

SALT

Salt Long Short Fund Fact Sheet – January 2021

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 January 2021

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	\$48.8 million
Inception Date	31 July 2014
Portfolio Manager	Matthew Goodson, CFA
Associate PM/Analyst	Michael Kenealy, CFA

Unit Price at 31 January 2021

Application	1.7122
Redemption	1.7052

Performance¹ at 31 January 2021

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2014							6.28%	2.85%	2.74%	-1.67%	2.27%	0.89%	13.96%
2015	1.28%	1.07%	0.04%	2.17%	0.38%	-0.28%	0.75%	2.84%	1.34%	2.04%	2.37%	2.04%	17.21%
2016	-0.67%	-1.08%	3.81%	0.92%	1.72%	-0.39%	0.50%	2.26%	-0.51%	-0.57%	-0.20%	2.19%	8.14%
2017	0.68%	0.12%	0.74%	-0.01%	0.80%	0.30%	1.32%	0.25%	0.58%	-1.36%	-1.18%	3.62%	5.93%
2018	0.67%	0.05%	1.74%	-1.40%	-0.21%	-0.11%	1.20%	-1.06%	1.37%	-1.88%	-3.71%	-2.16%	-5.50%
2019	-1.26%	-0.97%	-0.96%	0.14%	1.94%	0.42%	2.56%	-0.03%	2.93%	2.34%	0.90%	1.70%	10.02%
2020	-2.01%	-2.51%	-14.47%	4.35%	1.80%	3.18%	3.39%	-1.81%	2.41%	-1.67%	8.31%	6.76%	5.88%
2021	1.24%												1.24%

Period	Fund	Benchmark	NZX 50 G/ASX 200 AI ²
3 months	17.08%	1.28%	11.90%
6 months	15.76%	2.58%	14.37%
1 year p.a.	9.38%	5.31%	6.11%
2 years p.a.	9.29%	5.82%	16.71%
3 years p.a.	3.68%	6.32%	11.75%
5 years p.a.	5.15%	6.45%	13.40%
Since inception p.a.	7.54%	6.86%	11.28%

¹ Performance is after all fees and before PIE tax.

² NZX 50 G/ASX 200 AI 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.

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 January 2021

Long positions	48
Short positions	33

Exposures at 31 January 2021

Long exposure	98.90%
Short exposure	41.78%
Gross equity exposure	140.67%
Net equity exposure	57.12%

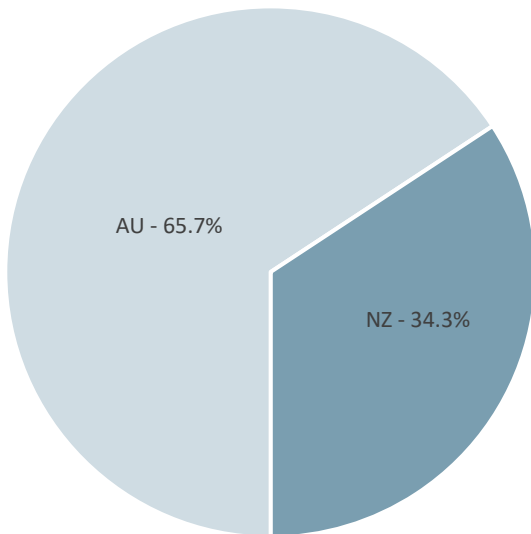
Largest Longs	Largest Shorts
Tower	Ryman Healthcare
Shaver Shop Group	Wisetech Global Holdings
Marsden Maritime Holdings	Vital Healthcare Property Trust
Graincorp	Pointsbet
Vitalharvest Freehold Trust	REA Group

SALT FUNDS MANAGEMENT

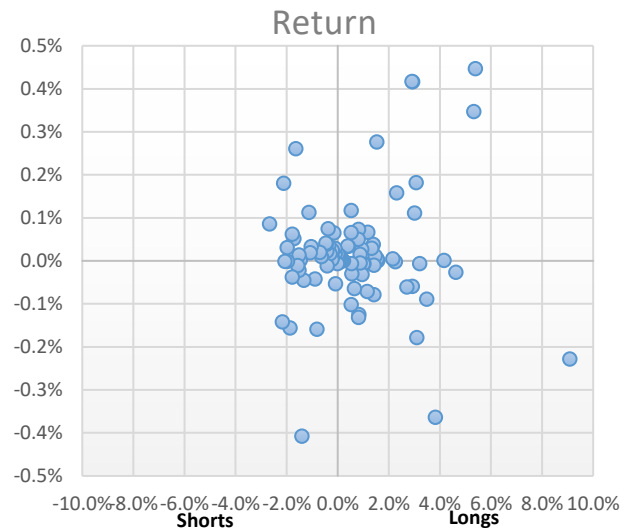
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Country Allocation at 31 January 2021 (Gross Equity Exposure)



January 2021 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

While not quite repeating the exceptionally strong performance of the prior couple of months, January was another solid period for the Fund, with a return of +1.24%.

Net length remained optically very long at 57.2% but as highlighted previously, a portion of this comes from quasi-cash holdings and we generally continue to perform solidly on negative days for the market. There were ten down-days in January for the 50/50 index of Australia and NZ, with an average return on those days of -0.69%. The Fund was up on eight of those ten days and delivered an average return of +0.05%. While hardly startling, this shows how the Fund continues to deliver its aim of equity-like returns with no correlation to said equities.

January saw a backdrop of thin, choppy markets and some quite remarkable retail investor activity globally. The Reddit-inspired retail short squeeze of Gamestop (GME) will go down in infamy. We have no special knowledge of GME and are not short it! That said, a bricks and mortar video game retailer would appear to be somewhat akin to a blacksmith. We suspect the shorts will eventually be correct but the trade had become far too crowded.

To show how absurd the retail investor activity is at present, GME Resources in Australia rose by 15% the day after Gamestop's surge. Same ticker – genius.

We are not quite sure how to frame the longer-term investment implications of this activity. However, it was

perhaps best summed up by a typically pithy quote by Jim Rogers, “a mania first carries out those who bet against it and then those that bet with it.” We’ve seen the first load of stretchers go to the morgue with Melvin Capital and the second load is underway as this piece is being written.

The Robinhood bubble coincides with commission-free trading and near-zero short term interest rates, facilitated by central banks. When a security is trading beyond any possible rational valuation of its future profitability, the price move is by definition Ponzi in nature. It will burn itself out soon enough when a new marginal buyer is unable to be found.

While the worst excesses such as Gamestop are burning themselves out as we write this, there is no guarantee as to when the wider market euphoria will dissipate.



Signs of excess are everywhere, with the chart on the prior page that was sourced from JP Morgan being self-explanatory. There has been a surge in IPO's coming to market and they have far outperformed existing stocks – clearly the quality of IPO's is unusually high at this late stage of the market cycle!

Along with this, we have seen record levels of insider selling. Bloomberg reported that during January, US executives sold \$300m of stock, which was 16 times the amount they purchased (through Jan 21). Coincidentally, new buyback authorisations amounted to \$29bn, up 46% from a year earlier.

According to JP Morgan, US equity allocations by households as a percentage of their total financial assets have soared above the dot.com bubble era levels and have hit new all-time highs at near 40%. One other notable data-point is that on the Gamestop explosion day on 27 January, 23.6bn shares were traded on US exchanges, the most ever. This surpassed the 19.7bn shares traded on 10 October 2008 at the height of the GFC uncertainties re bank solvency. Just as it did back then, such massive volume capitulation can be a sign of market highs and lows.

What the eye-popping short squeeze activity does illustrate is the importance of position sizing and diversification, especially from the short-side. Our largest shorts tend to be in the 2-3% position size range and we only occasionally go up to 4% of the Fund. While we are willing to take liquidity risk with some of our longs, we are extremely conscious of both liquidity and sizing with our shorts. Looking at the 20 most shorted names as a proportion of market cap in Australia, we have only one position in that group. That is actually a 0.8% long in #17, Resolute Mining, which is a potential double-bagger in our view as they sort out operations at their massive gold mine in Mali and pay down debt.

We have observed in recent months and quarters that short interest has declined in many markets around the world as the relentless bull market has marched ever onwards. The Gamestop squeeze did not happen in isolation. Research from Goldman Sachs has found that a more generalised US market short squeeze in the last quarter has been the most extreme in over 25 years. The 50 most shorted Russell 3000 stocks with market caps above \$1bn have rallied by a remarkable +98%.

There has been far weaker evidence of a similar short squeeze in Australia, with the 40 most shorted stocks delivering 6% outperformance in the last quarter. Again, according to

Goldman Sachs, short interest across the S&P/ASX200 has fallen by 45% over the last two years and the 40 most shorted stocks have an average of 5.5% of their market cap net short versus 12% previously.

Interestingly, our Fund has enjoyed one of its best periods ever against this backdrop, showing we truly do march to the beat of our own drum, often shorting ultra-expensive glamour names which might wobble and being long cheap names with under-appreciated growth outlooks. As frustrating as it can be watching 20x revenue companies rise remorselessly on pure price momentum, it feels as though we are playing on fallow turf.

From the long side, a notable change in the Fund's positioning has been a gradual sale of yield-sensitive TINA (there is no alternative) stocks as they hit our exit prices. As this is written, NZ 10-year yields are at 1.25% compared to 0.99% at the end of December and a low of 0.44% in September. There is enormous valuation convexity at such low yields and few investors and certainly no sell-side analysts appear to have yet noticed the change. The number of analysts who have made up target prices by augmenting DCF valuations with simplistic bond yield versus dividend yield comparisons is surely a sign.

There is a real tension beginning to form between the negative valuation impact of higher long term bond yields versus ultra-low short-term deposit and mortgage rates driving investors into equities and houses. To our mind, the circle can be squared by owning cyclicals.

The move up in yields should hurt the GAAP (growth at any price) stocks and be helpful to cyclicals whose earnings upside from stronger economic activity can more than offset the higher discount rate. We are becoming ever longer a range of better quality (to our eye) cyclicals. Associated with this, there has been a notable plunge in Covid-19 infection rates in the UK and some US states in recent days as vaccinations gather steam, so we see the re-opening trade as one that should prove profitable. Examples include Vista Group, Redcape Hotels, and United Malt Group.

We have argued for several quarters now that a rise in bond yields is coming, that this will occur in anticipation of a lift in future inflation and that this will see a change in market leadership as outlined above. It has worked rather well so far although we are somewhat frustrated that some of our hideously overpriced Australian information technology darlings are yet to give up the ghost. The door has been kicked

in as bonds yields rise but the rotten edifice is yet to come crumbling down.

From here, the key question for 2021 is will this continue? In the US, we have seen a couple of the Fed Governors make tentative noises about tapering at some stage but they have been firmly put back in their box by Chair, Jerome Powell:

"You know, in terms of tapering, it's just premature. We just created the guidance. We said we'd want to see substantial further progress toward our goals before we modify our asset purchase guidance. It's just too early to be talking about dates, which we should be focused on progress. We'll need to see actual progress. And when we see ourselves getting to that point, we'll communicate clearly about it to the public. So nobody will be surprised when the time comes. And we'll do that well in advance of actually considering what will be a pretty gradual taper."

In Australia, the RBA surprised the market on Tues 2 February with an uber-dovish release despite signs there of strength in consumer prices, the labour market and especially in housing markets. As expected, they held both the cash rate and 3-year bond yield targets at 0.1%. However, they announced a further \$100bn of QE when the current programme ends in mid-April and announced this this will continue at a fixed \$5bn/week. They also stated that there would be no rate hike until 2024 at the earliest. The bottle housing the inflation genie is being rubbed furiously.

We have no insight into the current thinking of the RBNZ but consumer and business surveys suggest inflation expectations are rising sharply and the labour market appears to be improving rapidly. The problem for the RBNZ is that they are hemmed in by the dovishness of their offshore counterparts, which is putting upward pressure on the NZ\$. One possible solution is for the RBNZ to buy offshore assets. There may be a day when these come in very handy. A small open economy that is running large twin deficits may not be loved by the rest of the world forever.

Whatever one thinks of the wisdom of these stances, they are what they are and it would be folly as an investor to bet against them until the signs become clearer that they are unsustainable. Given that we see inflationary pressures rising everywhere, the battle for 2021 will be between these pressures and the ongoing policy stance of central banks. We suspect that the market will increasingly test their policy resolve by pushing long bond yields ever higher and making

the yield curve ever steeper. Cyclical outperform but TINA and GAAP stocks should struggle.

This force will be added to by extremely loose fiscal policy and record levels of fiscal deficits around the world. Increasingly, fiscal policy may merge with monetary policy. If anyone wants to buy any bonds, Joe Biden will soon have a few for sale. Bonds and bond proxies aren't for us.

Returning to the performance of the Fund in January, our return of circa +1.42% pleasingly featured gains from both the short and long books – exactly what one would hope in a choppy month. Our longs contributed +1.27% while our shorts just got their nose over the line with a +0.15% outcome. 62% of our longs worked and 69% of our shorts did, with our overall “winners to losers” ratio being 65%.

The largest detractor by some distance was a short we have gradually built up in Pointsbet (PBH, +31.5%). PBH has become a darling for several growth-oriented analysts whose thesis is chiefly that the US market is opening up and that PBH appears to be making strong headway. Our observation is that they are doing so with unsustainably aggressive odds which attract sophisticated punters who have precisely zero business repeatability once the odds normalise to sustainable levels. Anyone can attract wagering revenues at a negative margin. Our thesis is that the optically impressive revenue growth will not translate to future earnings as is being forecast. PBH's performance was aided by passive buying ahead of ASX200 index inclusion in early February, although it actually fell by -4.5% on that inclusion day.

The second key headwind was our large long in Pacific Edge Biotechnology (PEB, -11.5%) which gave back a modicum of its strong gains in earlier months in the absence of any new news. We firmly believe that further positive sign-ups will be announced in coming quarters and that plenty of potential valuation upside from current levels still exists.

Similarly, our large long in Tower (TWR, -2.8%) pulled back slightly on no particular news. The next key event that we may see is an easing in their required capital ratios from the RBNZ as Christchurch claims are now becoming ever more minimal but TWR is still carrying a \$50m additional regulatory solvency margin. Even with this extra margin they have capital coming out their ears following the EQC settlement. We suspect that once they know exactly where they stand from a capital perspective, the way will be paved for the long-awaited resumption of dividends. This would be very positively received.

The largest winner was our long-standing holding in Shaver Shop (SSG, +7.6%) which delivered an exceptional trading update for December, with the quarter featuring 13.7% like for like growth and 64.7% online growth, taking that channel to over 30% of total sales. They are now guiding for their H1 profit to be +75-85% on the prior year. Yes, there may be an element of one-off growth in this but a good proportion of their sales are repeatable and are not one-off consumer durables as are sold by JB Hi-Fi and Nick Scali (which we are both modestly short). SSG has strong further growth from expanding their NZ footprint, their purchase of their remaining franchised stores, and most importantly by their expansion into product adjacencies (e.g., after-shave and perfume). It is still only on a forward PE of circa 10x with potential upgrade risk but it has little sell-side coverage – at the moment.

The second key stand-out was a name that we have mentioned several times here in the small cap environmental and engineering consultancy, Intega Group (ITG, +16.4%). They have major revenue tailwinds behind them in their various jurisdictions but are still only on a Jun22 PE of 8.7x. We have puzzled why the majority private equity owner, Crescent split them out of the old Cardno Group, which tipped them out of several indices. The only answer we can come up with is to put them in play.

Other winners were led by a long in the oft-mentioned Kina Securities (KSL, +13.3%) which is on a forward PE of 4x with strong growth beyond that. PNG is the risk but it is also a huge opportunity given the country's leverage to strong and rising commodity prices. Marsden Maritime (MMH, +6.8%), Coronado Coal (CRN, +15.4%) and Turners (TRA, +4.5%) also helped from the long side, while Xero (XRO, -11.5%) and Fortescue Metals (FMG, -7.0%) were short-side winners.

Thank you for your continued support of the Fund. We are pleased to have started 2021 on a solid note and will continue to stick to our disciplines. While markets continue to be in something of a sweet spot, the steady rise in bond yields and steepening in yield curves in recent weeks is sending a clear signal. We are very positive on the outlook for most cyclical stocks but more guarded on markets overall, particularly given the absurdly elevated retail investor bullishness. 2021

may be a year where having no correlation to equity markets pays off.



Matthew Goodson, CFA