SALT

Salt Long Short Fund Fact Sheet – September 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 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 September 2024

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$96 million
Inception Date	1 July 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 30 September 2024

Application	2.9059
Redemption	2.8942

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 September 2024

Long positions	52
Short positions	28

Exposures at 30 September 2024

Long exposure	95.65%
Short exposure	46.75%
Gross equity exposure	142.40%
Net equity exposure	48.90%

Investment Risk to 30 September 2024

Fund volatility[1]	6.56%
NZ50G / ASX200AI volatility[1]	13.46%
NZ50G / ASX200AI correlation	0.052

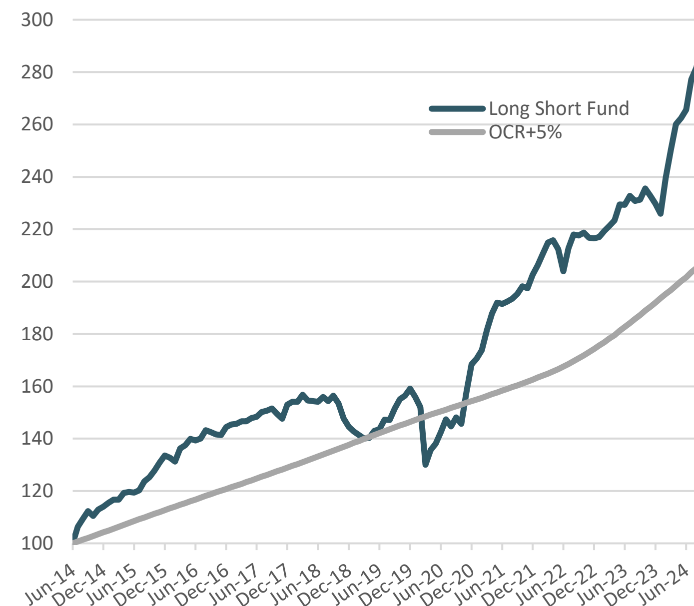
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 30 September 2024

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	2.71%	0.83%	1.39%
3 months	8.98%	2.59%	6.92%
6 months	15.66%	5.17%	4.65%
1-year p.a.	25.12%	10.47%	15.78%
2 years p.a.	15.33%	10.08%	11.42%
3 years p.a.	14.02%	8.85%	2.88%
5 years p.a.	13.82%	7.46%	6.21%
7 years p.a.	9.69%	7.23%	8.31%
10 years p.a.	9.93%	7.32%	9.09%
Inception p.a.	10.92%	7.34%	8.95%

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 September 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	Breville Group
Monash IVF Group	Scentre Group
Servcorp	Wesfarmers

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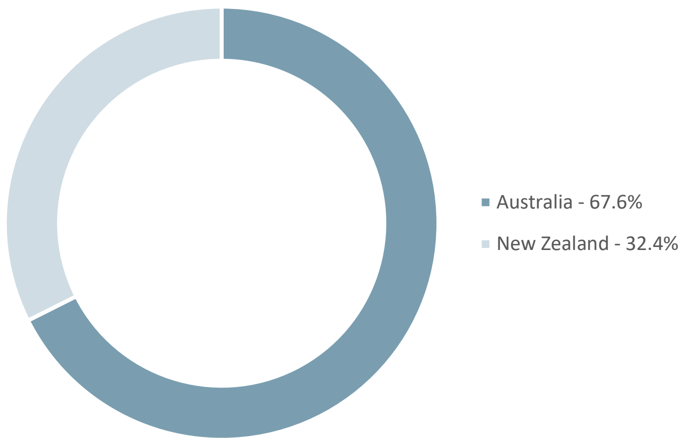
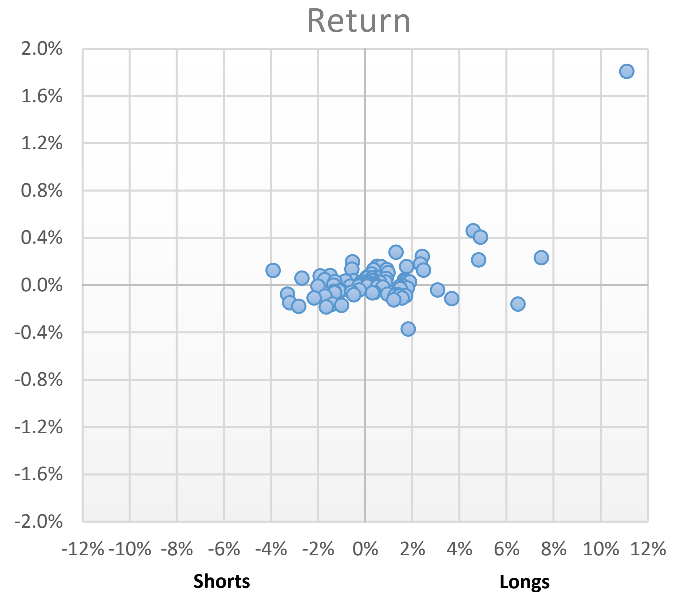
Country Allocation at 30 September 2024 (Gross Equity Exposure)



September 2024 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

We are pleased to report a very strong month for the Fund in September, with a return after all fees and tax of +2.71%. This compared to mixed returns from long-only equity benchmarks, with NZ declining -0.2%, while Australia advanced by +3.0%.

For the September quarter, the Fund returned +9.0% compared to +6.0% for NZ and +7.8% for Australia. We would not normally expect to surpass long-only equities during such a bullish quarter but we enjoyed a very strong period of stock selection outcomes in the Fund. This more than offset the unsurprising headwinds from our short book.

Importantly, we did not simply ramp up our risk tolerance and naively chase high-beta Australian growth stocks to ride the bullish wave. The Fund continues to have less than half the volatility of long-only equities and no correlation to them. What this means is that when we next walk into a nasty negative quarter for markets, we would have every expectation of still grinding out positive returns (but obviously no guarantee!).

Economic developments were very favourable for equities during the month, with inflation generally showing signs of abating, while the US economy looks set to have a soft landing. NZ is showing some tentative signs of hope that our hard landing may be near an end. With the exceptions of Japan and Australia, most central banks are moving into easing mode. Goldilocks is in the house.

The critical event during the month was the Fed cutting their rate target by 50bp to 4.75%-5.0% on 19 September. The key reasoning was, “the Committee has gained greater confidence that inflation is moving sustainably towards 2% and judges that the risks to achieving its employment and inflation goals are roughly in balance.” Their new dot-plot showed another 50bp of cuts by year-end. Governor Powell’s commentary made it clear that they will be data dependent. The equity market implications are obviously positive and the S&P500 rallied by 1.4% on the day and 3.2% from that point to month-end.

The decision was franked near month-end, with US core PCE inflation advancing by only +0.1% in August although it is still +2.7% YoY. This came alongside data showing weaker income growth and a cooling but not unduly soft labour market. Investors are now pricing 75bp of rate cuts over the two remaining Fed meetings. Powell made further comments

consistent with a data-dependent Goldilocks scenario – further rate cuts are coming but just when depends on the data.

The main risk to this immaculate disinflation is that services inflation proves stickier than markets currently expect. There are still some signs of this, with the US core CPI earlier in September printing at +0.3% versus +0.2% expected. Core goods were in outright deflation at -0.17% (-1.7% YoY) but core services were high at +0.41% (+4.9% YoY) and "supercore" inflation was +0.32% (+4.39% YoY). There are good reasons for the Fed to be data dependent and not rush into imprudent rate cuts as the market is demanding. On balance though, the data is leaning Goldilocks.

A key source of deflationary pressure for the world has been China, with its property market bust and excess supply issues in many industries. Consumers there are not spending as they are concerned that their main financial asset, their apartment, has been falling in price and job security has diminished. Well, the last few days of the month saw a concerted effort by the authorities to jump-start the economy out of this deflationary trap.

Without digging into the minutiae of the policies, the most salient point seems to be that the Politburo held its Q3 meeting a month early and that it delivered a clear message of "growth first" as the top priority.

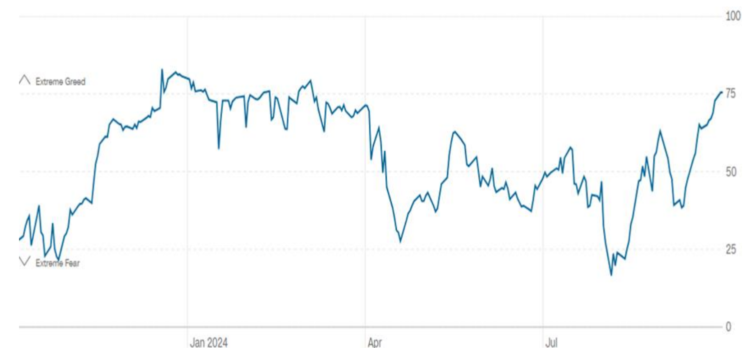
We cannot claim any special insight as to whether their policies will ultimately work and they do require a massive turnaround from supply-side over-expansion to spurring the demand-side. One key thing to watch for will be any material bank sector recapitalisation. Macquarie pointed out that the actual measures taken so far amount to less than 10% of the size of the post-GFC US TARP program in relative terms. In their view, much more needs to be done.

In any case, the market reaction to the new policy thrust was swift. The Shanghai Composite Index rose +21% in the last five days of the month, with there being a strong whiff of burning short-sellers as they scrambled to cover ahead of market closures for the Golden Week holiday. China A-share turnover in those five days broke all records at a staggering US$1.057trn and brokerages were reportedly staying open 24/7.

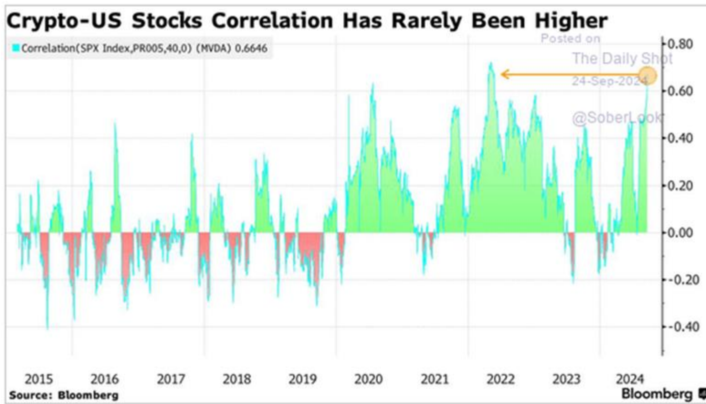
In turn, this sparked a major rotation in Australia out of banks and into resource stocks. The Fund was well placed for this, holding large shorts in the historically expensive bank stocks and having covered off most of our earlier large iron ore shorts. We are down to less than a 1% net short position in the key iron ore names and this was more than offset by strong performance from small longs in an array of interesting but very high-risk smaller resource exposures. At some point, we will revisit the iron ore short given the structural oversupply outlook but not quite yet.

Put all this together and we have a picture where the US is easing, China is easing materially and the ECB cut the deposit rate from 3.75% to 3.5% earlier in the month. Australia appears stuck at its current settings for some time and only Japan looks a possibility of lifting rates from here. A continued rotation out of carry-trade beneficiaries (e.g. Australian banks) would seem to make sense from both ends of the trade.

This is an environment just tailor-made for financial speculation and the CNN Fear & Greed indicator rose steadily over the month and finished in "extreme greed" territory at over 75. This is not normally a good place to buy equities but the gauge may perhaps stay here a while if the major central banks remain in easing mode at a time when equity market multiples are very high versus history and credit spreads are extremely tight.

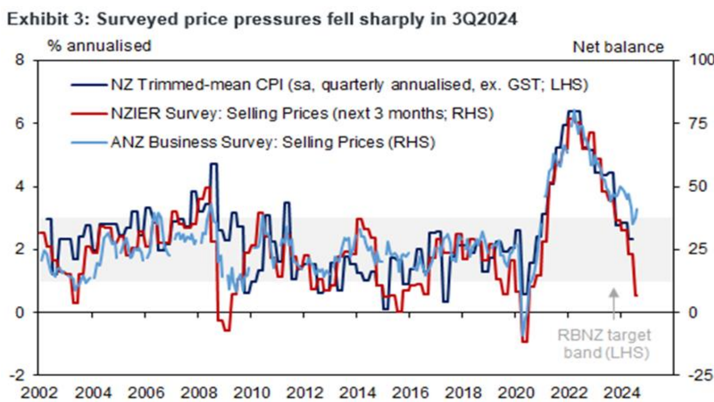


We have occasionally in the past mentioned crypto-currency fervour as an interesting way of cross-checking the degree of financial market speculation that is taking place. The chart below shows how the correlation between US stocks and crypto has varied over the last ten years. Right now, it is almost at record highs. Hmm, should we buy Nvidia or Dogecoin? Decisions, decisions. The point is that we are in a speculative environment which will likely persist as central banks ease.



One last counter-point is something that will likely receive far more focus over the month of October. What would a President Kamala Harris mean for US equities? Much also depends on who wins Congress and the Senate, so the answers are guesswork. Her proposal to lift the corporate tax rate from 21% to 28% would shave 5% off S&P500 earnings. Higher capital gains taxes would lift the cost of capital and the sun-setting of the 2018 income tax cuts for higher incomes would also impact. Conversely, President Trump's policies for tariffs and continued high deficits would see higher inflation and bond yields. Despite central banks easing, politicians could still spoil the market party.

Returning to NZ, our situation is analogous to other countries, with a central bank that is likely on the verge of a significant series of rate cuts.



The chart above is from September's Quarterly Survey of Business Opinion which the NZIER has been running since the 1960's. The red line shows a sharp decline in firms' expected selling prices and that this has a close albeit imperfect correlation with trimmed-mean CPI inflation. September's answers may be a little good to be true but suggest that inflation may fall to the bottom-end of the 1%-3% target range. The monthly ANZ Business Outlook Survey is a little more guarded, with firms' selling price expectations being off their peaks but still a little stuck at levels consistent with the top-end of the band.

The next RBNZ rate decision is on Weds 9 Oct and the market is now very much split between 25bp and 50bp cuts. The problem is that September quarter CPI inflation data does not come out until one week later. Who knows what our mercurial Governor will decide. The final meeting for the year is in late November and is likely to see further rate cuts given they then take a good old-fashioned holiday until February.

The implications for the Fund are fairly clear. It will be a supportive environment overall for NZ equities, and barring negative shocks, we may eventually experience the long-forgotten phenomenon of an earnings upgrade cycle later in 2025. Markets will anticipate this and we are already well positioned in the likes of Freightways, NZME, Heartland Bank, Turners et al that should be among the larger beneficiaries.

Conversely, we have rarely had so few shorts in NZ, with there being much greater opportunity from this side of the ledger in the overblown Australian market. As we argued last month, the misaligned monetary policy cycles may see the four-year run of Australia outperforming NZ come to an end.

Fund Performance in September

Returning to the Fund's performance in the month of September, our overall return of circa +3.1% pre fees and tax was driven by an extremely strong contribution from our long book (+3.8%), partially offset by our short book (-0.7%) which did as one might expect in a strong month for Australia. Our overall "winners to losers" ratio was a very solid 59%, with one massive winner and no major losers of great note.

Our gross exposure was largely unchanged at 142% (143% prior) although this concealed the ever- evolving composition of our holdings under the hood. Our net exposure rose a little further from 47% to 49%. Our NZ net length rose particularly sharply, while the continued rise in Australian equities generated some attractive short-selling opportunities. We continue to carefully assess the nature of our holdings and believe that despite this net positioning, our set-up and performance is still very much "market neutral".

Despite September being strong overall, it had a surprisingly high number of 12 negative days for the 50/50 index of Australia and NZ. The average return for the market on those days was -0.39%. By contrast, the Fund was up on eight of those twelve days and had an average return on all of them of +0.16%. A month is a short timeframe to measure over but regular readers will understand the consistency with which

this happens. We are very comfortable that the Fund continues to be "market neutral" and is well-placed irrespective of the direction in which markets move next.

By far the largest positive contribution came from our large long-standing holding in Tower Limited (TWR, +17.4%). TWR rose by a phenomenal 53.4% over the quarter, creating a high-quality problem for the Fund in managing the position size. There was a cavalcade of positive events. Early in the month, their strategic review concluded with no outcome. However, the RBNZ removed the old additional solvency margin of $15m. TWR proposed a $45m (11.9cps) return of capital in the upcoming March quarter. They placed their 2025 reinsurance programme on terms that were considerably better than analysts expected. Some of this will doubtless be passed on to policyholders but it will still benefit TWR margins. They concluded the financial year with no major calamities, result in a $32m NPAT benefit from reinsurance deductibles that they would otherwise have had to pay. Our view has long been that analysts are far too conservative in assuming they have to pay out these deductibles each and every year, when history points to nothing of the sort. Finally, there is a strong prospect that they will enter the S&P/NZX50 Index in the near future.

Our relatively large Servcorp (SRV, +9.3%) position again did well as it continues to re-rate towards more realistic valuation multiples. We repeat last month's comment that despite their share price soaring over the last year, they are still on a high-teen free cashflow yield, have a solid growth outlook and have $115m net cash within a market cap of $508m. Insiders have been buying and they have a possible catalyst coming up in early 2025, with the potential float of their Middle Eastern business at likely multiples far above those that SRV is trading at.

Another old friend came in at number three on the list of winners in the form of our decade-long holding in Turners (TRA, +8.5%). They delivered a solid trading update at their ASM which thankfully aligned with our thesis that their strong market share gains would offset a difficult used car market. From here, we continue to see TRA as a below-the-radar compounder, which is earning returns that are well in excess of ROIC as it invests across the NZ used car market and inexorably takes share from undercapitalised competitors. In the shorter term, they will be one of the largest winners from RBNZ rate cuts as these immediately expand margins on the finance book and then in time will lead to an upswing for used car sales and associated verticals.

There was a plethora of other smaller but still solid winners. Intelligent Monitoring Group (IMG, +23.1%) had another strong month on no new news. At $0.72, it has been a hugely successful investment since our initial purchase at just $0.15. Our mid-sized position in NZME (NZM, +10.3%) did well. We see a business on a circa 20% free cashflow yield, with a solid radio business, a legacy newspaper business which has the opportunity to become the news-source of record, and a real estate business in One Roof which is rapidly catching up to Trade Me and could be worth more than the entire current NZM valuation if it continues on its current trajectory. Finally, our moderate short in Auckland Airport (AIA, -1.5%) flipped to a modest long at favourable prices as we participated in their discounted equity raising alongside our other funds.

Headwinds consisted entirely of a series of random price movements rather than any great negative fundamental developments of note. The largest was our very successful long-term holding in DUG Technology (DUG, -20.2%) which has entered a phase of its listed life where it is a plaything of speculative Australian growth "investors". That volatility is something we just accept and go the other way and trade against. We see a compelling super-computing business, with a small market share but a clear edge against its global competitors in its geophysics analytical capabilities. Further, it has less certain but potentially huge upside from two businesses it has developed in small scale "data centres in a box" and its data centre cooling capability, where it has partnered with a global leader in Baltimore Aircoil.

Other headwinds were relatively minor. Our still large holding in Global Data Centres (GDC, -2.7%) pulled back a touch as the market tries to estimate its ultimate cash returns. A series of shorts were modest headwinds as they ran strongly in a good month for the lemming-like group of Australian growth investors, for whom no valuation multiple is too high until that glorious day when something fundamental breaks. Names included Goodman Group (GMG, +10.8%), Lovisa (+15.8%), ARB Corporation (ARB, +11.6%) and Reece Limited (REH, +4.2%).

Thank you for your continued support and interest in the Fund. We have continued to enjoy an extremely strong run of returns as a number of our key holdings have delivered on our theses for investing in them. It has been a long, lonely wait in some cases which makes this strong patch of success all the more satisfying. That said, we have not sat on our hands and have taken profits in a number of cases and looked to get set in what we hope/expect will be the next crop of positive contributors.

We are especially pleased to have delivered excellent numbers in such a strong quarter for long-only equities, when the insurance policy of our short book would normally weigh. Instead, we now find ourselves in a position where we have been able to get set in a range of attractive NZ longs ahead of a rate-cutting cycle versus a more mixed book of Australian longs and shorts as their market appears expensive and their rate-cutting cycle is likely to be deferred. We will continue to do our level best to extend the Fund's 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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