Salt Long Short Fund Fact Sheet – October 2023

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 October 2023

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$77 million
Inception Date	1 July 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 31 October 2023

Application	2.3645
Redemption	2.355

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 October 2023

Long positions	54
Short positions	34

Exposures at 31 October 2023

Long exposure	103.66%
Short exposure	49.63%
Gross equity exposure	153.28%
Net equity exposure	54.03%

Investment Risk to 31 October 2023

Fund volatility[1]	6.45%
NZ50G / ASX200AI volatility[1]	13.67%
NZ50G / ASX200AI correlation	0.076

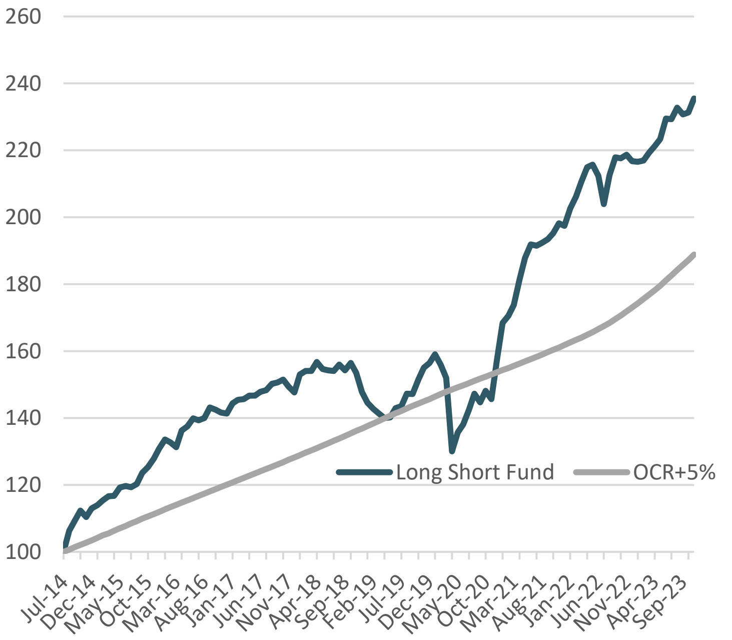
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 31 October 2023

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	1.81%	0.88%	-2.53%
3 months	1.20%	2.54%	-2.99%
6 months	5.44%	5.18%	-2.80%
1-year p.a.	7.69%	9.91%	7.23%
2 years p.a.	9.00%	8.29%	-3.03%
3 years p.a.	17.37%	7.27%	5.17%
5 years p.a.	8.94%	6.76%	5.90%
7 years p.a.	7.53%	6.76%	7.32%
Inception p.a.	9.61%	7.05%	7.66%

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 October 2023



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
GDI Property Group	Reece
Tower	Goodman Property Trust
Global Data Centre Group	Commonwealth Bank of Australia
Lynch Group Holdings	Data#3
Superloop	Fortescue Metals Group

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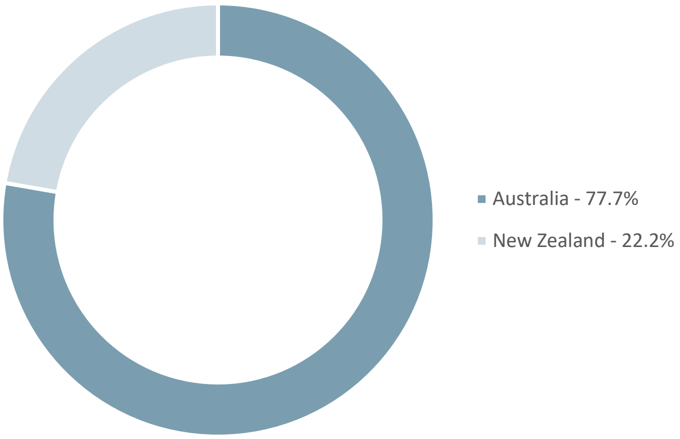
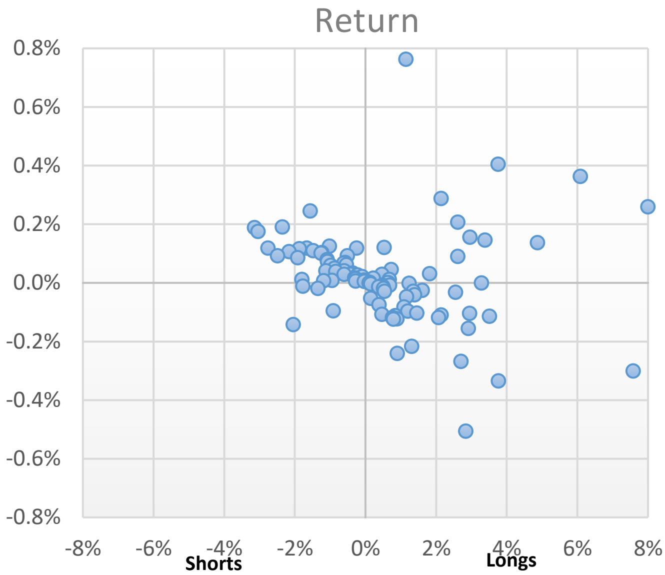
Country Allocation at 31 October 2023 (Gross Equity Exposure)



October 2023 Individual Stock Contribution



Fund Commentary

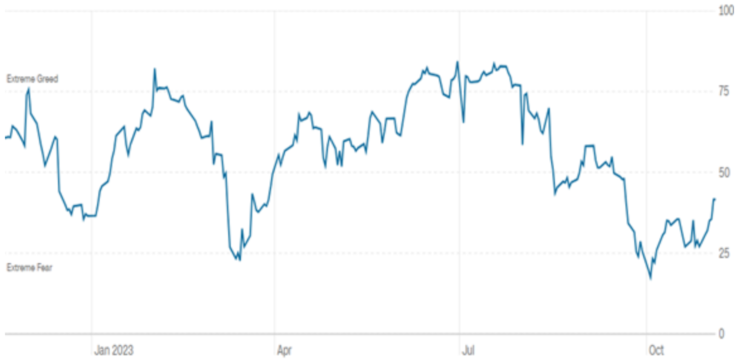
Dear Fellow Investor,

The month of October saw the Fund deliver a very pleasing return of +1.81%. This contrasted starkly with dismal performances by long-only equity markets around the world. The MSCI World Index declined by -2.9%, Australia fell by -3.8% and the formerly low-beta NZ index fell by a nasty -4.8%.

Sharp rises in bond yields cast a pall on almost all investment classes but we were pleasingly able to shake that off. Despite further extending our net length over the 50% mark, a combination of our investment style and strong stock selection saw the Fund do well. This again shows how the Fund delivers equity-like returns over the medium to long term but with less than half the volatility of equities and with no correlation to them.

It is important to highlight that while we did well this month, there is no guarantee that the Fund will always perform well in such circumstances. No correlation really does mean no correlation. When markets are up, we may be up, down or flat. When markets are down, we may be up, down or flat. What really matters is that we are up far more often than we are down, with 77 out of 112 months of the Fund's existence having been positive. 31 out of 37 quarters have been positive.

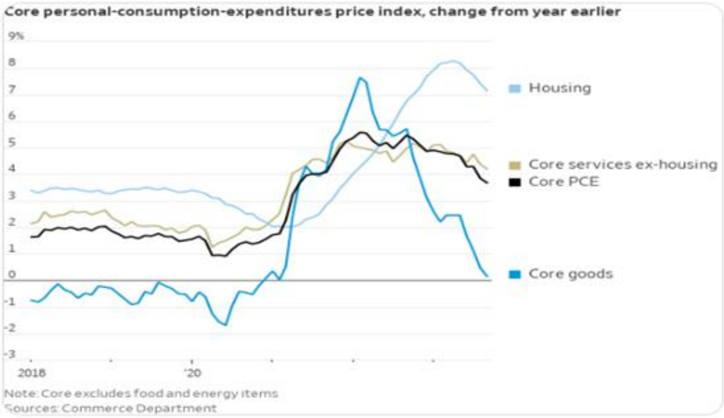
While equity markets were dismal in the month, the capitulation in sentiment made them prime for a bounce in early November, which we have indeed seen. As shown below, the CNN Fear & Greed Index made a rare excursion into "extreme fear" territory below 25 in early October and spent the last few days of the month close to that territory.



Along with a large range of other indicators, this spike in fear pointed to a tradeable sentiment trough and so it has proven. While markets felt awful, and we were nervous that we were getting too long in the 54% region, early November's movements suggest we should have gotten longer still.

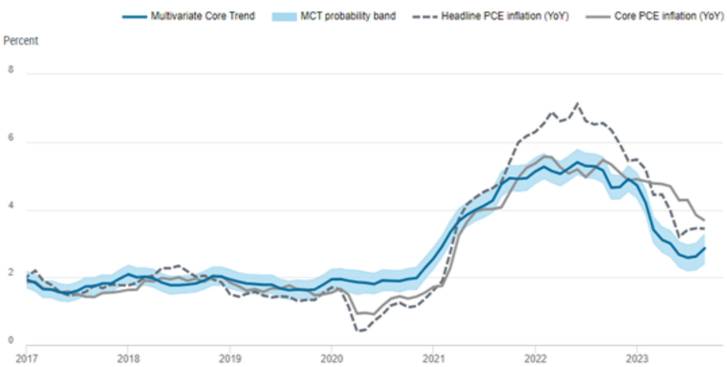
The CNN Fear & Greed Index has yet again proven a useful short term trading tool. That said, markets are almost back into neutral sentiment territory already and such positioning indicators provide little information about the longer-term fundamental drivers that really matter. The key question from here is whether the pincer attack on equities from higher bond yields and weaker earnings forecasts is really over. Maybe we have seen the worst of it but difficult days remain ahead.

In thinking about the bond yield part of the pincer attack, you need to break nominal yields down into their real yield and inflation components. Relatively muted Fed comments at month's end raised hopes that we have seen the last rate rise and saw US 10-year bond yields rally from 4.91% to 4.52%, entirely reversing the sell-off in October. Equities have reacted similarly. On balance, evidence in October suggested that US inflation has peaked and is now declining. This is shown by the Fed's favourite core PCE deflator below.



What is striking in this chart is the collapse in goods inflation, whereas services inflation is only slowly dwindling due to continued high wage inflation. To this end, the non-farm payrolls data for October released just after month-end was encouraging. Unemployment ticked up from 3.8% to 3.9% and average hourly earnings rose by only 0.2%, albeit they were still up by 4.1% YoY.

Inflation has clearly peaked but the inflation compensation component of bond yields will only continue to fall if such evidence continues. On this, the jury is still out. US CPI inflation for September was stronger than expected, while "persistence" measures such as NY Fed multivariate core trend PCE inflation measure ticked up at end-October (blue line below).



Data is similarly mixed down under. NZ CPI inflation was less bad than expected for the September quarter but this all came from tradeables inflation with non-tradeables still being far too high. Timely measures such as firms' cost expectations and selling price intentions in the ANZ Business Outlook survey remain very high. The RBNZ was correct in its pre-election monetary policy decision to leave the OCR at 5.5% but strongly suggest that rates will remain higher for longer.

Australian Q3 CPI inflation was well above market and RBA expectations, with the key trimmed mean measure being +1.2% for the quarter and + 5.2% for the year. The only surprise is that the market is only pricing a 69% chance of a Melbourne Cup-day rate hike rather than 90%+.

What does this extended inflation discussion all mean? We think the inflation component of bond yields has peaked and correctly fallen in the last few days but don't extrapolate this too much further. It will likely require a sharper economic slowdown that what the US and Australia are experiencing for the inflation genie to be truly put back into the bottle.

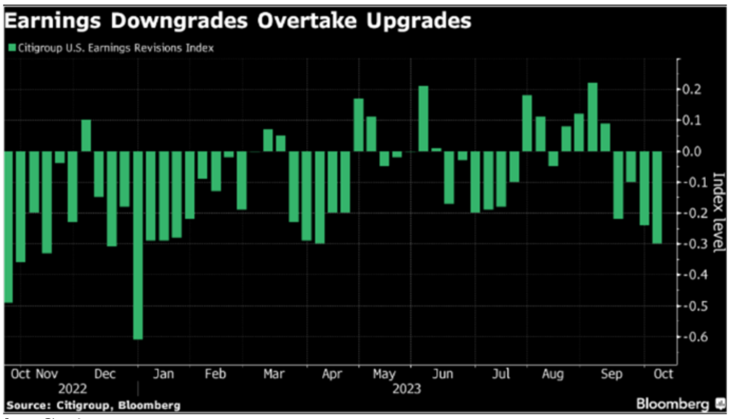
Meanwhile, as shown below, the real yield component of bond yields has surged to new multi-decade highs of 2-2.5%. With governments running large deficits at a time of record low unemployment and ahead of a demographic iceberg, there seems little appetite in most Western countries to move to more sustainable fiscal settings. Who would lend money to profligate money-printing governments against this backdrop. Real yields are unlikely to fall below 1.5%-2% any time soon. They certainly won't return to their -1% levels in the heady days of 2020-21.

Put all this together and we think bond yields may have seen a short-term peak as inflation comes off its highs. However, it is only falling slowly and real yields will remain high. We think bond yields are more likely to range trade rather than fall markedly further from here. Going forward, equity markets will have to contend with proper discount rates that they haven't seen since pre-GFC times.

Historically, equities have been a good hedge against moderate inflation because it tends to boost earnings growth, offsetting the impact of higher bond yields. However, it is different this time because rather than being caused by excess demand, inflation has been generated by negative supply-side shocks due to Covid, wars and the maturation of China's labour cost impulse.

Heavily inverted yield curves are a harbinger of recession, with earnings downgrades and somewhat lower bond yields to follow. We reiterate our view from last month to be short expensive cyclicals and long a range of names that had been hammered by the rise in bond yields. This is the opposite set-up to the post-Covid 2021 period.

The Citigroup US Earnings Revision Index shown below speaks for itself.



Source: Bloomberg

In NZ, the August earnings season saw the largest proportion of downgrades and the lowest proportion of upgrades in the last two decades according to Forsyth Barr analysis. This weakness came from cost inflation, softer revenues leveraging through to lower profits and also from a sharp lift in interest rates beginning to feed through to financing costs. Australia was thematically similar although the better state of their economy meant that downgrades were less intense.

Fund Performance in October

Returning to the Fund's performance in the month of October, our overall return of circa +1.9% pre fees and tax saw our short book unsurprisingly contribute +2.6%, while our long book only cut -0.7% off returns – a pleasing outcome in such a tough month for markets. 24 out of our 56 long positions actually rose and a number made strong positive contributions. At the same time, 39 out of our 43 shorts fell although none were individual stars in terms of contribution. Digging under the hood a little, strong stock selection more than offset relatively long positioning and headwinds from a couple of large detractors. Our overall "winners to losers" ratio was an excellent 64%.

Our gross exposure fell slightly over the month from 156% to 153% as we covered a degree of our shorts on weakness. Our net length rose slightly from 53% to 54% but we were still able to provide solid returns when markets fell. We suspect this was due to stock selection rather than truly neutral positioning and our stance is now perhaps slightly net long in risk-adjusted terms.

October saw the 50/50 index of Australia and NZ repeat its dire performance from September, with an extremely high number of 14 down days. Those 14 days had an average return of -0.47%. Pleasingly, we were up on 9 of the 14 days, with an average positive return on all of them of +0.05%. As always, the sample set of daily returns over a month is very small but for years now we have reported a similar pattern – when markets are down, we tend to either be up or be down far less.

One of my favourite albeit banal sayings is that "luck is where skill meets opportunity". If that is the case, then we will happily take the luck that came from our mid-sized long in Tietto Minerals (TIE, +67.2%). This is a name we have bought and sold several times over the last several years as they have been building a large, low-cost gold mine in Cote d'Ivoire, one of Africa's best jurisdictions. We sold out prior to them hitting commissioning issues due to artisanal mining depleting some near-surface zones and slightly disappointing grade reconciliation to what had been modelled. With the share price being crushed on these issues, we bought back into what we still see as a large, low-cost, long-life gold mine. Clearly the Chinese major, Zhaojin Mining shared this view with their takeover bid late in the month. We took a little off the table but we see some prospect of a competitive situation, so we will see what unfolds.

More generally, we only have around 2% of the Fund in gold stocks at present, with Resolute Mining (RSG, +4.4%) being the only other (small) position. We are somewhat conflicted in our views on this sector. The US$ gold price has done very well but gold equities have not really kept pace and many appear very cheap. However, with real interest rates around the world returning to pre-GFC levels of 2%-2.5%, the opportunity cost of holding non-yielding gold is high, so the price may fall if the US$ ever regains any traction.

The second notable tailwind came from another long in the form of our good-sized, long-held position in Turners (TRA, +11.2%). They had earlier delivered a surprisingly strong trading update at their ASM in August and they continued to rise as it became clear that they are likely to enter the key S&P/NZX50 Index in December. TRA is a classic long-term position for the Salt investment style. They generate strong free cashflows, pay a high dividend and have good reinvestment opportunities for the cashflow that is left over. On top of that they are cheap, with a Mar24 PE of 10.2x going to 9.7x in Mar25. Their brand name and financial wherewithal are seeing them inexorably take share from their undercapitalised competitors and this will likely continue for many years. A key headwind has been the partial hedging of their finance book in a rising rate environment but they are now through the worst of that and it may turn into a tailwind next year.

A third stand-out was our large, highly successful investment in Global Data Centres (GDC, +5.5%). After several doleful reports from us as we loaded up while it fell from the mid $1's to the low $1's, this has turned into a material winner. Press articles in the month pointed to Airtrunk being sold or listed and we believe this would create material upside versus GDC's carrying value. GDC's share price has already moved from the low $1 region to the low $2 region but we think their NTA could end up around $3 before the sale/wind-up process completes.

Other material contributors were led by our medium-sized long in APM Human Services (APM, +13.3%) which we bought near its lows when it fell away sharply post-IPO. There are some market concerns regarding their gearing but we view their cashflow generation as easily sufficient to meet any issues. We like their cheap valuation (forward PE of 10.1x) and their countercyclical exposure to rising unemployment rates from their retraining programmes.

Tower (TWR, +3.2%) did well after they upped their NPAT guidance from a mid-point of $0.5m to $8.5m. It is still a low number but it is remarkable to think that they will still make a profit in this year of volcanic explosions and biblical downpours. El Nino promises to be a quieter year and we suspect their profitability in a quiet claims year could shock the market as their repricing for inflationary cost pressures rolls through.

We had a large number of winners from the short-side but these tended to reflect overall market movements and none were particular standouts in their own right.

The largest headwind was yet again our position in the litigation settlement fund manager, Omni Bridgeway (OBL, -15.6%). The ongoing and aggressive short-selling attack continued unabated, with short interest rising from 19.6m to 21.2m shares. Our view remains that OBL has sufficient working capital to cover their ongoing management costs, contrary to the thesis of the shorts. Positive litigation settlement announcements have always acted as a catalyst in the past and we expect them to do so again, especially as OBL is close to large waterfall payments from some of their earlier funds now that they are almost through the preferential returns to investors. OBL has seen continued buying from Directors and large existing holders.

The second key detractor was our large holding in Superloop (SLC, -8.3%) as it became clear that it would be the jilted suitor in the chase against Aussie Broadband (ABB) to buy Symbio (SYM). We are relaxed about this and actually somewhat relieved that they showed good financial discipline. There are plenty more fish in the ocean as SLC deploys their under-geared balance sheet and extracts large potential synergies from bolt-ons as they move traffic onto their own network. As an offset, we have a moderate short position in ABB on the basis that they may need to raise equity and this has played out in early November as this is written.

Other negatives were smaller and were mainly among our longs in a tough month for the market. Emeco (EHL, -8.7%) declined on no particular news. Its free cashflow generation is not quite as strong as suggested by its PE of 4.3x but it is a very cheap stock and the mining equipment industry outlook is okay. We have been gradually building a holding in Elanor Investors Group (ENN, -21.9%) which was beaten up in line with other property fund managers. However, we see it as far cheaper, less geared and they are very good operators as shown by their remarkably accretive deal with Challenger.

A final headwind was a newish holding in Iress (IRE, -14.3%) which we are tiptoeing into amongst the carnage post their poor result. It closed the month at $4.99, which puts their Board's rejection 2 years ago of a $15.50 bid in an interesting light.

Thank you for your continued support of the Fund. Performance during the month, particularly from the long side, was very pleasing in what were once again very difficult equity markets.

Last month, we wrote that, "the sell-off in bonds will end when economic growth begins to slow and central banks can start to take their foot off the pedal. We are seeing increasingly interesting opportunities in sectors that have been hammered by higher yields, while we are becoming warier and ever shorter expensive cyclicals."

Well, early November has seen a sharp bounce in equities thanks to signs that bond yields have seen their highs, with central banks perhaps having down the bulk of their tightening. We do think Australia and especially Japan have further work to do but the markets likely have this right.

However, before piling headlong back into equities, do not forget that money supply growth is still negative in many countries and that "liquidity" continues to be removed from markets as key central banks continue QT. Further, while overall inflation has peaked thanks to goods inflation peeling off, it will take quite some time for services inflation to decline. Further still, long-term real yields have risen into the 2%-2.5% region that prevailed prior to the GFC as investors have lost faith that governments are serious about tackling large fiscal deficits post-Covid.

Put all this together and we have our doubts that the sharp bounce in early November will continue. Bull markets are much more fun but we doubt that bond yields can fall massively further from here. The other side of lower bond yields is that they speak to expectations of weak economies and thence earnings downgrades. We have used recent strength to lift our shorts in cyclicals which may be exposed to this. In these volatile times, we will likely lag equities in the odd sharp up-month but will highly likely do far better in down-months. Overall, we aim to continue to churn out equity-like returns over the long term with no correlation and far less volatility.

Matthew Goodson, CFA