Salt Long Short Fund Fact Sheet – July 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 31 July 2022

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$60.8 million
Inception Date	31 October 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 31 July 2022

Application	2.1355
Redemption	2.1269

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 July 2022

Long positions	43
Short positions	34

Exposures at 31 July 2022

Long exposure	96.31%
Short exposure	53.82%
Gross equity exposure	150.13%
Net equity exposure	42.49%

Investment Risk to 31 July 2022

Fund volatility[1]	6.45%
NZX50G / ASX200AI volatility[1]	14.02%
NZX50G / ASX200AI correlation	0.087

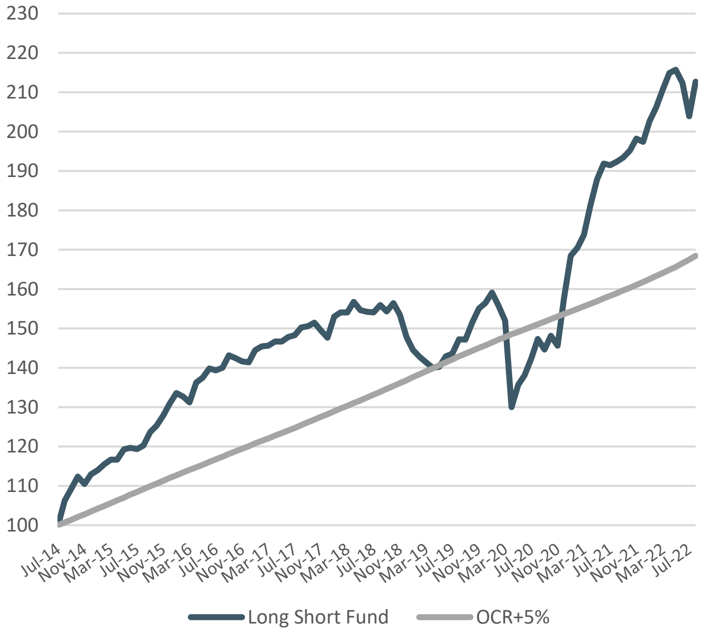
1. Annualised standard deviation since fund inception.

Fund Performance[1] to 31 July 2022

Period	Fund Return	OCR+5% Return	NZX50G/ASX 200AI Return[2]
1 month	4.31%	0.56%	5.75%
3 months	-1.41%	1.69%	-4.64%
6 months	3.16%	3.13%	-0.76%
1-year p.a.	10.56%	5.96%	-5.40%
2 years p.a.	20.16%	5.59%	6.39%
3 years p.a.	13.05%	5.64%	4.48%
5 years p.a.	7.20%	6.07%	8.48%
7 years p.a.	8.49%	6.39%	8.75%
Inception p.a.	9.79%	6.66%	9.16%

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 31 July 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
Dalrymple Bay Infrastructure	Arena REIT
Global Data Centre Group	Wisetech Global
GDI Property Group	Endeavour Group
Australian Vintage	ASX

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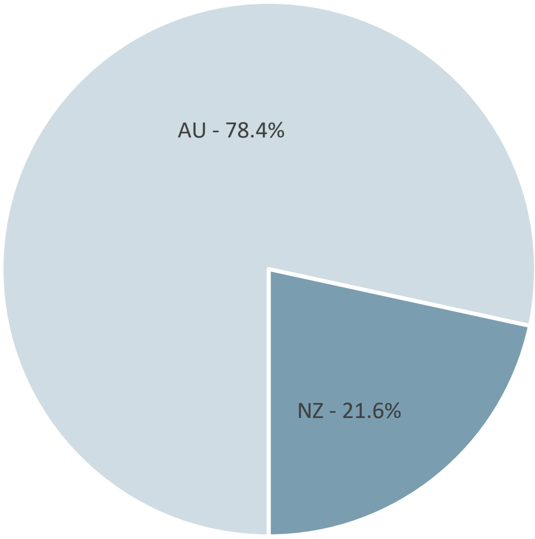
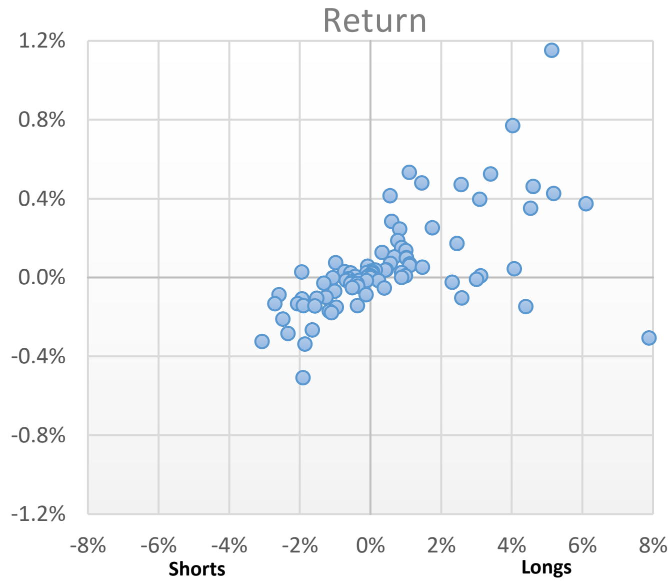
Country Allocation at 31 July 2022 (Gross Equity Exposure)



July 2022 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

The Fund rebounded from its temporary weakness in June and enjoyed a month of very strong performance in July, with a return of +4.31%. Markets similarly bounced extremely hard, with both the NZ and Australian equity markets rising by +5.7%, within which, we saw aggressive short-covering rallies in the most oversold portions of the market. With longer term bond yields falling across the world, technology stocks and REITS staged particularly strong advances.

Superficially, it appears as though the Fund has become more correlated to long-only markets in recent times, with the Fund following equities down (albeit by far less) in June and rising by slightly less than equities this month. While that is certainly the performance outcome, movements under the hood suggest we remain uncorrelated. This is shown by how the 50/50 index of Australia and NZ had eight down-days in July but the Fund was actually up on seven of them and delivered a positive average return of +0.28%. By month's end, it just so happened that both the Fund and long-only equities were up strongly – we very much retain a zero correlation to equities.

So far in calendar year 2022, the Fund has returned +5.0%, while NZ equities are -11.8% and Australia is -4.7%. Our difficult but generally successful quest to deliver positive returns with less volatility and no correlation to equity markets continues unabated.

The most commonly cited explanation for equities rising so sharply in July was that "bad news was good news". A mix of weak economic data and an inverted yield curve saw markets interpret what seemed a relatively balanced and data-dependent set of comments from Fed Governor Powell as dovish. The view emerged that by raising rates another 0.75%, the Fed has now caught up with economic pressures and will be able to slow down its hikes from here. Bulls argue it may even reverse some of them in 2023.

Similarly, the ECB moved further than some expected and hiked its three policy rates by 50bp rather than 25bp and signalled more rate hikes are in prospect for their next meeting in September.

So, the bull case is that economies are slowing, which means inflation has already peaked, which means that central banks will soon be able to slow and then stop hiking. We view this as a very dangerous justification for breaking rule number one of investing – "don't fight the Fed".

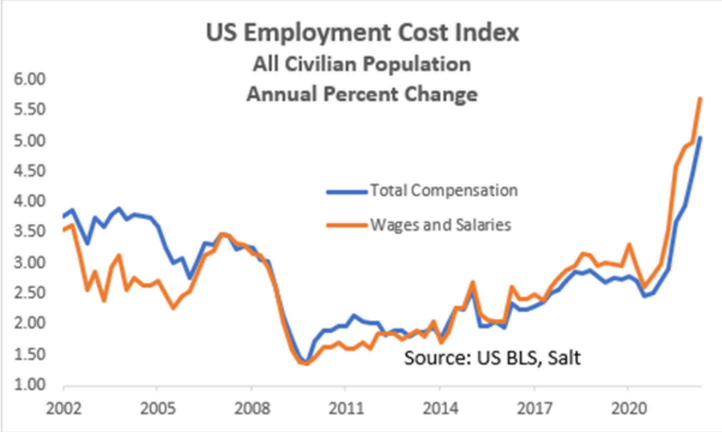
The problem is that this is a very different economic cycle to those in recent decades. We have seen two major negative supply-side shocks from Covid and the Ukraine war collide with super-charged demand that was created by ultra-loose monetary policy which wrongly presumed inflation was beaten. It isn't. The market is suddenly forgetting that negative supply-side shocks mean both less economic activity and higher prices. See the 1970's.

From here, what really matters is whether inflation has peaked (possibly), and more importantly, to what levels it will recede (more likely to be problematic). Our fear is that inflation is indeed peaking but that it may not fall back to within central bank target ranges. The risk-on rally in July seemed to discount what we think is this very reasonable view.

We think that inflationary pressures are currently plateauing in many countries around the world but evidence for this is still anecdotal rather than appearing in the hard data. For example, the Fed's favourite measure of the core PCE deflator rose by 0.6% in the month of June to post a new high of +4.8% YoY versus + 4.7% expected. Similarly, in NZ, firms' selling price intentions in the monthly ANZ Bank survey have at least stopped rising sharply but the +74.0% reading in July was a tad above June's +73.7% and can't actually climb much further with agricultural firms being lower. Generalised inflation expectations rose again from 6.02% to 6.23%.

Our view that inflation is peaking is based on a range of anecdotal observations that will feed through to the data with varying lags. Soft and hard commodity prices have both fallen sharply. Iron ore has plunged -23% from its recent peak, copper has declined -25%, oil is -18% and wheat has fallen -26% as the North American harvest outlook appears favourable and some Ukrainian exports may occur. Shipping rates are still very high but have fallen from their peaks and we have written previously that a "bullwhip effect" may increasingly occur in commodities and goods that have been overstocked. House prices are generally falling quite quickly and this may feed through to lower rental inflation. These factors will lessen CPI inflation.

However, there is a key remaining problem with the inflation outlook, which is that the wage inflation party is only just beginning. Stories abound in many countries of labour shortages and rising wage inflation. With labour being 70% of the cost of everything on average, this really matters. This wage/price feedback loop is why once inflation gets embedded, it can be so hard to stamp out. With unemployment in the low 3% region, no one is going to accept a wage increase that is less than price inflation. For example, the Fed focuses on the wages & salaries component of the Employment Cost Index and this has risen from +5.0% in January to +5.7% in April. The golden post-GFC period for markets saw this anchored at 1.5%-3.0%.



Central banks now have little choice but to do their best Volcker impersonation and stamp inflation out. They are saying they understand this (even the RBA and RBNZ seem to) but financial market movements during the month suggest that the idea of a "Fed put" remains alive. They are not yet credible in their inflation-fighting efforts. For this nano-second, the market wants to "fight the Fed" but charts such as that above suggest that central banks shouldn't buckle as soon as the going gets tough. They may need to keep tightening even as economies fall into recession. As Paul Keating once said, maybe it will be "the recession we have to have".

The other thing for bulls to remember is that past tightening is still feeding through the system. The Fed's QT program has been at $47.5bn for each of June, July and August but will ramp up to $95bn a month from September onwards. This is driving slower US money supply growth (M2). This has averaged +7% growth long run but spiked to well over +20% through much of 2020 and 2021. It is now back to +5.9% and appears certain to fall further. Markets behaved in July as though we're back in the halcyon 2020/21 days of free money but we would suggest that liquidity conditions are tightening and will tighten further.

Similarly in NZ, the RBNZ has ended its controversial programme of QE and has embarked upon $5bn/year of QT beginning in July. Liquidity conditions are tightening everywhere.

Summarising our macro view, we think that inflation is peaking but that is unlikely to fall back into central bank target ranges any time soon. Central banks will need to keep the pressure on. Markets rallied sharply in July on hopes that central banks are through the heaviest of their hikes but we would suggest this view is premature. Future inflation outcomes will determine the accuracy of our view but inflation is getting too entrenched in labour markets to be over already. Further, the full impact of QT is barely getting started as the liquidity punchbowl moves from getting emptied a little to being removed. Don't fight the Fed!

So what did the Fund do above this during the month? We certainly did not sit idly by and enjoy the rally. Market outperformance was led by our old enemies of GAAP stocks (growth at any price) and TINA stocks (there is no alternative), which turned in what will hopefully be one last cameo appearance as long-term bond yields fell across most markets.

In Australia for example, the two leading sectors were Information Technology (+15.2%) and REITs (+12.1%) versus the S&P/ASX200 at +5.7%. We lightened longs and lifted our shorts in both segments. At the same time, our fears of a potential stagflationary environment meant we did not chase lagging cyclicals. We have tried to concentrate on longs in stocks that are very cheap, which are special situations and where earnings outlooks are hopefully somewhat robust to the gathering stagflationary pressures.

Overall, we took the Fund's net length down from 49.5% to 42.5% and used the volatility that the month offered to lift our gross positioning (longs + shorts) from 147% to a slightly higher than average 150%.

Fund Performance in July

Returning to the Fund's performance in the month of July, the overall return of circa +4.3% pre fees and tax was unsurprisingly driven by highly divergent contributions from our long book (+8.0%) and our short book (-3.7%). It felt really bad at the time during June but we are relieved that we kept our nerve and took advantage of some quite extreme tax-loss selling in the month. We unwound some of this during July into the sharp rebound.

Our overall "winners to losers" ratio was a solid 57% and our winners tended to be of greater magnitude than our losers. We had 48 longs and 85% of them rose, while we had 41 shorts of which only 24% declined in a strong month across the board.

The largest contributor by some distance was the large long we build up in Global Data Centres (GDC, +22.9%). In recent months, we have bemoaned its declining share price which had been exacerbated in June by tax-loss selling. During July, GDC delivered a 29% uplift to its NAV, taking it to $2.37 versus a share price that started the month at $1.29 and ended the month at $1.585. This is ungeared with GDC having net cash. In our view, the NAV may still be somewhat conservative given the reported successes of mega data centre developer, Airtrunk, in which GDC holds a small minority position.

From here, we see GDC as being something of an orphan on the listed market. We don't expect that the external management business of the highly experienced David Yuile is making any money at GDC's current scale but the continued discount to NAV makes raising new equity problematic. We think that a privatisation by a pension fund or some form of private equity would make a lot of sense as they would get some attractive assets and a capable investment team. However, this is purely our speculation and may happen tomorrow or never.

Our second key contributor was the long-held position in Monash IVF (MVF, +18.6%), which rebounded from declines in the prior two months. At the start of the month, MVF used their pristine balance sheet to make a sensible bolt-on acquisition in Queensland which generated moderate earnings upgrades. Medicare data suggests that procedure numbers remain solid and we remain attract to the acyclical tailwind that comes from an ageing population. Takeover activity in the broader sector has seen MVF mentioned as a target in the press although this has been rather loosely sourced. We view it as a superior operator to Virtus, which was a strong contributor to the Fund following an epic private equity battle.

A moderate holding in Tietto Minerals (TIE, +54.8%) was a surprising number three on our contribution list. We have holdings in three cheap/quality gold names on a slightly speculative view that the gold price has done little thanks to the strength of the US$ which may in turn be close to peaking. The Australian sector has been under enormous pressure from cost blow-outs, with diesel and labour costs being key drivers. TIE is building a very attractive mine in the Ivory Coast, its construction costs are largely locked in, it is powered by hydro-electric sources and has significant exploration upside on what looks like an under-priced mine based on existing reserves alone. The Chinese major, Zhaojin Mining became a SSH during the month and this lit a fire under the share price.

Similarly to the above, another gold holding Bellevue Minerals (BGL, +32.8%) also contributed strongly. BGL is also in the advanced stages of developing what is projected to be an extremely attractive gold mine. They are located in WA but have in locked the great bulk of their construction costs and very low operating costs provide a strong shield against future margin pressure.

There were a number of other strong contributors as names rebounded from the weakness in June. The mining equipment business Emeco Holdings (EHL, +13.1%) had been oversold in our view as its low labour intensity should see it be less susceptible to cost blow-outs; Superloop (SLC, +17.4%) rose as a buyback began; Kina Securities (KSL, +9.3%) rose on new news although the ruling PNG Government appears likely to return after a typically chaotic election; GDI Property (GDI, +7.7%) bounced with numerous other property stocks; and our small holding in Genex Power (GNX, +87.0%) benefitted from a takeover bid which may have further to play out yet. There were no notable short-side contributors.

The largest headwind by quite some distance was a short in our old friend, Wisetech (WTC, +32.3%). We had a moderate position when they upgraded guidance for sales to the top end of their range and earnings above the top-end based on cost savings. They also benefitted from the general backdrop of tech stocks running hard in July on lower bond yields. We shorted more into the strength as it seems to us that Australian tech investors view themselves as a special case, immune from the calamitous decline that such stocks have suffered elsewhere in the world. To put WTC in context, it now has a $16.5bn market cap for Jun22 revenue of $621m and NPAT of $176m. So, it is on a price/sales multiple of 26.5x and PE ratio of 94.5x. Never mind, it falls to a mere 21.6x revenue in Jun23 and PE of 73.4x – assuming the post-Covid cargo boom continues unabated.

The second detractor of note was our short in the property funds management business, Homeco (HMC, +18.6%), which ran hard after being a good hedge in earlier months. We have no particular issues with HMC per se but view the current environment of rising interest rates and cap rates as being rather difficult for an aggressive growth-focused manager that is valued on multiples that require growth to be delivered.

Similarly, two of our other hedges in the property space also detracted from returns. Bunnings Warehouse Property (BWP, +10.0%) is not hugely geared but models out as being very expensive on our relative valuation model. We used strength to lift the short position. We had covered off much of our Arena REIT (ARF, +12.7%) short into extreme weakness in June and the share price then promptly went straight back up again. While not super-geared, its long WALT leases are mis-matched against a shorter debt profile and we are wary that its childcare tenants are not experiencing the most profitable of periods. Entry barriers for childcare property are low.

The only notable detractor from the long side was our large position in Tower (TWR, -3.9%) which declined on no particular new news other than vague fears that the wet July may create more claims. We still see a company on a sub-10x PE, with a strong balance sheet, decent growth, an apparent IT edge against its lumbering competitors, a positive exposure to rising interest rates and an insurance cycle where they will benefit from having repriced for claims inflation that may have peaked. The one headwind is that reinsurance rates may rise but this will be the case across the market and should be passed on.

Thank you for your continued support of the Fund. We are pleased to have reversed June's losses by holding our nerve in that weakness and adding to long positions. It was not easy at the time. Conversely, we view the sharp rally in July as being premature at best, with low quality names having led the way in many markets. We sold into it.

While inflation may be peaking, we view it as having become somewhat embedded and that it is too soon to expect central banks to take their feet off the brakes. QT is only really getting under way now. As ever, Covid and Ukraine developments remain the wild cards. Irrespective of what surprises lie ahead, we will strive to continue delivering equity-like returns over the long run, with far less volatility than equities and no correlation to them.

Matthew Goodson, CFA