SALT

Salt Long Short Fund Fact Sheet – March 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 31 March 2024

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$80.6 million
Inception Date	1 July 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 31 March 2024

Application	2.5125
Redemption	2.5024

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 March 2024

Long positions	52
Short positions	36

Exposures at 31 March 2024

Long exposure	102.12%
Short exposure	59.80%
Gross equity exposure	160.87%
Net equity exposure	41.48%

Investment Risk to 31 March 2024

Fund volatility[1]	6.51%
NZ50G / ASX200AI volatility[1]	13.56%
NZ50G / ASX200AI correlation	0.069

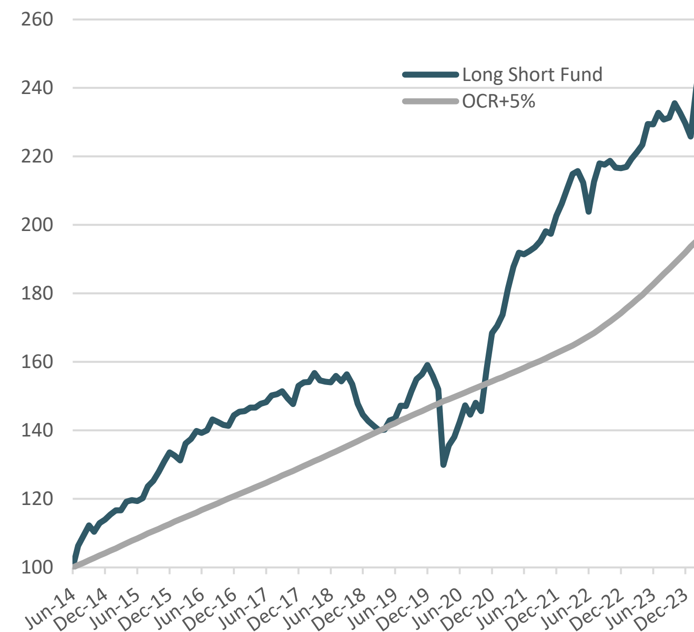
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 31 March 2024

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	4.46%	0.77%	3.19%
3 months	8.93%	2.48%	4.09%
6 months	8.18%	5.06%	10.63%
1-year p.a.	13.11%	10.36%	7.53%
2 years p.a.	7.91%	9.23%	3.22%
3 years p.a.	11.31%	7.96%	3.95%
5 years p.a.	12.31%	7.05%	7.42%
7 years p.a.	7.93%	6.97%	8.29%
Inception p.a.	9.86%	7.18%	8.92%

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 March 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
GDI Property Group	Reece
Global Data Centre Group	Wesfarmers
QANTM Intellectual Property	Breville Group
Servcorp	Stockland

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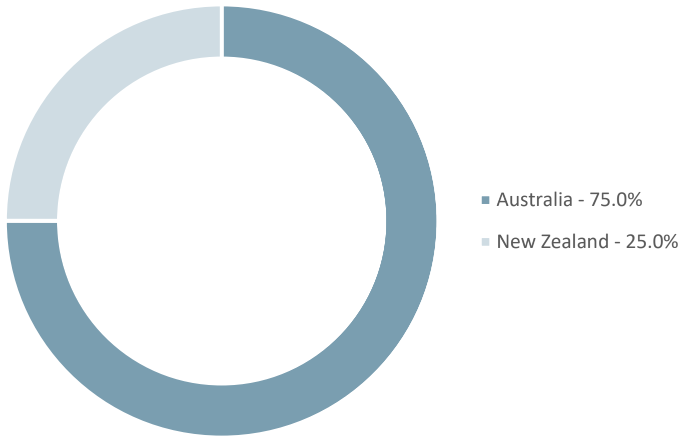
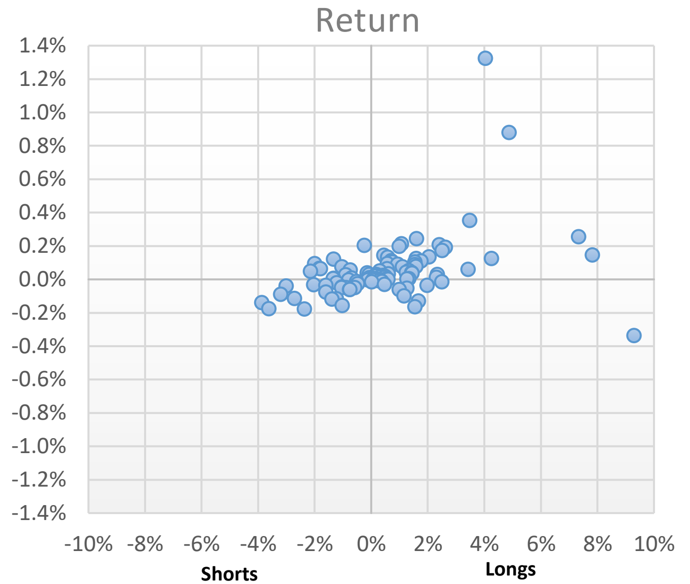
Country Allocation at 31 March 2024 (Gross Equity Exposure)



March 2024 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

The Fund delivered another very strong performance in the month of March with a return of +4.46%. We are delighted that the unit price of the Fund has now climbed from $1.00 to over the $2.50 mark in less than ten years since starting the Fund. While there have been one or two periods requiring patience and a modicum of faith, this performance has been delivered with less than half the volatility of the NZ/Australian equity markets and with no correlation to them.

A couple of our long-held positions began to be recognised by the market and the overall balance of returns from our longs and shorts was favourable. Most markets were strong in March and the Fund's performance compares to returns from the NZ and Australian benchmarks of +3.1% and +3.3% respectively.

After previously battling for several months, the Fund has now had two very strong months in a row. We by no means feel that this sudden burst of performance is over for now. We have a number of arrows left in the quiver and the portfolio is always evolving as new opportunities come knocking. Whether we can repeat the pace of February and March remains to be seen but we do see the Fund as being well placed for continued solid returns.

Importantly, we have not delivered 10.5% over the last two months by abandoning our religion and getting on board the momentum train. Indeed, it has been quite the opposite, with our short book proving a gradually increasing headwind as we have methodically sold and shorted a variety of names as ever more longs reach our price targets and more shorts reach nose-bleed levels of hopefulness. At just over 42% net length, we view the Fund as actually being net short on a risk-adjusted basis and see it as very well placed to provide uncorrelated returns for the inevitable phase when go-go markets have a breather.

The old saying goes that it's only a bubble if you aren't invested in it. That said, current market conditions feel extremely bubbly even though they have a clear initial fundamental catalyst in the form of the artificial intelligence "revolution". In terms of investment returns, we suspect many companies have been priced on vapour-ware as opposed to likely earnings that will actually materialise in the future. However, the market perceptions of who are the winners and losers will evolve rapidly and we have been very wary of going short too early.

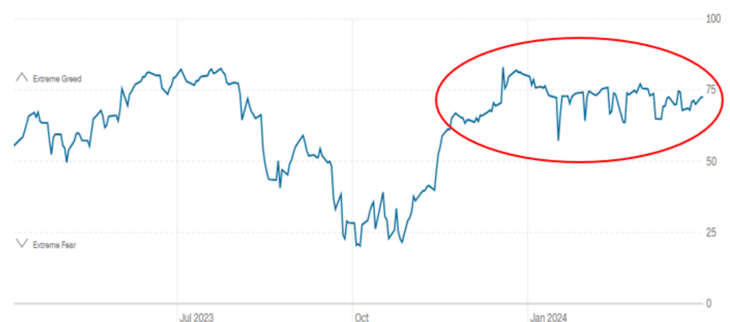
Our shorts in the broad AI space have tended to pick on pieces of potentially significant overvaluation to act as modest hedges against longs that we have in the segment. Thus, we put on a 1.7% short in Next DC (NXT) near its highs to offset our large 8.1% Global Data Centres (GDC) and smaller 1.6% Macquarie Technology (MAQ) holdings. We see a huge upcoming catalyst for GDC in the mooted $15bn sale of Airtrunk, in which they hold a stake just below 1%.

We have also put on a 1.8% short on Goodman Group (GMG) near its highs. We model it out as being very expensive based on any analysis of future free cashflows from potential data centre developments. Two things bug us about whether property developers can truly earn excess returns in this space. Firstly, it is access to electricity that really matters and why would the provider not charge fully for that? Secondly, while some future uses of AI will require edge locations (gaming, driving and market front-running machines), it is not at all clear as to why slight latency is not acceptable for many other uses in model-training and inference. This could point to locations close to electricity generation sources which may be well away from industrial areas that are supposedly being repurposed to data centres.

We suspect that some AI associated companies will ultimately prove to be sound investments from even current inflated levels, just as was the case for some internet companies from early 2000. Our concerns are that we have no idea which ones will be the winners and even they may initially see significant share price falls when sentiment turns. The AI thematic certainly has the feel of being the fundamental spark that has set the speculative blaze afire and evidence of bubbly behaviour was everywhere one cared to look during the month:

- Graniteshares launched a 2x long Nvidia ETF (NVDL) which has quickly grown to over US$2bn.
- On just one day (the 27th) during the month, the following leveraged ETFs were launched: 4x long Semiconductors; 5x long Magnificent 7; 3x long Artificial Intelligence; 3x long IONQ; and 2x long Super Micro Computer. This does not happen in normal times.
- Trump Media & Technology (DJT) listed and has a market cap of US$7bn as this is written. It had $4m of revenue and $58m of losses in 2023. Its revenue is less than half that of a single Chick-fil-A restaurant and they aren't open on Sundays. I'll back the chicken…
- The Renaissance IPO ETF rose by 15.3% in February and 5.8% in March. It is now 66% above its early 2023 lows although it is still 40% below its post-Covid bubble highs.
- Barron's magazine ran a headline, "Bet On The Bull"…"Stocks look poised to keep rising…"
- JP Morgan global research showed that there is extreme investor crowding into Momentum strategies, such that it is at its 99.8% percentile. Past such Momentum crowding has been followed by crashes in those segments subject to the rally – in this case, there is extreme crowding into Size and Growth.
- According to Verity Research published in the FT, the ratio of tech insider selling relative to buying has risen to near all-time highs, as informed sellers unload to retail bag-holders. Aside from all the highly speculative plays, examples included Palantir, Amazon and Meta.

Our favourite CNN Greed & Fear measure shown below continues to register greed/extreme greed around the 75 region. It is very easy to get used to certain behaviours when you see them every day in the market but the nearly five months that we have spent up at these extremes is not normal and is surely vulnerable to a sharp pullback in the event of some unforecastable left-field catalyst.



A key underpinning of all this extreme market behaviour is the self-reinforcing nature of current market movements. While traditional active investing has been in decline for years, two big growth areas within active funds have been systematic quantitative investing and hedge fund pods. The latter operate under the sponsorship of one large overall sugar-daddy, with capital allocated or removed from an array of separately managed accounts based on how successful the individual traders are proving. Risk management controls are then applied to the overall agglomerated positions.

When markets are rising, volatility invariably falls, with current VIX readings of 13 being close to the lows of the glorious pre-Covid bull market days. This means that equities are apparently less risky, so risk limits are relaxed, which sparks more buying, which lowers volatility further. It requires some left-field event to shock this self-reinforcing mechanism onto a new path and that is the key risk for current markets when some shock inevitably comes along.

While all of this foregoing description concerns the US market, it absolutely had spillovers to Australia. While that market rose +5.3% in the March quarter, Technology

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massively outperformed at +24.4% and REIT's did +16.8%, largely thanks to Goodman Group.

However, we would not include the somewhat marooned NZ bourse in these events. While the forward PE for our core market of 26-27x is certainly high relative to history, the nature of our index has changed a lot from the staid old "trees and telephones" of the early 2000's. Our largest names are now somewhat higher ROIC, higher growth companies.

Looking at NZ's median PE, we think it is about where it should be at 15x-16x given a bond yield of around 4.6%. This also lines up with the "Rule Of 20", which states that a market is fair value when the sum of its one year forward PE and inflation rates equals 20. We are at around those levels. In what is anything but a coincidence, the Fund is just starting to find a few mid-large cap NZ names that are interesting from the long side for the first time in years.

Last month, we set out how reporting season was rather more mixed than normal, with year-ahead downgrades being the most widespread in some years albeit generally limited in magnitude. Cost pressures and higher interest rates were the key culprits, with the overall Australian economy muddling through in a satisfactory manner. In NZ however, the revenue line is a greater concern and GDP data during March showed that four of the last five quarters have been negative and that per capita GDP growth was a literally depressing -3.1% over the year to December.

The timelier ANZ Business Survey is giving rather mixed readings. While there had been a relief bounce on the change in Government, this is now starting to fade. March saw firms' year-ahead own activity expectations fall from 29.5 to 22.5 and profit expectations fall from +5.3% to -3.8%. A saving grace is that firms' selling price expectations continue to gradually decline, now sitting at +45.1%, but this is still far too high for the RBNZ to feel comfortable. Rates cuts are coming but deeply embedded service sector inflation means they will be later and probably less than one would otherwise hope.

<u>Fund Performance in March</u>

Returning to the Fund's performance in the month of March, our overall return of circa +4.5% pre fees and tax was again driven entirely by our longs. Our long book added +5.3%, while our short book detracted -0.8%. Given the strong performance by equities during the month, we were relatively pleased with the limited headwinds from the shorts. There was a major skew to two of our longs being large winners and no major detractors of any great concern. Our overall "winners to losers" ratio was a very pleasing 64%.

Our gross exposure continued to gradually decline from a very high 177% at end-January, to 165% at end-February and 162% at end-March. The biggest change was to our net length, which fell sharply from 53.4% to 42.3%, the lowest it has been in quite some time. This Fund never sits still and we reduced the size of a number of longs as they rose and lifted our shorts as bubbly markets provided some interesting opportunities from that side. We now regard our positioning as being slightly negatively correlated to the market on a risk-adjusted basis but would highlight that this is constantly changing depending on the ever-evolving opportunities that the market provides.

Strong markets meant there were only seven negative days for the 50/50 index of Australia and NZ in the month. The average return of the market on those days was -0.34%. The Fund was up on six of those seven days and our average return on all of them was +0.48%. There is obviously a large element of chance as to the day on which we have big wins in any given month but March was again one of those wonderful months when we had no correlation to the market because we were up irrespective of what the market did.

The strongest contributor was our again our large long in Superloop (SLC, +30.4%), where the scrip bid by Aussie Broadband (ABB) took some fascinating twists and turns. The main driver was the huge victory by SLC in winning the Origin Energy telco contract off ABB. This will be hugely accretive given that SLC has significant free capacity over which all this new traffic can be handled. Initially they are taking on 130k new broadband customers but Origin's own targets have this potentially growing to over 600k in the years ahead. Even worse for ABB, their purchase of 18% of SLC overlooked that SLC's Constitution limits any single holder to a maximum of 12% due to their Singapore subsidiary. ABB had to sell down to this just after month end. We did take some money off the table but the magnitude of the upside from the Origin deal coupled with the ongoing strong core business performance by SLC means this is a name we will continue to own for a while yet.

The second major winner was another two-peat, being our good-sized holding in Qantm IP (QIP, +18.8%). The initial bid from UK intellectual property peer, Rouse fell away but QIP granted due diligence rights to the private equity player, Adamantem Capital based on an indicative bid of $1.817.

QIP closed the month at $1.58, which allowing for the time value of money, suggests a view that the bid will probably although not definitely be consummated. When we look at QIP, we see a business with a strong market position, a sound balance sheet which can fund expansion into Asia, a modicum of AI hype via the successful Sortify trademarking business and a still-reasonable valuation on a forward PE of 12x. We are hopeful that these factors will lead to a deal being concluded.

A third but somewhat more moderate tailwind came from our good-sized position in Australian Vintage Group (AVG, +9.6%) after an earlier period of poor performance. We think they are one of the best quality players in what is currently an exceptionally difficult industry cycle, with many millions of litres of low/mid quality Australian wine being in storage and unsaleable. Vines are being pulled but there is also some concern around current consumption trends towards spirits and cannabis. AVG have a leading market position in the UK, they are moving up the value-chain and they are a global leader in the rapidly growing low/no alcohol wine segment.

AVG's performance in the month wasn't due to a sudden market recognition of these attributes. Rather, the lifting of Chinese tariffs on Australian wine will be helpful both directly (small) and indirectly in terms of demand for excess wine supplies. Further, AVG confirmed media speculation that they are in exploratory discussions with the recapitalised major, Accolade Wines. We have no idea what form this might take other than that the relative sizes would see Accolade swamp AVG and that it can only happen if strongly value additive to the latter.

Other smaller but still notable tailwinds were led by our large holding in Global Data Centres (GDC, +3.6%) which ground a little higher due perhaps to generalised hype within the sector and more importantly a number of press articles re the imminent Airtrunk sale process. Beach Petroleum (BPT, +14.7%) rose well and we remain bullish on future East Coast gas prices; a brief trade in Resmed (RMD, +13.1%) worked well and our long in OFX Group (OFX, +7.2%) rose on no new news. The only notable winner from the short-side was Dicker Data (DDR, -14.5%) which fell on a management share sell-down.

Our headwinds were fewer in number and of materially lower magnitude. They were led by our largest holding, Tower (TWR, -3.5%) which gave back some of its strong gains in February thanks to random flows and no new news. We remain very bullish on how the business is tracking and the extremely cheap valuation. As a reminder, based on the mid-point of the profit targets TWR released in February for the next couple of years, they are on a PE of 5.3x in Sep25 and 3.8x Sep26. We almost hope that their strategic review doesn't lead to a change in control.

The next laggard was a reasonable short we have built up in Stockland (SGP, +8.0%), which rose for reasons that completely escape us. Investors seem to use them as a proxy for the residential land development outlook, (which looks middling), while forgetting their significant commercial property assets, for which a fulsome valuation is implied at current market prices.

Other smaller head-winds were led by our large short in Reece Limited (REH, +4.6%), where a forward PE of 43x for a plumbing retailer at five minutes after midnight in the housing cycle seems too aggressive to us; the moderate short we built up in Goodman Group (GMG, +13.1%) was a fraction early as it rose steeply over the month; and what is now a relatively modest long in Omni Bridgeway (OBL, -10.1%) ebbed away.

Thank you for your continued support and interest in the Fund. We are delighted to have moved into a period of strong returns and especially pleased to do so against an overall backdrop of bubbly markets which could potentially have been dangerous from the short-side. Choppier markets early in April have seen the Fund continue to do well and it has often been our observation that our net length naturally falls as markets become more extended. We will continue to do our level best to extend our 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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