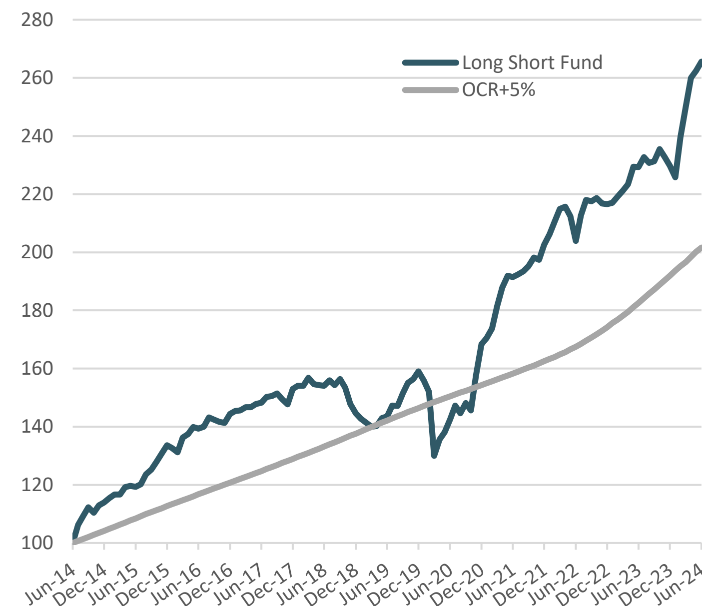
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 30 June 2024

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	1.21%	0.74%	-0.12%
3 months	6.13%	2.51%	-2.12%
6 months	15.60%	5.05%	1.88%
1-year p.a.	15.80%	10.38%	5.05%
2 years p.a.	14.13%	9.69%	8.28%
3 years p.a.	11.53%	8.39%	1.71%
5 years p.a.	13.09%	7.24%	5.46%
7 years p.a.	8.68%	7.09%	7.64%
10 years p.a.	10.26%	7.26%	8.46%
Inception p.a.	10.26%	7.26%	8.46%

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 30 June 2024

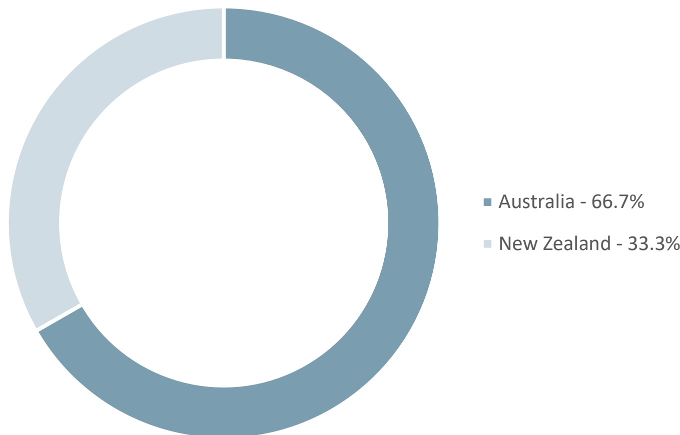


Fund performance has been rebased to 100 from inception.
Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

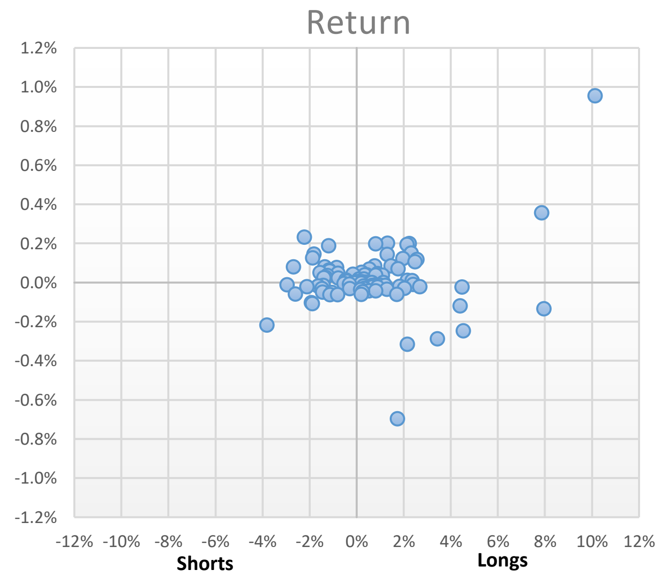
Largest Longs	Largest Shorts
Tower	Commonwealth Bank of Australia
Global Data Centre Group	Wesfarmers
GDI Property Group	Reece
Servcorp	Breville Group
Heartland Group Holdings	Wisetech Global

SALT FUNDS MANAGEMENT
Level 3, The Imperial Buildings, 44 Queen Street | PO Box 106-587, Auckland 1143
Email: info@saltfunds.co.nz | www.saltfunds.co.nz

Country Allocation at 30 June 2024 (Gross Equity Exposure)



June 2024 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

Against a choppy equity market backdrop, the Fund delivered another pleasing month of performance in June, with a solid return of +1.21%. This compared to a -1.3% decline by the NZ benchmark and a +1.0% advance in Australia.

In the past, the Fund has sometimes tended to temporarily struggle in the month of June as a few of our cheap Australian holdings come under tax-loss selling pressure but we were able to more than offset those headwinds this year with a variety of wins elsewhere.

A month is a short period for major macro trends to convincingly assert themselves but June was notable for a torrent of evidence that the NZ economy is slowing sharply and that inflationary pressure is finally easing. This contrasts with Australia likely needing to tighten and the US only now starting to slow. We see some interesting investment implications from this:

1. The RBNZ will cut its 5.5% OCR rate well before its absurd current view of late 2025, a view that few investors believe anyway. The market has priced this to a degree, with the yield curve 100bp inverted out to five years and 50bp positive thereafter.

2. Buy rate-sensitive NZ equities. We aren't brave enough to touch the bevy of distressed cyclicals which may not make it to the other side but names such as Turners, Freightways, NZME and Heartland Group are obvious future beneficiaries, trading at much-denuded valuations. While not riskless, we have reasonable confidence that they are performing roughly as the market expects and we have built reasonable positions into recent weakness.

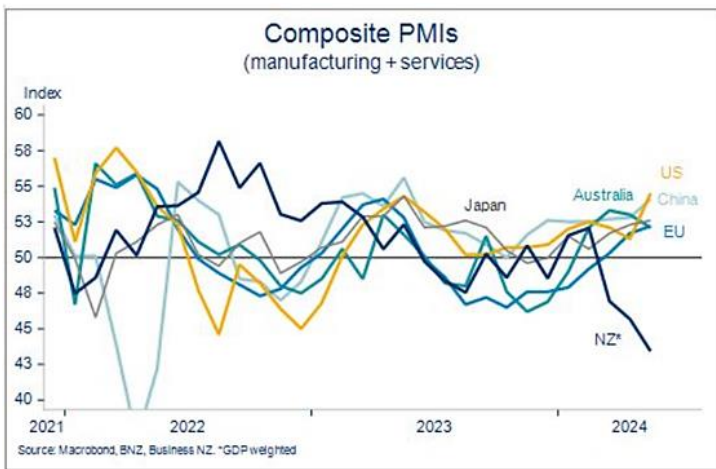
3. As rate paths diverge sharply, the NZDAUD may weaken (perhaps back to the low-mid-80s), supporting companies with Australian divisions.

4. In common with many markets around the world, large-cap NZ and Australian stocks have outperformed small to mid-cap names in recent years due to a convergence of investment strategies (passive, quant) and superior earnings growth. Smaller names have struggled with cyclical downgrades, while large caps have benefitted from technology megatrends irrespective of valuation. However, if we really are close to a cyclical low, then this will likely reverse for a period, with smaller operationally leveraged names outperforming.

5. Equity markets are forward-looking and have a funny way of moving ahead of hard evidence. For now, the fear of further downgrades is outweighing the slowly emerging view of future rate cuts. This will change but the hard part as an investor is perfecting the timing.

For some quarters now, we have consistently expounded the view that economic activity is slowing across most Western countries but that inflation pressure is proving somewhat sticker. A veritable tidal wave of evidence over June showed that this view still remains accurate for Australia but that the sledgehammer of pressure on the NZ economy is finally cracking the inflationary nut. US evidence is somewhere between the two, with their economy starting to slow but inflationary evidence still being mixed.

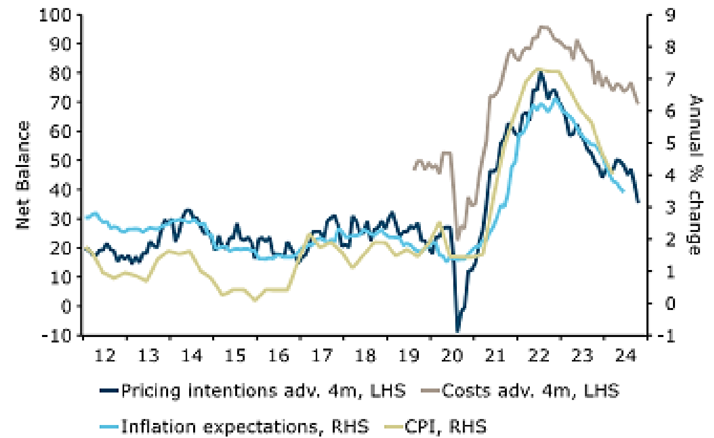
The chart below tells the story of NZ's exceptionalism in this economic cycle. Our composite PMI for manufacturing and services is far below that of our peers. While we are not officially in recession, that has been masked by strong net immigration – we are in a deep per capita recession.



Thankfully, June finally saw a bevy of softer inflation data accompany the dire numbers on economic activity. Food price inflation is a big part of the CPI and May saw food prices rise just +0.2% YoY. While a welcome -11.4% fall in volatile fruit and vegetable prices had much to do with this, overall grocery inflation was only +1.3% versus readings in the teens for most of 2023.

REINZ data showed that the median house price fell by 1% YoY in May after modest previous increases. Inventories rose +25%, so a further lessening in general price pressure from the housing sector can be expected. Barfoot & Thompson sales are at a 14 year low.

An interesting alternative measure to the CPI comes from the price deflators contained in the GDP data for the March quarter. The PCE deflator in this data rose by only 1.7% YoY, the first time it has been below 2% in four years and well below its recent 4-8% readings. It tends to have a strong correlation with the CPI, so this was a very welcome outcome.



The chart above comes from the ANZ Business Outlook Survey at the end of the month and builds on the earlier evidence. Firms' selling price intentions fell from +41.6% to +35.3% and inflation expectations declined from 3.59% to 3.43% - still a bit high but well below the peak of over 6% and well on their way to returning to the 1.5%-3% range that was enjoyed in the halcyon days pre-Covid and before central banks lost their minds in the aftermath.

Finally in this rollcall of deflationary doom, the Westpac McDermott Miller Consumer Confidence Survey for June found an 11pt plunge in the reading to just 82.2. The only previous cycles to have plumbed these depths were the immediate panic after Covid and the deep nasty recession in the early 1990's. This is shown below.

Put all this together and it is little wonder that the RBNZ Chief Economist, Paul Conway suffered severe whiplash when he gave a speech on 19 June that essentially walked back the surprisingly hawkish RBNZ Monetary Policy Statement in May and professed greater confidence that the economy was on a path to returning to the 2% inflation mid-point. We expect the first rate cut to happen before year-end and pressure to really build on the RBNZ before then. They have made a major policy

error once and we just hope they avoid another one on the opposite side of the ledger.

Taken together, our sense is that it's close to as bad as it's going to be for cyclical NZ stocks. The median market PE has retracted to 14.5-15x compared to Covid bubble highs in the 24x region. In many cases, this is a multiple of expected earnings that have sunk in step with the economy. This PE looks fair value to slightly cheap when we compare it to current bond yields of around 4.7% and it looks quite cheap on the old-fashioned "Rule Of 20", which says buy equities when the sum of the forecast year-ahead PE and CPI is less than 20. We are now in the 18x region.

We have focused on the median PE as the forecast PE for the cap-weighted NZ market has actually risen to the 29x region from recent lows of around 24x. We are wary of comparing this too much to history as the composition of our market has changed greatly in recent years with the largest cap stocks tending to be higher growth than the old days of Telecom NZ and Fletcher Paper. However, the gap between the two is sizeable and it is interesting that the S&P/NZX Large Cap Index has returned +3.6%/annum for the last five years, whereas its Mid Cap peer has returned -0.1%.

Australia marched to the beat of a very different drum in June. They have tightened less than most countries over the last several years, and thanks also to strong commodity prices, the "lucky country" has been in a much happier economic space. However, data in June finally caught up with their past monetary laxity. Mid-month, they had extremely strong job numbers, which forced the RBA to make some moderately hawkish comments out both sides of their mouth a few days later. Late month however, they had a shockingly high May CPI outcome, with the trimmed mean being +4.4% (+4.1% prior), indicating broad-based inflationary pressure is in full swing. The market is now vacillating around whether they will make a 25bp rate hike to 4.6% in August.

Finally, on the macro front, US data continued to generally be weak during the month and the PCE deflator at month-end pleasingly came in at the +2.6% that was expected after being higher than consensus forecasts for four months in a row prior. All bets could be off in that market depending on the outcome of the US Presidential elections – our fear is that if Trump gets in, his tariff and immigration policies would see a spike in inflation, as well as in projected fiscal deficits, and thence bond yields.

In a mirror image of our longs in unloved NZ cyclicals, we have several shorts in formerly loved US cycle-sensitive exposures such as James Hardie (JHX) and Reece Group (REH). We did cover Reliance Worldwide (RWC) during the month and will likely dial back the JHX and REH positions as economic gravity asserts itself and the love disappears from their share prices.

<u>Fund Performance in June</u>

Returning to the Fund's performance in the month of June, our overall return of circa +1.3% pre-fees and tax was driven by a range of solid contributions, book-ended by one large positive and one large negative. Our long book added +1.0% and our short book added +0.4%. Our overall "winners to losers" ratio was an unusually poor 52% but the magnitude of our winners tended to be somewhat larger than that of our losers.

Our gross exposure crept up a little further from 156% to a moderately high 160%, but as always, this is a function of volatility creating opportunities, rather than any pre-determined setting. Our net exposure fell back from 52% to 48%, although some of this was selling a name that is quasi-cash due to being under a takeover bid that is almost certain to consummate. As is almost always the case, our positive net length should not be taken to infer that we have suddenly taken a punt and gone long. The Fund's results continue to point to market-neutral positioning on a risk adjusted basis, with our performance being uncorrelated with that of long-only equity markets.

There were ten negative days for the 50/50 index of Australia and NZ in June and the average return for the market on those days was -0.46%. As it usually does, the Fund marched to the beat of its own drum on those days. It was up on six of them and had an average overall return on them of +0.12%. Despite being around 50% net long, the high-beta nature of many of our shorts means we tend to do better on negative days than positive ones.

By far the largest positive was our large, long-held position in Tower (TWR, +9.6%). With the benefit of knowing in hindsight about biblical floods and rampant claims of cost inflation, we may have been a couple of years too early, but it is working in spades now. The new news was that TWR upgraded their guidance again for 24-year NPAT to be greater than $40m rather than greater than $35m previously. We found this upgraded guidance a little odd as it came only two weeks after their interim result and nothing obvious changed in the interim. Our take is it still looks conservative and that it is before the huge potential impact of their large events allowance. If there are no major calamities before end-September, NPAT will lift by a further $32m – massive in the context of a $330m market cap. In our view, the market materially mis-forecasts TWR as having to eat their full large

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events allowance every year, when history suggests it is far less frequent than this.

A second large tailwind came from another repeat performer in our large, long-held position in Global Data Centres (GDC, +4.3%). Market speculation and tactical leaks to the Australian press suggested that a very large price could be forthcoming for Airtrunk, with a likely sale date of mid-late August. Ahead of that, GDC is seeking shareholder permission to start a buyback. The discount to NTA is now far less than what it was but we do see a little more juice in the tank.

A smaller but interesting positive came from our moderate long in the small-cap, NZ Windfarms (NWF, +16.7%). They are engaging in a major exercise to re-power their dated, under-sized turbines in a joint venture with Meridian Energy (MEL). The terms on which MEL entered that JV appear to imply a materially higher valuation for NWF than the market price that it has been wallowing at. We bought everything we could get our hands on. Market interest has finally been piqued by the MEL CEO, Neal Barclay standing down from the NWF Board to avoid conflicts of interest.

Other positives worth noting were a repeat appearance by Intelligent Monitoring Group (IMB, +6.2%); a bounce (dead-cat?) by our volatile and poorly performing investment in Omni Bridgeway (OBL, +32.1%) which we are gradually trading our way out of; a small bounce by NZME (NZM, +9.5%) which is still ultra-cheap on what is hopefully bottom-of-cycle earnings; a retreat by our short in the expensive Meridian Energy (MEL, -7.0%); and James Hardie (JHX, -7.0%) slowly shedding a degree of Australian investor love as the US building cycle turns down.

We had one stand-out laggard which was a continuation of the bleeding from our holding in Australian Vintage Group (AVG, -29.5%). It was in suspense at the prior month-end and fell a further 29.5% from the 22cps that we had written it down to. Their earnings downgrade was not actually an Armageddon situation at all, with revenue being as expected but earnings coming under some pressure in what has rapidly become a very difficult time for the entire wine industry. They successfully raised $15m at 20cps and extended their bank facilities but closed the month at 15.5cps, with the decline seemingly exacerbated by tax-loss selling. Any hint of discussions with the unlisted giant, Accolade Group have gone cold but we still see it as making enormous sense, with the cost synergies potentially dwarfing AVG's market cap in value. We shall see if it comes back.

A second headwind came from our mid-sized long in the property fund manager, Elanor Investors Group (ENN, -10.5%). It has little broker coverage and we see them as having created significant value from their major deal with Challenger's real estate business. This long-term annuity upside is being masked for now by a paucity of fee-earning deals and by a number of legacy funds not performing particularly well and in some cases have more debt than is ideal. We believe they can manage their way through these and the upside from the core fund management business will become apparent as the cycle turns.

A third detractor was our relatively large long in the hitherto strongly performing Monash IVF (MVF, -9.5%) which fell away for reasons that were not apparent to us. The only fundamental issue we can put our finger on are court cases by some customers for whom IVF did not work but these have been around for some time and we believe they are covered by insurance anyway. IVF procedure numbers appear fine, so the only other thing we think it could possibly be is forced selling from a mandate change. We could not resist buying into the weakness.

There were only two other laggards of a magnitude that merits mentioning. One was our large long in Turners (TRA, -5.4%) which fell away on cyclical fears despite having delivered a good result in May. We used the weakness to top up as they will be an immediate winner from any rate cuts from the portion of their finance book that is floating rate funded. The second was our large short in what is very much a consensus view on the Commonwealth Bank of Australia (CBA, +6.6%). We particularly hate losing money when we are marching in the same direction as the crowd but a forward PE of 22x for a bank is simply egregious.

Thank you for your continued support and interest in the Fund. We are pleased to have turned in another solid month against a choppy market backdrop. NZ feels simply awful at present but the old cliche that it is darkest before the dawn may have something to it. We are finally seeing widespread evidence that inflation pressure is ebbing and that the RBNZ is way behind the eight-ball in recognising the scale of deflationary forces at present.

The key question for NZ investors to ask right now is how will each stock fare when the OCR is suddenly cut by 50-100bp? We have been buying those names that should benefit, while accepting the risk that they may still have a little earnings risk stored up. At some point, our market will buy the last downgrade. We vividly remember how dreadful the recession was in 1990/91 but how strong the bull market was on the back of rate cuts in 1992/93.

Against a rather doomy background, it's nice to be bullish again for reasons that are not just knee-jerk contrarianism. Only time will tell whether we have picked the bottom or whether there is further nastiness to come but we do think the evidence for ebbing inflation is compelling. Conversely, Australia needs to raise again and a number of expensive stocks in that market are in denial. As always, we will continue to be flexible and do our level best to extend the Fund's long-term track record of delivering equity-like returns, with far less volatility and no correlation to long-only equity markets.

Matthew Goodson, CFA

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