Salt Long Short Fund Fact Sheet – April 2022

Manager Profile

Salt Funds Management is a boutique investment management firm wholly owned by its employees which specialises in managing NZ/Australian equity and listed property mandates for wholesale and retail clients.

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 30 April 2022

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$61.2 million
Inception Date	31 October 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 30 April 2022

Application	2.166
Redemption	2.1573

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 April 2022

Long positions	46
Short positions	28

Exposures at 30 April 2022

Long exposure	82.76%
Short exposure	40.71%
Gross equity exposure	122.95%
Net equity exposure	41.52%

Investment Risk to 30 April 2022

Fund volatility[1]	6.40%
NZX50G / ASX200AI volatility[1]	13.96%
Fund correlation to 50/50[2] (daily)	0.081

[1] Annualised standard deviation since fund inception.

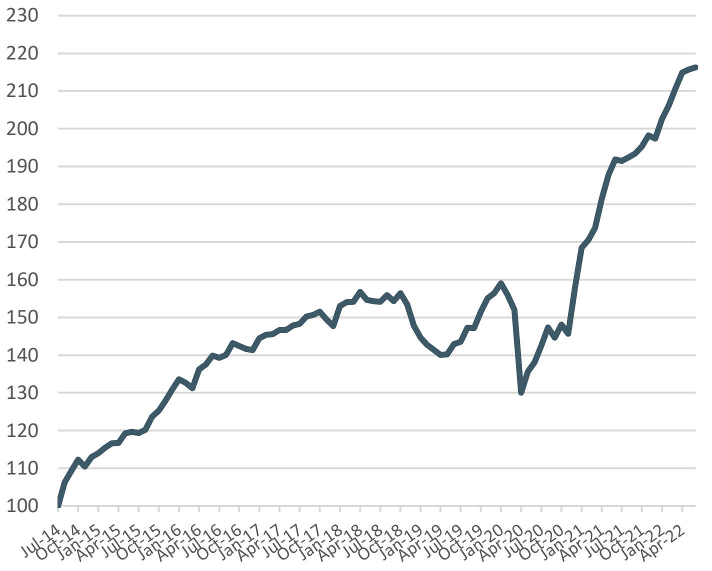
Fund Performance[1] to 30 April 2022

Period	Fund Return	OCR+5% Return	NZX50G/ASX 200AI Return[2]
1 month	0.38%	0.48%	-1.36%
3 months	4.63%	1.42%	4.06%
6 months	8.84%	2.87%	-3.00%
1-year p.a.	14.85%	5.54%	1.53%
2 years p.a.	26.11%	5.39%	13.99%
3 years p.a.	15.44%	5.61%	9.07%
5 years p.a.	8.02%	6.07%	9.69%
7 years p.a.	8.84%	6.44%	9.61%
Inception p.a.	10.31%	6.66%	10.13%
YTD	6.48%	1.90%	-3.81%

[1] Fund performance is after all fees and before PIE tax.

[2] NZX50G/ASX200AI is a 50/50 blend of the S&P/NZX 50 Gross Index and the S&P/ASX 200 Accumulation Index and is for comparison purposes only.

Cumulative Fund Performance to 30 April 2022

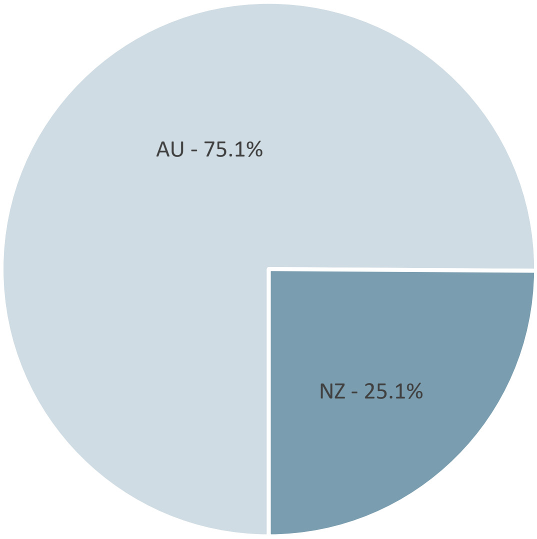


Fund performance has been rebased to 100 from inception.
Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

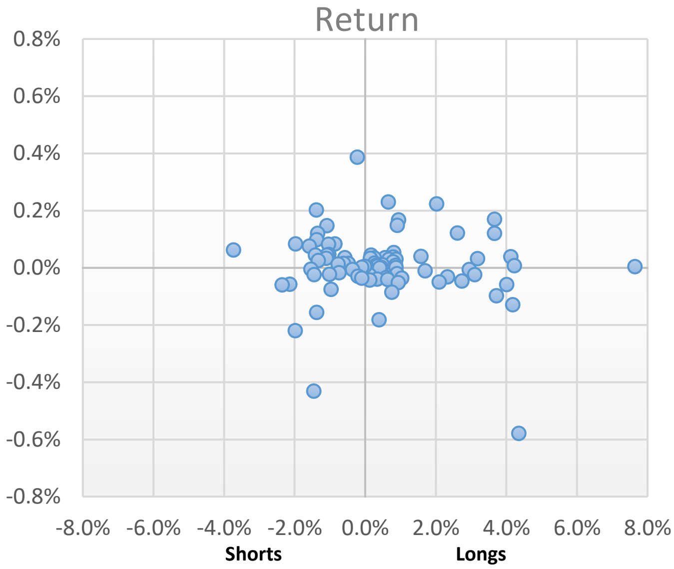
Largest Longs	Largest Shorts
Tower	Home Consortium
Emeco Holdings	Charter Hall Long Wale REIT
Lynch Group Holdings	Corporate Travel Management
Australian Vintage	Johns Lyng Group
Shaver Shop Group	Arena REIT

SALT FUNDS MANAGEMENT
Level 3, The Imperial Buildings, 44 Queen Street | PO Box 106-587, Auckland 1143
P: +64 9 967 7276 | E: info@saltfunds.co.nz | www.saltfunds.co.nz

Country Allocation at 30 April 2022 (Gross Equity Exposure)



April 2022 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

Against a backdrop of volatile and negative equity markets, the Fund experienced a modestly positive month in April, with a return of +0.38% after all fees and taxes. This compared to -1.9% for NZ equities, -0.9% for Australia and an alarmingly weak -8.3% for the MSCI World Index. We again delivered on our aim of providing an uncorrelated, less volatile return.

With a backdrop featuring the drums of war and rampant (although perhaps peaking) inflation pressures, we have lowered the risk levels of the Fund, with a gross exposure level of just over 120% and a net exposure in the low 40% region. As always, the nature of our generally high multiple, high beta shorts relative to our generally low multiple longs, means that we are running little net exposure on a risk-adjusted basis.

As the late, great Kenny Rogers put it, “You've got to know when to hold 'em, know when to fold 'em, know when to walk away and know when to run.”

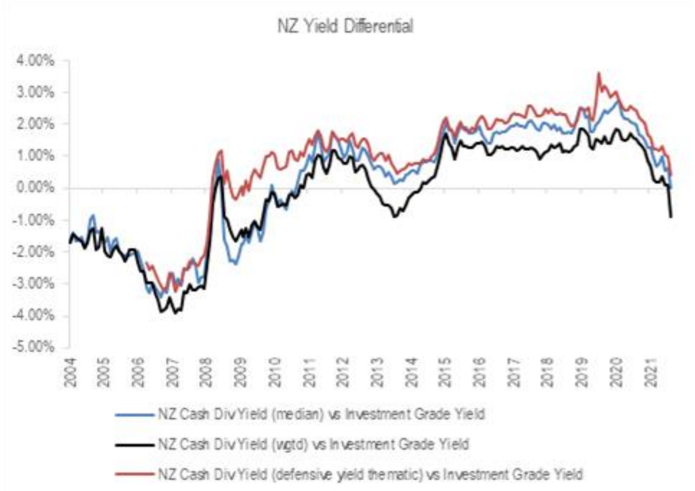
Over the last several months, we have been gradually walking away and lowering risk levels across many of our long and short positions as the reasons behind them have played out. There are two over-riding thought processes driving this.

Firstly, it would be a huge positive if the Russian war on Ukraine ended in some form of armistice. This looks less and less likely as each day goes by and the position of Europe and the USA appears to be shifting to weaken Russia to the point where it can’t mount another invasion. This points to a longer rather than shorter war. A black swan of tactical nuclear weapon usage cannot entirely be ruled out. We are obviously not geo-political experts but have to be cognisant of possible outcomes. The risk of escalation and the negative global supply-side shock from the war could hang over markets for some time yet.

Secondly, inflation readings continue to be horrid and central banks are way behind the curve. We have argued this for a long time but the difference now is that central banks are aggressively tightening and trying to restore credibility that they will do whatever is necessary to combat inflation. While the ECB and RBA are moving glacially, the main exception is the BoJ, whose continued targeting of a 0.25% long-bond yield has seen the Yen collapse in a rather alarming manner in recent weeks. Stop press, the RBA has raised by 0.25% to 0.35% as this is written, their first hike in 4,200 days.

We have just had two major negative supply-side shocks from Covid and the Ukraine, while inflation expectations are becoming entrenched as they spill over into wage inflation. The key risk is that inflation may only fall back to levels that are still above the top end of central bank ranges. If correct, this means that the era of zero and negative interest rates is over, possibly forever. In turn, that means the end of the TINA (there is no alternative) and GAAP (growth at any price) stock trades.

As shown in the chart below supplied by Forsyth Barr, NZ investment grade bond yields now exceed dividend yields. Equity market tourists from the term deposit department will be returning to whence they came. It is not that unusual historically for dividend yields to be below bond yields but the chart also shows that in the pre-GFC period they were far further below than now.



Are we already through the worst of the impact of inflation on bond yields? US 10-years have moved from 0.5% to 3.0% and NZ 10-years have risen even further from 0.5% to 3.8%. One way to think about these moves is to disentangle real bond yields from inflation expectations.

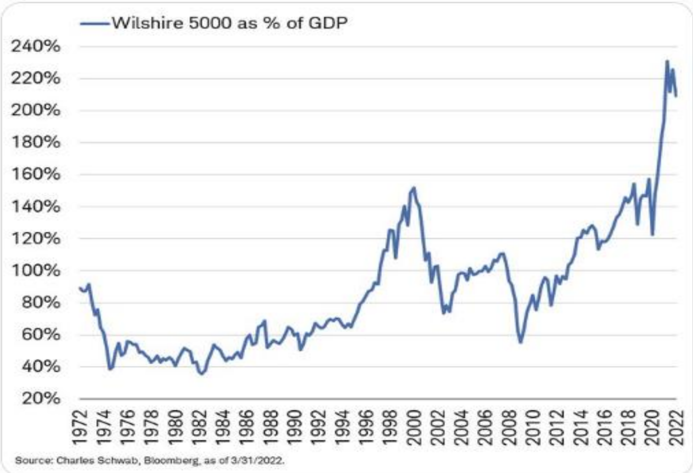
The chart below for the bellwether US market 10-year TIPS yield shows that real yields sat persistently at -1% in the era of ultra-loose monetary policy post-Covid. Apart from one other brief excursion below 0% in the 2013/14 period, negative real yields are most unusual. Indeed, the chart below suggests positive 1%-3% yields are more normal as monetary policy is tightened and QE changes over into QT. Add stabilised inflation at say 2.5% and this gives a potential nominal bond yield range of 3.5%-5.5% - still comfortably above the current yield of 3.0%. We are on the journey but haven't reached the destination yet.

Where bond yields ultimately settle remains to be seen but the view here is that the sell-off has fundamental legs and it is quite conceivable that it still has some distance to go.

The implications for what equities to own are clear. Our longs tend to be companies which can recoup inflation and which are cheap. We continue to avoid TINA and GAAP stocks, even though the latter have been massacred. The first chart below shows the ASX All Technology Index, which is - 30% from its highs in late 2021. Its constituents have tended to feature heavily in our short book. Globally, lower quality names have fallen far further, with this exemplified by the Ark Innovation Fund in the second chart below. So, while we have been covering some of our shorts, this is more of a tactical trading decision. Fundamentally, the darling-stock sell-off won't end until investors start focusing on earnings multiples and valuations rather than sales multiples.

Put all this together and our view remains very much unchanged from the last few months. Inflation is high and will decline to levels that are still above the top-end of central bank targets; bond yields have sold off sharply but real yields have only risen to 0% and surely have further to go; GAAP and TINA stocks are under the pump and will likely remain so due to rising bond yields; the lowest quality stocks have fallen the hardest.

We are sticking to stocks with pricing power, cheap valuations and special situations. Short term sentiment indicators from a whole host of sources are extremely bearish and possibly point to a tactical bounce but the monetary policy backdrop is still tough. The chart below of the "Buffett Indicator" puts the recent retracement into an ultra long-term context. The NZ equity market is far smaller as a percentage of GDP and less concerning at circa 70% of GDP but the US has become historically over-financialised.



One last quirky sign of the times comes from my favourite lagging indicator – thoroughbred yearling sales. The Inglis Easter Yearling Sale in Sydney in April grossed $151m, finally surpassing the all-time "unsurpassable" record high set back in April 2008. We know what happened six months later. The average price for an unbroken, untried 1 year old horse that is 70% likely to lose money was $399k. Yearlings and art are the ultimate sign of easy money and tend to move with a slight lag.

Fund Performance in April

Returning to the Fund's performance in the month of April, the overall return of circa 0.5% pre fees and tax was comprised of a fractionally positive contribution from the long book and +0.5% from our shorts. In a negative month for markets, we are delighted to have made a slight positive return from our longs.

Our overall "winners to losers" ratio was again very acceptable at 60%. There was one large negative but a host of positives that were somewhat larger than our other detractors.

We lowered our net length from 47% to 42% over the month and still continued to do far better than the market on negative days. There were 9 down-days in April for the 50/50 index of Australia and NZ, with the average loss for the market being -0.55% on those days. The Fund was only up on 4 of those 9 days but delivered an average return on them of +0.03% - still markedly better than being -0.55%.

Interestingly, over the Fund's long history, there have been 1,121 positive days for the 50/50 index and we have delivered an average return of +0.022% on them. There have been 837 down days and our average return has been +0.065%. This is what uncorrelated positive returns look like.

The largest headwind yet again was our position in the multinational flower grower and distributor, Lynch Group (LGL, -11.1%), which continues to gradually wither. Our thesis is unchanged, it is just that the share price is markedly lower and it is on a forward PE of 10x Jun22 and 8.5x Jun23, with many years of growth ahead as it pushes on an open door in the Chinese flower market and benefits from supermarkets inexorably taking share from florists in Australia.

The short-term problem for LGL is that the lockdowns in China will undoubtedly be proving disruptive, with that market being around 40% of their profit. It should prove one-off and LGL should hopefully be benefitting from a post-Covid rebound in Australia but for now sentiment is as dreadful as the share price. We will stay our painful course.

Other headwinds were considerably smaller. For some time, we have been actively trading a short position in the highly volatile Corporate Travel (CTD, +10.5%) which rose sharply in the month on the apparently surprising information that travel is recovering post-Covid. Our issue is that CTD tends to be very promotional, that they are a serial acquirer with impenetrable accounts, and that even with analysts expecting a strong recovery, they are still on a PE of 27.6x Jun23 and 21.3x Jun24 consensus.

Other detractors were led by a tiny long in Hipages Group (HPG, -32.8%) which is the dominant portal in Australia for tradespeople. We like it because it has a clear path to profitability but it was hammered in line with every other small SaaS company during the month.

Our short in the medical insurer, NIB Holdings (NHF, +11.3%) also weighed on returns. Some investors appear buoyed by the coming recovery in their small travel insurance business and the continuing super-profits from their core health business. Our feedback is that there is a veritable flood of delayed procedures to be carried out as Australia comes out of Covid, so the period ahead could feature far heavier claims than are in anyone's numbers.

The largest winner was our small holding in the coking coal company, Stanmore Resources (SMR, +36.6%) which soared again after a 62% return in March. Coking coal prices are through the roof, and while patently unsustainable, SMR is on an EV/EBITDA of <1x at spot. If this continues for much longer, they will repay all their debt and build a large cash pile. Such is the vast leverage in these sorts of businesses. We are slowly leaking our holding out as we do not want to be part of a very long queue at a very small exit door when coking coal prices inevitably start falling.

Last month, we bemoaned our poor timing in building a position in United Malt Group (UMG, +10.1%) but this turned around to be a key contributor in April. This strong performance came despite an earnings downgrade based on a surge in malting barley prices in Canada forcing them to pay up for supplies from other countries. There appear to have been very good levels of rain and snow over the winter on the Canadian plains so this won't be repeated. The key remaining risk is the Ukraine war's impact on grain prices more generally but the bulk of this should be dealt with by their pass-through contracts. They are a big re-opening beneficiary as well as having structural tailwinds from a move towards craft beers and high-end whisky. Debt is a little high but UMG is on a cash PE of 10x in a couple of years in a highly concentrated global industry. From time to time it has been the subject of idle press speculation around potential PE buy-out interest but this is obviously in the lap of the gods.

A third strong tailwind came from our long-held short in Breville Group (BRG, -12.2%). We have covered some of this position as it has weakened but we just cannot get our head around a maker of kettles, toasters and coffee machines being on a PE of 30x Covid-assisted earnings. It used to be 40x and the darling-stock allure appears to be slowly dulling.

Other winners of note were our large holding in the Perth-centric property company, GDI Property (GDI, +4.1%); our now much smaller holding in Pepper Money (PPM, +7.8%); a bounce in the high-quality skincare biotech, Aroa Biosurgery (ARX, +14.8%); and our short in Wisetech (WTC, -11.4%).

Thank you for your continued support and interest in the Fund. After many years of golden weather, long-only equity markets are sailing in choppier waters as central banks finally begin to tighten monetary policy and bond yields rise. Positive returns are possible but will require skilful navigation rather than simply jumping in the newest, shiniest boat.

This Fund will strive to continue its history of delivering positive returns irrespective of whether markets rise or fall – that is what having no correlation means and we think it is a very valuable attribute as a part of one's portfolio. While we still have a number of high conviction positions, we have reduced the Fund's risk at both a gross and net level and we go to sleep each night intoning "don't fight the Fed". Perhaps at long last, central banks really do mean it.

Matthew Goodson, CFA