SALT

Salt Long Short Fund Fact Sheet – February 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 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 28 February 2023

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$71 million
Inception Date	31 December2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 28 February 2023

Application	2.2015
Redemption	2.1926

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 28 February 2023

Long positions	47
Short positions	34

Exposures at 28 February 2023

Long exposure	80.32%
Short exposure	40.11%
Gross equity exposure	120.43%
Net equity exposure	40.21%

Investment Risk to 28 February 2023

Fund volatility[1]	6.40%
NZ50G / ASX200AI volatility[1]	13.93%
NZ50G / ASX200AI correlation	0.078

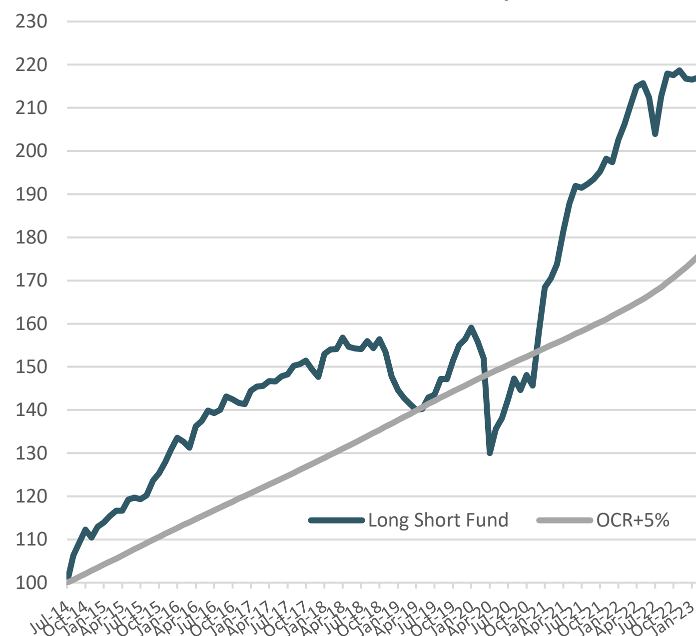
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 28 February 2023

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	1.06%	0.69%	-1.53%
3 months	1.15%	2.21%	1.65%
6 months	0.60%	4.27%	4.36%
1-year p.a.	4.11%	7.79%	3.17%
2 years p.a.	12.33%	6.61%	3.57%
3 years p.a.	12.99%	6.15%	5.54%
5 years p.a.	7.31%	6.30%	7.86%
7 years p.a.	7.61%	6.47%	10.13%
Inception p.a.	9.48%	6.80%	9.19%

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 28 February 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
Tower	Reece
GDI Property Group	Meridian Energy
Global Data Centre Group	Auckland International Airport
Monash IVF Group	Carsales.Com
Australian Vintage	Technology One

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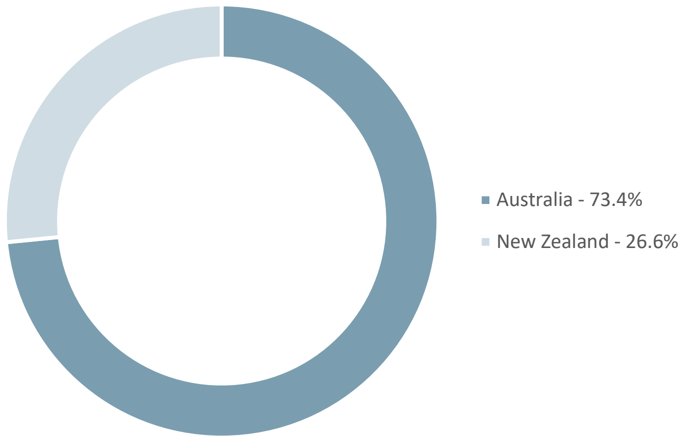
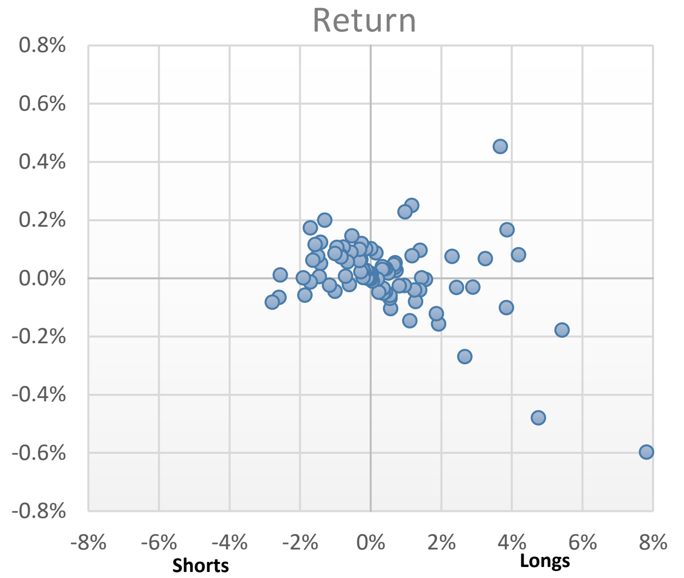
Country Allocation at 28 February 2023 (Gross Equity Exposure)



February 2023 Individual Stock Contribution



Fund Commentary

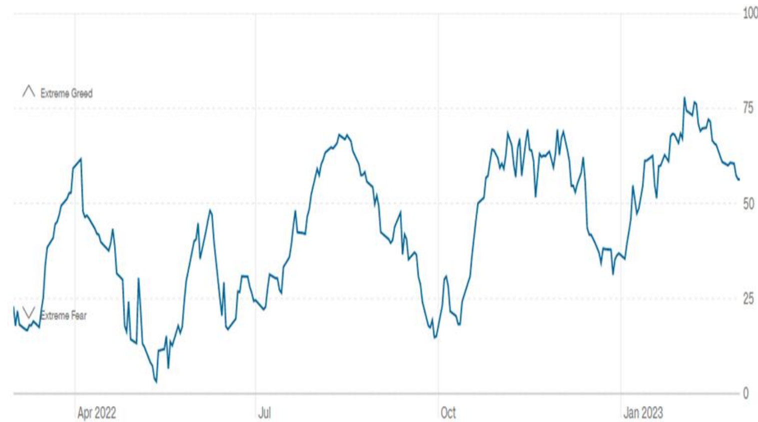
Dear Fellow Investor,

The Fund delivered a solid return of +1.06% in the month of February, which contrasted with negative outcomes in the NZ (-0.6%) and especially the Australian (-2.4%) equity markets.

As always during results season, our overall outcome was a mixture of pluses and minuses, with the source of a number of these performances not necessarily being what we may have expected one month earlier. That is why we diversify widely and were able to deliver a solid outcome despite several disappointments that should prove fleeting.

Our macro view remains almost entirely unchanged and will therefore be brief this month. Rule number one of investing is "Don't Fight The Fed". Rule Number Two is to repeat Rule Number One. Yet that is exactly what global equity markets did in the prior month of January, with a burst of euphoria driving the global MSCI Index up over 7%. February saw inflation outcomes and central bank moves that delivered a cold dose of reality, with global equities declining -2.4%. January is looking like it was a last hurrah.

That said, as shown below in the CNN Fear & Greed Index, the hopey-dopey meme-stock loving euphoria of January has proven slow to fade. We have retreated from "extreme greed" above 70 but the latest reading of 56 is still in "greed" territory. Cross-checking this using the ARK Innovation ETF as a proxy for "junk" technology, it rose by +27.8% in January but only declined -0.8% in February.



Our view of the macro set-up is the same as it has been for some time. Inflation has more or less peaked in most countries but it is proving very slow to fade given the spill-overs into wage inflation and a wage-price feedback loop in an era of structurally low unemployment.

Central banks have now largely moved to this view. February saw the RBA hike by 25bp and deliver hawkish commentary; the RBNZ went from 4.25% to 4.75%; the Fed lifted 25bp to a 4.5%-4.75% range; the ECB hiked by 50bp to 2.5% and the list goes on. Add to that a continuation of QT in the US, the beginnings of QT in Europe from the start of March (at

E15bn/month growing to E20bn) and a new BoJ Governor who has been openly sceptical in the past about their yield curve control policy which currently is controlling 10-year yields at 0.50%.

This is not a set-up in which one would normally expect equities to thrive unless they had already been beaten down to cheap valuation multiples and central banks were on the cusp of moving to easier policy settings. In our view, most markets are in a range of fair to somewhat expensive and it will likely be quite some time before central banks can start cutting rates.

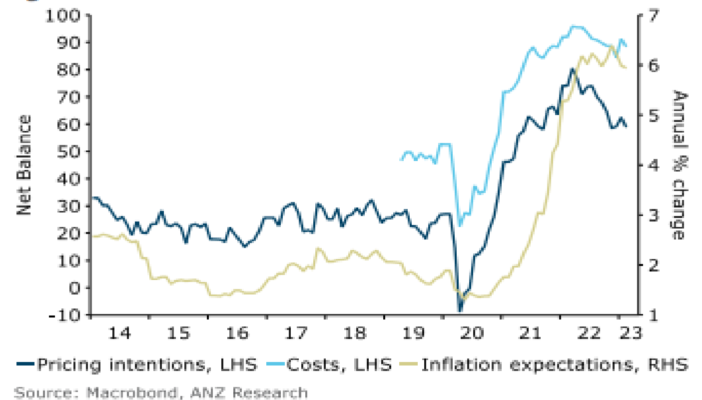
The other potential shoe to fall is earnings risk. Indeed, we think that longer term bond yields have now priced in the great bulk of further rises in short term policy rates. The key risk has moved from bond yields gapping higher to companies disappointing in their earnings outcomes. The NZ earnings season was generally although not uniformly disappointing. With evidence such as the monthly ANZ Business Outlook survey still showing a clearly negative profit outlook across the economy, we would expect this to continue for a while yet.

JP Morgan analysis of the Australian earnings season was that it was more bifurcated than normal, with 43% missing (33% normally) and 38% beating (35% normally). To us, this suggests a turning of the tide. The US was similar, with fewer beats of their carefully curated "guidance" than normal.

There is one very simple thing that would turn us more bullish – a run of downside inflation surprises that take the pressure off central banks and allow markets to start pricing in future easing. We haven't seen them yet.

February saw US core CPI inflation come in an as-expected +0.4% but this was partly held down by volatile airfares and health insurance, with labour-intensive services categories rising by +0.6%. Revisions to US CPI sub-index weightings towards rents and services did not help matters. Near month-end the crucial core PCE inflation outcome was higher than expected at +0.6% m/m and +4.7% y/y. This is a long way from the 2% target.

NZ inflation released in late January showed it clearly remains far too high at +1.4% q/q and +7.2% y/y although there was a faint sign of light at the end of the tunnel with non-tradeables inflation being a mere +6.6%. Forward looking indicators remain difficult. As shown in the chart below, inflation indicators in the ANZ Business Outlook survey have peaked but remain far too high.



Putting all this together, our current macro view is that bond yields have seen the great bulk of their increases but that equity markets have only partially priced in the sharp rise in discount rates. Further, earnings risks are now beginning to come through, with the latest earnings seasons being the beginning of what may be a difficult few quarters. It will take great care in the months ahead to sort between the wheat and the chaff. While the Fund is 40% net long (up from 38%), our longs are extremely defensive and tend to march to the beat of their own drum, while our shorts tend to be high beta and very sensitive to market swings.

Fund Performance in February

Returning to the Fund's performance in the month of February, the overall return of circa +1.06% after fees and tax was the net outcome of the long book detracting -0.7%, while the short book contributed +1.9%.

Our "winners to losers" ratio was an extremely strong 67%, with a key highlight being that 35 out of our 42 shorts worked in the month. While equities fell in the month, they did not plummet, so this speaks to pleasing stock selection during earnings season. 26 of our 49 longs also worked but the size of the detractors was larger than the size of the contributors.

The Fund's positioning did not change a great deal over the month, with net length rising from 38% to 40% and gross falling from 124.5% to 120.4% as we covered some of our shorts which worked. Our market-neutral exposure means we continue to deliver equity-like returns while having no correlation to the equity markets from which those returns come.

The 50/50 index of Australia and NZ had a high number of eleven down-days in February, with an average return on them of -0.49%. We were up or flat on eight of those eleven days, with an average return on them +0.10%. This is a very

similar picture almost every month – there is no correlation between the Fund's performance and long-only equities.

The largest negative was once again our large Tower Limited (TWR. -7.5%) holding. Until this year, there has not been a single large event that reached their $20m reinsurance deductible limit since the Christchurch earthquakes back in 2011. Well, after the biblical downpour in Auckland in January, Cyclone Gabrielle came along 3 weeks later. The good news is that TWR has structured their reinsurance extremely well and have 2 paid reinstatements in place, so they are covered for any further events (with a deductible). Their NPAT guidance has been lowered a little to $18m-$23m but it's remarkable they will still likely be profitable after such events. Premia will go through the roof going forward so this will lift their future earnings power even further if they can ever get a quiet claims year.

The second major headwind was our extremely frustrating holding in Global Data Centre Group (GDC, -8.7%). Their result at end-month was as expected and displayed growing EBITDA profitability which will soon translate to the bottom-line as their data centre utilisation scales. More importantly, the value of their ownership in the European and Asian edge data centre business, Etix Everywhere was franked by the European pension fund, Eurozeao buying into it at a price equivalent to GDC's carrying value. Add GDC's other assets of a Perth data centre and 2% of the major global player, Airtrunk and you get an asset valuation in the mid-$2 range versus the $1.16 share price. The listed market just doesn't care, so GDC really does need to be taken private.

It is an interesting commentary on the overall Fund performance in the month that our two largest holdings performed very poorly and detracted -1.08% between them, yet the Fund was up +1.06%. It could have been a stellar month if the stars had aligned and we do remain bullish that these two holdings will eventually do very well.

A third detractor was our mid-sized holding in the Australian telco, Superloop (SLC, -9.0%). The simple thesis is that they have high marginal returns from adding customers onto their own network. It is a highly competitive space but their asset ownership gives them an edge and they have been a highly accretive consolidator. Their balance sheet is solid and they are on a clear multi-year path to strong free cashflows.

Other headwinds were more modest in size and generally reflected a weak overall market in the month rather than any particular company issues. GDI Property (GDI, -3.1%), Apiam Animal Health (AHX, -7.1%) which is the only listed company in the booming animal health sector, and Resolute Mining (RSG, -10.9%) all fell into this camp. No shorts detracted to any notable degree.

The largest tailwind came from our long-suffering holding in the flower business, Lynch Group (LGL, +11.6%) which is coming out the other end of a long tale of woe. Their H1 result was very weak as expected but their full year guidance showed a strong recovery run-rate. Even though analysts are understandably burnt and cautious, it is still only on a F24 PE of 7.3x partly recovered earnings. Air transport costs from China to Australia are still very high but are now starting to fall; the Chinese consumer has returned with a vengeance since January; Australian demand is still strong; their issues from being put into the one size fits all ordering system of a large supermarket group are being resolved; and surge labour costs and availability are becoming less problematic.

A second key winner was a newly instigated holding in the skincare clinic operator, Silk Laser (SLA, +15.9%). We had tracked them for some time as a fallen glamour stock which has come down from over $5 to as low as $1.60, in which region we did most of our buying. They delivered a solid result which gave confidence to our thesis that they offer an affordable luxury which should be relatively resilient to the impending slowdown of the Australian consumer. Their balance sheet is fine and they appear to have a good organic and inorganic growth pipeline. It is on forward PE ratios of 9.3x Jun23 and 7.9x Jun24 earnings. Value multiples for a growth stock.

A third contributor was our moderate holding in Sierra Rutile (SRX, +22.5%). This Sierra Leone based business was spun out from Iluka and produces 20% of the world's natural rutile. It is on an EV/EBITDA of circa 0.3x and has 3-4 years of mine-life left. They will use the cash they generate from this to fund a major new development that will produce for many years. It has been hammered as it fell out of every passive index following its spin-out and we have bought and sold it in 20% trading ranges since then.

Other positives were widespread but were relatively lesser as we do tend to take smaller, lower risk positions from the short-side. Some of the more notable names were the expensive mining services business, Monadelphous (MND, -13.7%); the ultra-expensive albeit high quality healthcare tech company, Promedicus (PME, -8.7%); the low multiple but cyclically exposed retailer, Adairs (ADH, -18.4%), and PWR Holdings (PWH, -17.8%) which had earlier zoomed on index inclusion expectations. Note that we did partially cover a number of these on weakness.

Aside from the largest contributors and detractors, there were several other portfolio changes of note. We have been a long term fan of Shaver Shop (SSG, +0.0%) which has performed wonderfully well for the Fund in recent years. At times we have had nearly 5% of the Fund in the name but we have lowered it to just 0.35% into the recent sharp strength. SSG is a superb retailer in their niche but tougher times may lie ahead and they are now merely somewhat cheap as opposed to being egregiously undervalued when we had a large holding.

We also lowered our very large holding Monash IVF (MVF, +0.0%) position when it spiked to $1.10 and a little higher. They delivered a positive result and their outlook is as good as it has ever been, so we have started adding back at a 7-8% lower price than where we sold. Similarly, we largely covered our NIB Holdings (NHF, -3.4%) short when it plunged following a slightly disappointing result. We have put this on again as it has since bounced. Our view remains that the market is putting too high a multiple on temporarily inflated post-Covid earnings. They may get caught in a pincer between catch-up procedure volumes and weaker policy growth as affordability concerns bite.

Thank you for your continued support of the Fund. We are pleased to have delivered a positive month against a background of relatively weak equity markets. We are slightly frustrated that it could have been a stellar month but for what we view as a couple of temporary setbacks.

Our overall market view remains somewhat bearish and rather simplistically based on “Don’t Fight The Fed”. We think that it will be many quarters before central banks can afford to step off the brakes in their fight against inflation. If the facts do change, then so will our view. The worst of the rise in bond yields may have already happened but the next shoe to fall will be earnings downgrades. This earnings season gave a few hints about what lies ahead. We have no doubt that long-only equities will wax and wane on varying macro-data that will see views oscillate around how far and for how long monetary policy tightens. Against this backdrop, we will do our level best to keep grinding our positive returns irrespective of what the market delivers us.

Matthew Goodson, CFA

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