SALT

Salt Long Short Fund Fact Sheet – November 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 30 November 2021

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$54.2 million
Inception Date	31 October 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 30 November 2021

Application	1.9824
Redemption	1.9744

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 November 2021

Long positions	51
Short positions	31

Exposures at 30 November 2021

Long exposure	101.63%
Short exposure	48.22%
Gross equity exposure	149.84%
Net equity exposure	54.42%

Largest Longs	Largest Shorts
Tower	Johns Lyng Group
Dalrymple Bay Infrastructure	Premier Investments
Lynch Group Holdings	Auckland International Airport
Monash IVF Group	Breville Group
Shaver Shop Group	Commonwealth Bank of Australia

Performance[1] at 30 November 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%	1.90%	4.42%	3.52%	2.16%	-0.23%	0.48%	0.56%	0.93%	1.52%	-0.39%		17.22%

Period	Fund	Benchmark	NZX 50 G/ASX 200 AI[2]
3 months	2.06%	1.32%	2.26%
6 months	2.89%	2.64%	4.67%
1 year p.a.	25.15%	5.28%	19.71%
2 years p.a.	12.35%	5.38%	11.47%
3 years p.a.	10.14%	5.73%	14.46%
5 years p.a.	6.91%	6.14%	12.47%
7 years p.a.	8.31%	6.60%	11.21%
Since inception p.a.	9.61%	6.70%	11.32%

[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.

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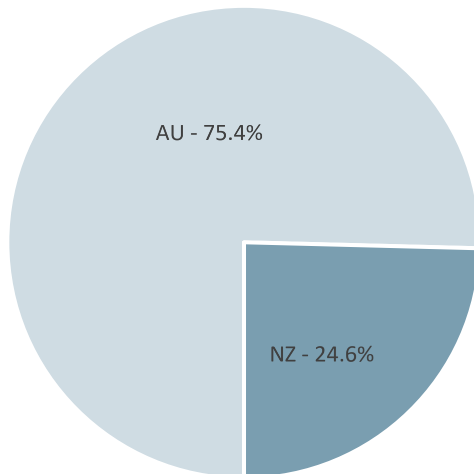
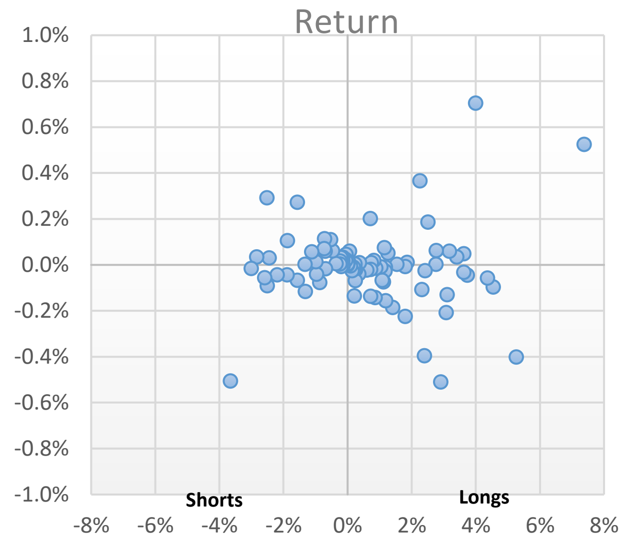
Country Allocation at 30 November 2021 (Gross Equity Exposure)



November 2021 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

The Fund experienced a modest decline in the month of November, with a return after all fees and taxes of -0.39%. This contrasted with a decline in the NZ equity benchmark of -2.9%, while Australia fell by -0.5%. We had our nose ahead until a surge in ultra-expensive growth stocks in the last couple of days punished our short book and pushed us slightly under water.

Our stock-picking was generally very good throughout the swings and roundabouts of AGM and result mini-season. However, our style exposure was horrid, with "growth" outperforming "value" by 6.6% in just the month of November alone according to JP Morgan analysis. With the divergence between these factors being at extremes, we believe we are well placed for the inevitable reversal when solid companies on 10x earnings with reasonable outlooks start to outperform 20x revenue vapourware companies once again.

For the last few quarters, we have been consistently banging the drum that inflation is emerging in NZ and globally, that central bankers will have to awaken from their deep slumber, and that higher interest rates will see a mixed impact on equities. Those with strong top-line leverage should do well in these inflationary times, while pure yield plays and long-dated growth stocks should struggle.

Our view of this investment paradigm continued to strengthen over November but a number of growth stocks did not play ball – money is still very cheap. However, under the hood, the winds of change are beginning to blow. Looking at the Nasdaq Index in the US, performance is becoming more concentrated to the largest and bluest chip names.

In November, the Nasdaq 100 Index rose by +1.8% but the wider Nasdaq Composite was only +0.25%. Worse, the ARK Innovation Fund (a proxy for the raciest growth names) fell by -12.9% and has slumped another 11.5% since. The phase where any piece of rubbish with half a story climbs to the stratosphere is behind us – investors' focus is beginning to change to who has a real business.

December 1 NZ time may be remembered for the "Powell Pivot". Regarding inflation, he stated that it is "time to retire the word transitory"; "the threat of persistently higher inflation has grown" and that "we can consider wrapping up the taper a few months sooner". In the days since, other Fed Governors have given speeches that sing from the same song-sheet. For now, a wave of liquidity continues to wash over markets but we would suggest that the punchbowl is in the course of being removed.

Evidence of inflation continues to abound. A few examples during the month:

- According to Bloomberg, world economy-weighted inflation rose to 4.7% at end-October. It was just 2.1% in early 2020.

- At its AGM, Australian builder Tamawood cited pressures including: timber +100%; Bluescope steel prices +69%; tapware +20%; windows +8%; shelving +18% etc and that they expect further increases.
- In NZ, Placemakers' price increases from December include: metal roofing +7-12%, imported MDF +10-20%, hardwood decking +20%, Selleys silicone and sealants +30%, polythene +18%, building wraps +10% etc
- The US core CPI for the month of October rose by +0.9% versus the +0.6% expected. Annual core inflation reached its highest level since August 1991.
- The RBNZ Survey of Inflation Expectations showed businesses expect annual inflation to average 3.7% over the coming year, the highest forecast in 11 years, and well up on the 3.02% in the previous survey.
- The monthly ANZ Business Outlook Survey found that "inflation pressures remain intense", with firms' selling price intentions at a record high net +66.5%.

Cost and inflation pressures

Source: ANZ, Statistics NZ, Macrobond

The fact that inflation pressures are emerging across the world removes one important constraint from the RBNZ – fear that the NZD might soar if we go harder and earlier than other countries. The OCR lifted from 0.50% to 0.75% in November, yet the NZD fell from 71.68 to 68.21. The Reserve Bank of Australia was late to the zero-rate party in 2020 and is looking increasingly out of step in leaving unconventional policies behind.

One interesting aspect that NZ investors might ignore at the peril is that while the RBNZ has only been lifting rates slowly, the market has pre-empted further moves based on the evidence that is available for all to see. A chart of the benchmark 3-year swap rate is below.

Notice how quiet property syndicators have been of late? The 3-year swap has risen from 0% to 2.5%. Worse, Citigroup research estimates that 40% of all NZ mortgages are set to be refinanced in the next 6 months and 70% in the next 12 months. The negative wealth effect and the impact on house prices could be sizeable. Yes, we remain net short the retirement village sector.

Returning to the Fund's positioning and performance in the month of November, our net length declined from 54% to a still high 50.5%. However, 2% of this is effectively cash from the Intega takeover bid. A further 4.7% is scattered across four particularly cheap gold stocks which have been under heavy pressure and which have significant potential upside if gold eventually responds to real interest rates being deeply negative. Resolute (RSG) and Regis Resources (RRL) are very cheap existing long-life producers while Bellevue Gold (BGL) and Tietto Minerals (TIE) have very exciting low-cost development projects.

As is generally the case, the Fund defied its superficially high net length to hold its own on negative days. There were a near-record 12 such down-days in the month for the 50/50 index of Australia and NZ, with the average loss for the market being -0.46% on those days. The Fund was up on half of those days and delivered an average return on them of +0.07%. It was actually the up-days where we struggled, with growth stocks tending to surge rather than the staider cheaper names that we prefer being long.

The Fund's performance in November of circa -0.3% (pre fees and tax) featured moderate gains from our short book and headwinds from our long book. We might have hoped for more gains from our shorts but ultra-expensive names outperformed even though markets fell in the month. Our overall "winners to losers" ratio was its weakest in some

time at just 51%, with losses from our larger longs tending to be a little greater than gains from our typically smaller shorts.

The largest winner by some distance was our large long-held position in Shaver Shop (SSG, +18.1%), which one or two people finally started to notice after they delivered a strong trading update at their AGM. SSG has already been a multi-bagger for the Fund and we have taken a little profit but it remains a sizeable holding given it is on a cash PE of circa 8x and still has a strong growth outlook from category expansion, store rollouts and its highly successful online business. Other retailers with lesser growth outlooks trade at more than three times SSG's multiples in the momentum obsessed Australian market. We are hopeful that SSG can get on the momentum train.

Our second notable tailwind came from another key holding in the form of Tower (TWR, +7.1%) which delivered a result at the top end of (downgraded) expectations and announced a capital return. We are the only boy marching in step in this name, which appears to be generally disliked because of strong claims cost inflation and a couple of years of high large events claims which have seen them hit their aggregate reinsurance limit.

What we see is a company with a flush balance sheet (even after the repayment); a comparative advantage in their IT system versus their key competitors; further management expense ratio reductions as they drop the support costs from old systems; the claims expense cycle headwind turning into a tailwind as they and the rest of the industry re-price; and an investor base which irrationally assumes that TWR will hit their aggregate large event claims limit each and every year. We look forward to when they have a light claims year and the market gets over-excited at the huge earnings number TWR delivers at that time.

A third important positive was our long in Graincorp (GNC, +9.9%) which delivered a strong result and announced a buyback for early 2022. GNC has been a very successful investment since our entry in the $4 region when we viewed analysts as underestimating the earnings upside from a massive grain harvest across their largely fixed cost network. This has played out as well as we could have hoped and the share price has responded strongly but we have a nagging question as to whether one should curb one's enthusiasm a little in the times of plenty and wait for a drought year to go hard again. We have therefore trimmed what was a very large holding back to sub-1%.

Other notable positives came from our short in the very expensive Commonwealth Bank (CBA, -11.0%) whose quarterly update was solid but not good enough to justify a PE of over 20x for a bank; our short in Ryman (RYM, -14.9%), whose result saw a step away from previous build-rate targets in the face of a housing market that may finally be peaking; a long in OFX Group (OFX, +28.5%) which has risen more than 50% since we bought it off forced passive sellers when it fell out of the S&P/ASX300 Index; and our long in Omni Bridgeway (OBL, +4.8%) which finally caught a respite from what we think is misplaced short-selling.

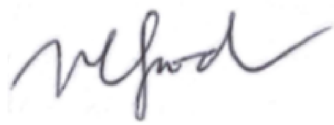
Our largest headwind came from a positive contributor last month in the form of Emeco (EHL, -14.6%) whose second-half weighted reiteration of guidance was not enough for the market. While EHL is experiencing some labour cost pressures, mining equipment markets are generally sufficiently strong for them to still be performing well. EHL is now on a Jun22 PE of just 6.3x, with decent growth thereafter. It is now trading at just 40% of its recent highs but its balance sheet has since been repaired and the overall commodity outlook is solid.

Our second notable detractor was misjudging the degree of adoration for our short in Johns Lyng Group (JLG, +14.8%). This is a company that provides commercial building and insurance remediation services, with their key clients include the major insurance companies. As one might expect from a low capital intensity service provider, their EBIT margins are in the 7-8% region and it would be a reasonable little business if it was on a PE of 10-15x. With there being claims cost pressures everywhere, we would be surprised if the large insurers allow JLG to earn super returns. For reasons that escape us, it has attained "darling stock" status and is on a Jun22 PE of 55x growing to 52x in Jun23. They'll no doubt buy a few small building services businesses on tiny multiples to generate a veneer of growth but this strikes us as having re-rated at least several bridges too far.

A third hit came from our large long in the coking coal export port operator, Dalrymple Bay Infrastructure (DBI, -9.7%). DBI has growth as it transitions its clients to light-handed regulation and has expansion plans that will be paid for by its clients. It has minimal exposure to thermal coal. DBI pays a fully free cashflow covered dividend yield of 8.8%, with a modest growth outlook. For a NZ investor taxed on a 5% assumed rate of return, this grosses up to a yield of 10.3% - a tad more attractive than term deposit rates.

Other hits came from a retracement in Pacific Edge Biotechnology (PEB, -16.3%), which always seems to weaken on its results as investors are impatient for a demonstration of its profit potential; an ill-timed long in Pepper Money (PPM, -11.3%) where fear of lending margin pressure seemed to triumph over the reality of a profit upgrade and a PE of 6.4x for a stock where margin pressure may be close to peaking; a long in GDI Property (GDI, -6.8%) which fell for reasons that escape us; and our long in the gold producer Regis Resources (RRL, -10.0%) which has been pummelled to half its price at the start of the year despite an A$ gold price that has broadly held up.

Thank you for your continued support of the Fund. Our long forecast macro backdrop of rising inflationary pressures forcing central banks to tighten is playing out. This would normally see cyclical and value names dramatically outperform expensive growth names, whose valuations are very sensitive to rising yields – instead growth dramatically outperformed in November. Such are the vicissitudes of measuring investments on a short-term basis. Strong stock selection meant we largely held in there and we certainly did less badly than long-only equities. We continue to be well-positioned to deliver equity-like returns with less volatility than equity markets and with no correlation to them.



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