SALT

Salt Long Short Fund Fact Sheet – November 2022

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 30 November 2022

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$66.5 million
Inception Date	30 November 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 30 November 2022

Application	2.1765
Redemption	2.1677

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 November 2022

Long positions	43
Short positions	31

Exposures at 30 November 2022

Long exposure	82.50%
Short exposure	40.04%
Gross equity exposure	122.54%
Net equity exposure	42.46%

Investment Risk to 30 November 2022

Fund volatility[1]	6.44%
NZ50G / ASX200AI volatility[1]	14.03%
NZ50G / ASX200AI correlation	0.081

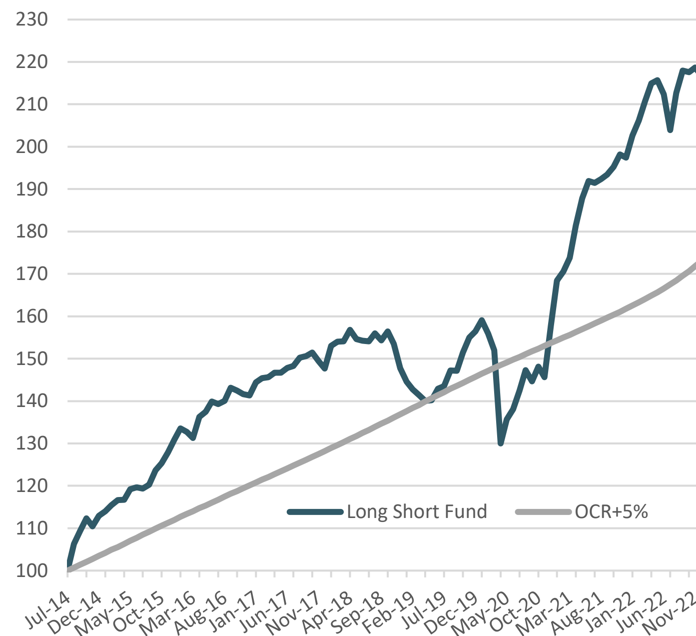
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 30 November 2022

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	-0.88%	0.69%	4.23%
3 months	-0.55%	2.02%	2.67%
6 months	2.06%	3.86%	2.77%
1-year p.a.	9.79%	6.93%	-2.34%
2 years p.a.	17.22%	6.10%	2.43%
3 years p.a.	11.49%	5.90%	4.64%
5 years p.a.	7.98%	6.17%	7.93%
7 years p.a.	7.47%	6.41%	9.67%
Inception p.a.	9.63%	6.73%	9.26%

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 November 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	BWP Trust
Monash IVF Group	Technology One
GDI Property Group	Amcor Ltd
Kina Securities	Carsales.Com
Global Data Centre Group	Auckland International Airport

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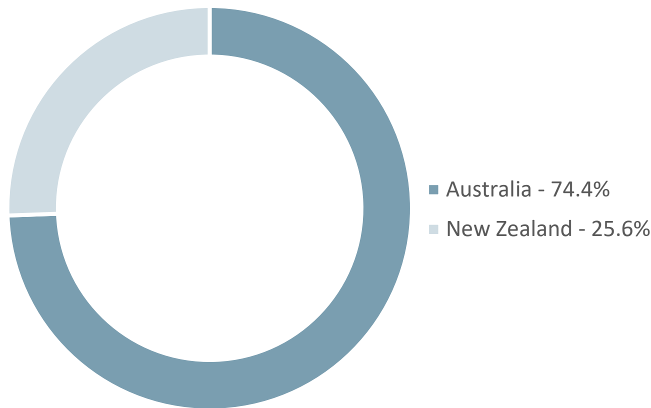
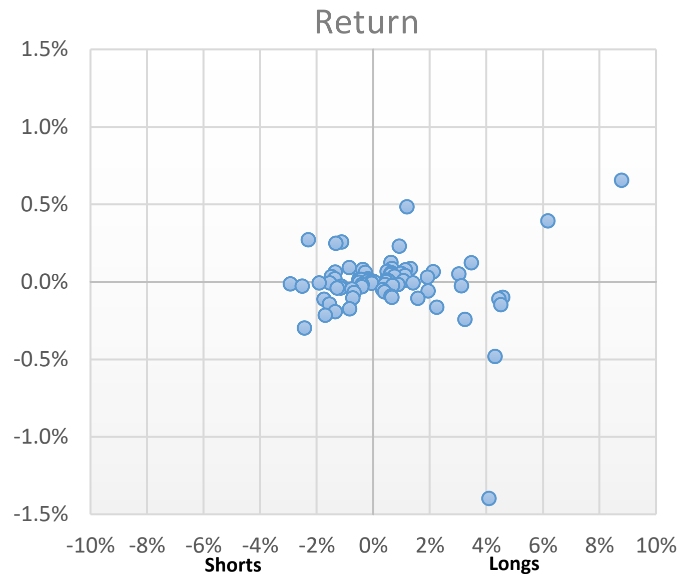
Country Allocation at 30 November 2022 (Gross Equity Exposure)



November 2022 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

November was a slightly disappointing month for the Fund with a return after all fees and taxes of -0.88%. The month saw numerous results and annual meetings, with subsequent share price reactions and over-reactions. Our stock selection was mixed, with several very good calls being offset by several poor or premature ones.

The macro-outlook for economies and markets is as scrambled as we can remember it for NZ, Australia and Western countries in general. One can hardly blame investors for being confused given the random grab-bag of guidance and changing views being put in front of us by central banks.

Adrian Orr has clearly changed stance from dove to hawk (or perhaps Haast eagle); RBA Governor Philip Lowe has been raising rates slowly and apologetically in Australia; while the Fed's hawkish resolve may or may not still be the case depending on what day one considers the headlines. As this is written, markets are jumping for joy on comments from Governor Powell that were perceived to be "balanced" rather than "hawkish".

Putting the daily somewhat schizophrenic reactions of markets to one side, we retain the same view that we have held for most of this year as to the choreography of economies and markets from here. Inflation is clearly getting close to peaking or perhaps has peaked already depending on the country. We are at that phase where numbers are coming in on both sides of the ledger and one just needs to push through emotional over-reactions and retain a clear overall view.

While it is clearly good news that inflation is peaking, the problem remains that it is doing so at far higher levels than the 1%-3% target ranges employed by most central banks. Worse, price inflation is spilling over to wage inflation, pointing to an extended wage/price spiral which may take time and a lift in unemployment to resolve. This is the position that Adrian Orr has now arrived at, while the Fed still thinks it is possible to engineer a soft landing.

For now, markets are looking to rise aggressively when they see any sign that central banks may ease off. For example, 11 November saw the GS non-profitable technology basket rise by +15.2%, its largest ever one day move. The lesson we take from this is that central bank tightening has not yet reached the pain threshold given the sheer volume of cash that had earlier been injected.

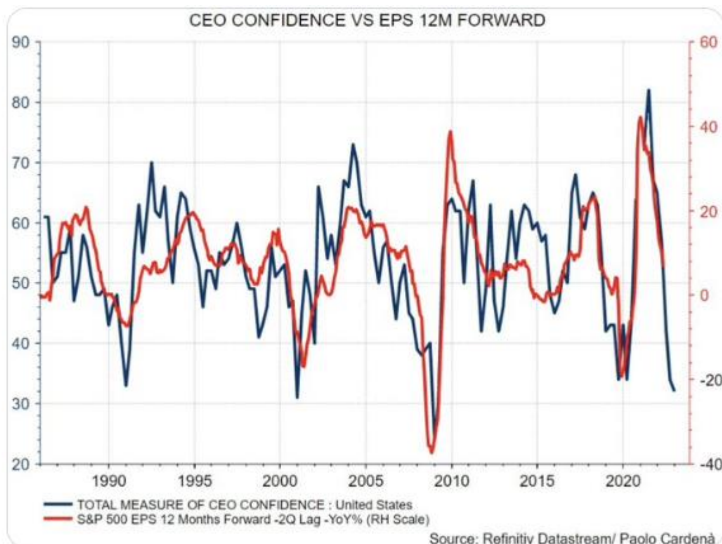
The Fed is still tightening, with the main question being whether they simply opt for 25bp rather than 50bp hikes while they assess the impact of what they have done so far. A

hike is still a hike. QT is continuing and money is gradually getting tighter. US M2 growth for October was just +1.3% YoY versus a long-term average of +7.1% and a peak of +26.9% in Feb21 – those were the days! Latest September data for NZ is -4.6% and Australia is -7.2%. The strong recent market rally will at some point come up against this withdrawal of liquidity.

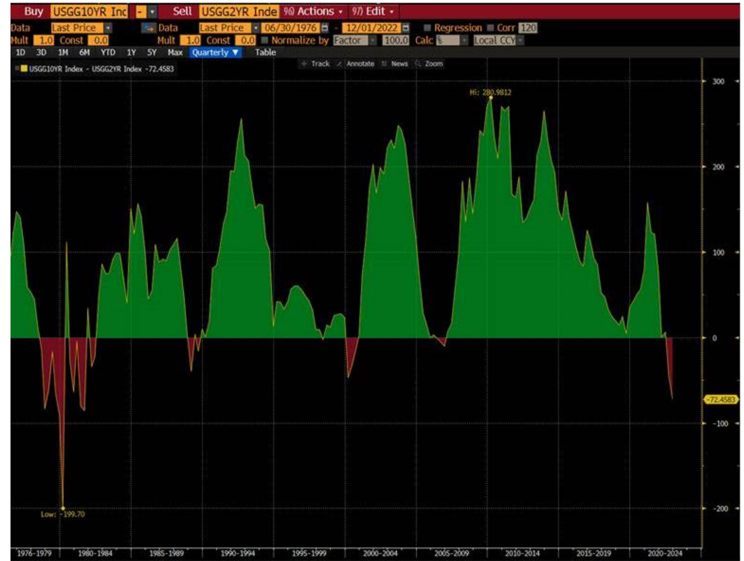
2022 was all about higher rates. We think 2023 will be all about tighter liquidity and avoiding earnings downgrades as economies falter thanks to tighter monetary policy.

For several years, we bemoaned the outrageously strong zero-rate driven performance of TINA and GAAP stocks. Many have come back to earth this year with a thud. That said, Australia remains the land of the 50x PE and 15x revenue multiple and some of our shorts in that space have been disappointing compared to the carnage amidst profitless "growth" stocks in the US market. We suspect 2023 could be difficult for cyclicals, with the complication that massive cost burdens post-Covid may start to ease for some companies.

The magnitude and likelihood of the earnings risk in the US market is really brought home to us by the chart below. CEO confidence suggests earnings downgrades have more to go yet.

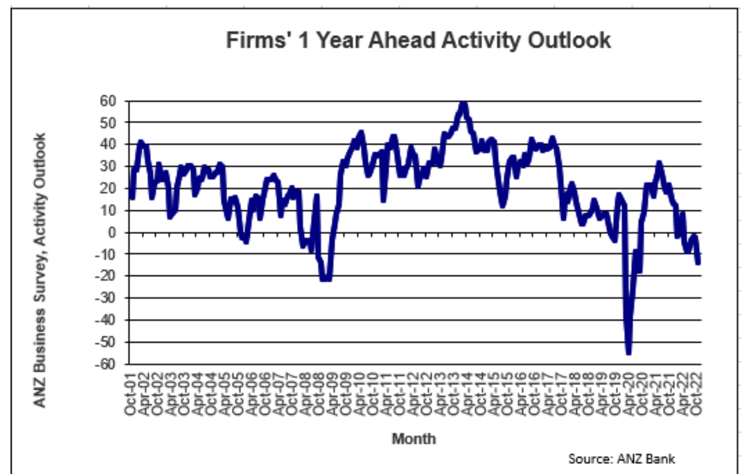


This is hardly one isolated data-point. The Chicago PMI is a good measure of heartland activity and tumbled to 37.2 in November (47 expected), similar to readings that foretold recession in 2001 and 2008/09. The US 2/10 year yield curve (shown below) is telling the same tale, with extreme inversion of 70-80bp, which is the most inverted since 1982. This screams a sharp economic slowdown ahead.



The situation in NZ is very similar. At month-end, our 2/10 year yield curve was 56bp inverted with yields of 4.67% and 4.11% respectively. This was a sharp move from only 11bp inverted at end-October and a 6bp positive slope at end-September. Fixed interest investors are sending a clear message about the economic outlook following the 75bp OCR rate hike to 4.25% on 23 November.

The monthly ANZ Business Outlook survey suggests this message is on the mark. Firms' own activity outlook has a strong linkage with future GDP and weakened to -13.7 at end-November. Aside from the brief Covid collapse, this is the lowest since the post-GFC recession.



Firms' year-ahead profit expectations weakened from -30.2 to -45.1 in November due to a nasty combination of rising costs and slowing revenues. Stunningly, this is even weaker than the -42.9 reading recorded in the grim post-GFC nadir in

Jan09. We repeat that 2023 will not be about the last rate hike or two from central banks, it will be about earnings.

One last chestnut in the ANZ survey was the collapse in residential construction expectations from -43.8 to a scarcely believable -90.0. We have received a lot of anecdotal feedback that builders are busy for the next several months but have a major hole after that. A large property company has told us that subbie costs are just beginning to fall and that trying to sell hoarded building materials at old high prices no longer washes.

This collapse in building sentiment has been accompanied by a plethora of evidence showing housing market weakness. Prices are falling, clearance rates have plunged and listings are starting to build up. Our long-standing bearishness on the closely linked retirement sector is finally coming to fruition, with Ryman's -20.6% plunge in the month engendering some unworthy feelings of schadenfreude given the pain we took on the way up a few years ago. We still have a short position and it was a good contributor to returns, but as always in hindsight, we wished it had been larger.

We remain cautious as the retirement companies are already seeing debt build up even though their reported sales have remained surprisingly strong thus far. Our doomsday thesis has been that a housing market slowdown would see incoming residents unable to sell their own homes and thus be unable to settle on their village unit. A build-up in resales and especially new sales inventory could then put enormous pressure on the companies' levered balance sheets.

Fund Performance in November

Returning to the Fund's performance in the month of November, the overall return of -0.90% pre fees and tax reflected the varied outcomes of individual stock selection decisions rather than any major biases. Both our long and short books detracted around -0.45% from returns. The "winners to losers" ratio of 54% was well down on previous months and our losers skewed larger.

Our overall positioning changed little, with the gross exposure remaining at the low end of our normal ranges at 122.5%. Our net exposure was also static at 42.5%, which given our style, provides us with a relatively neutral exposure to market movements.

We continue to have no correlation to long-only equities. The 50/50 index of Australia and NZ had eight down-days in November, with an average return on them of a negative -0.45%. The Fund was up on five of those eight days but with an average return of -0.01%. The Fund's performance had no relationship to what long-only markets were doing.

The strongest headwind again came from our position in Lynch Group (LGL, -27.5%). They delivered a disappointing update at their AGM, downgrading earnings for this year due to a trifecta of woes. Firstly, continuing Chinese Covid lockdowns hurt margins despite solid revenue growth; ultra-expensive air freight prices are yet to meaningfully revert (lockdowns seem to still be affecting space out of China); and one of their key supermarket customers in Australia implemented an automated ordering system which created issues. None of these problems are permanent and LGL is clearly a great re-opening play but we regret underestimating Covid impacts and buying LGL a few quarters ago rather than into its current weakness. They retain a dominant flower growing and distribution position in China and Australia, with strong returns in normal market conditions and ultra-cheap 5-6x PE multiples if/when such conditions return.

The second key detractor was another repeat offender in Global Data Centres (GDC, -9.8%) which has a poor performer for the Fund. There was no discernible news driving this and we can only surmise that it was caught up in broader weakness in the data centre sector. GDC is currently profitable, it has strong growth as capacity is filled up and it trades at just half of a very conservative independent NAV, which includes their minority stake in Airtrunk at well below likely future IPO levels. We retain a strong view that GDC has capable management but has not worked as a listed vehicle and would be better off being owned by an unlisted player.

The third notable headwind was our short position in Technology One (TNE, +12.9%). This is a name we have been in and out of over the last few years as our base position is that it is an old-fashioned enterprise software integration business which is all dressed up in fancy SaaS clothes. To our mind, it does not have the same growth potential and network economics of the best SaaS businesses and it should not be on their multiples. They delivered a slightly better than expected result which was enough to set off the growth investor brigade.

The stand-out positive contributor was our large long-held position in Tower Limited (TWR, +7.6%). They delivered a solid result which the market responded to positively. TWR remains a rare beneficiary of rising interest rates as their insurance float of c$340m is invested on a 4-6 month duration and is moving from earning nothing to considerable returns. Further, they are now largely through the worst of the claims cost cycle, where it takes a year for policies to turn over and be re-priced. Should costs start falling in the period ahead, this will work in reverse to their benefit. Although no longer that material, one negative is that old Christchurch claims keep being re-opened almost as fast as they are closed off. The real swing factor is large events. TWR has had $20-$23m in the last 2 years and assumes $30m in this year's guidance. 2 months into the year, we have had none and there have been a number of sub-$10m years in the past. Analysts are running with the full $30m impost and this is a hugely material swing factor in the context of their $27m-$32m guided NPAT range.

The second largest contribution came from our holding in the gold mine developer, Bellevue Gold (BGL, +48.6%). This is a name we have traded with the gold price for some time. It has a large low-cost mine that it is developing in West Australia, with everything to date going in line with or ahead of plan. The operational build and ramp-up is the riskiest period for any mining company, with Australian corporate history being littered with failures at this stage. For this reason, pricing can be very attractive for those that can get through it. We took the view that BGL was relatively low risk as these things go and exceedingly cheap. We lowered our holding into the sharp price increase.

A third key winner was our large long in Monash IVF (MVF, +5.8%). MVF was the subject of unsourced press speculation that they were in the sights of an unnamed foreign buyer. MVF subsequently said they are yet to receive any approach. We obviously have no insight as to the veracity of the article but MVF is the last man standing in the sector and has very attractive valuation metrics in our view for what is a long-term structural growth story. Nothing transpired by month-end but it was enough to lift the share price off its lows.

Despite general market strength in the month, we had three positive highlights from the short side. National Storage REIT (NSR, -8.4%) sharply underperformed the Australian property sector; Ryman Healthcare (RYM, -20.6%) revealed a surprising lift in debt levels in their result, ahead of a period where the housing market is only going to worsen; and Collins Foods (CKF, -18.6%) delivered notably weak guidance due to significant cost pressures.

Thank you for your continued support of the Fund. November was not a month that we will remember fondly but it was far from disastrous and we remain very comfortable with our key positions. It is always hard to know as events play out in live-time but we strongly suspect that the strength of the last couple of months in long-only markets is largely a bear market rally. While the last few rate hikes are now priced in, liquidity will only get tighter and earnings risk will really come into focus as 2023 unfolds.

I will be away at the very end of this month, so the next letter will be in early to mid-January. Best wishes for the festive season and 2023.

Matthew Goodson, CFA

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