Salt Long Short Fund Fact Sheet – October 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 31 October 2024

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$97 million
Inception Date	1 July 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 31 October 2024

Application	2.9251
Redemption	2.9133

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 2024

Long positions	53
Short positions	30

Exposures at 31 October 2024

Long exposure	96.70%
Short exposure	44.38%
Gross equity exposure	141.08%
Net equity exposure	52.33%

Investment Risk to 31 October 2024

Fund volatility[1]	6.54%
NZ50G / ASX200AI volatility[1]	13.44%
NZ50G / ASX200AI correlation	0.051

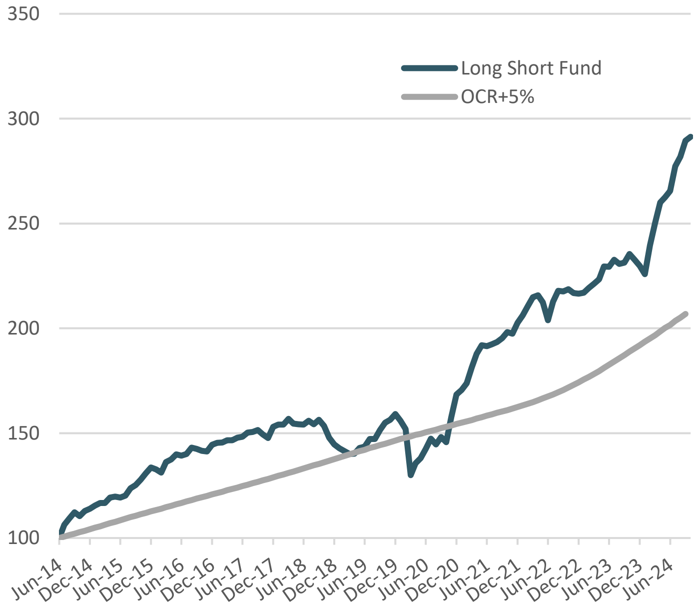
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 31 October 2024

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	0.66%	0.80%	0.15%
3 months	5.08%	2.46%	1.95%
6 months	12.02%	5.06%	7.04%
1-year p.a.	23.71%	10.39%	21.13%
2 years p.a.	15.42%	10.14%	9.21%
3 years p.a.	13.70%	8.98%	3.17%
5 years p.a.	13.45%	7.53%	6.41%
7 years p.a.	10.01%	7.27%	7.82%
10 years p.a.	10.19%	7.33%	8.74%
Inception p.a.	11.00%	7.43%	8.97%

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 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	Breville Group
Global Data Centre Group	Reece
Monash IVF Group	Scentre Group
Turners	Wesfarmers

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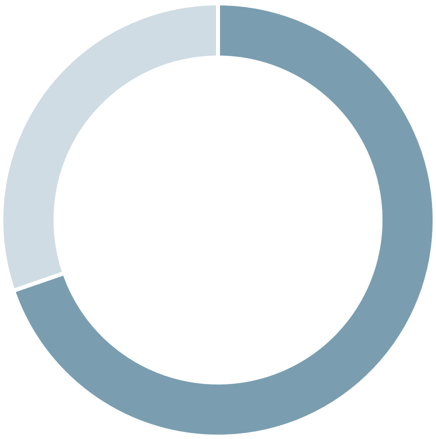
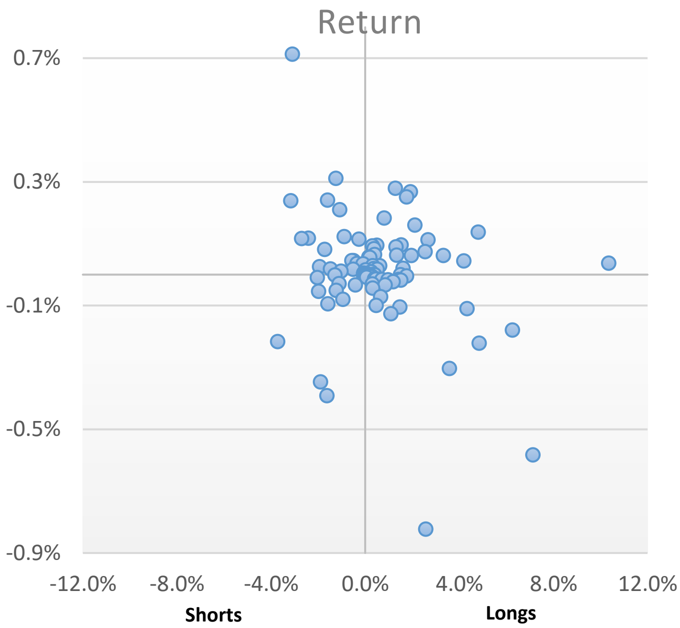
Country Allocation at 31 October 2024 (Gross Equity Exposure)



October 2024 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

After a succession of strong months, October saw the Fund revert to a lesser but still positive return after all fees and tax of +0.66%. This was against a backdrop of mixed returns from long-only equity benchmarks, with NZ advancing by +1.7% thanks to rate cuts, while Australia retreated by -1.3%.

The Fund continues to be heavily net long in NZ, where we are finding a number of reasonably valued stocks which may have solid earnings upside on a 12-18 month view as the rate cut medicine gradually feeds through. By contrast, we are finding many large cap Australian names to be relatively to egregiously expensive, making these a natural source for many of our shorts. Australia has sharply outperformed NZ in the years since Covid, but with the monetary policy cycles desynchronising, this may have run its course for now.

There were three key themes that we discerned during the month.

1) Until some cracks appeared right at month-end US time, the dominance of the Magnificent 7 and all matters AI continued unabated. Increasingly, this theme is looking extended in terms of both fundamentals and weight of money.
2) After earlier over-tightening monetary policy, NZ cut rates by 50bp and appears to have plenty of further room to move. This contrasts with far more mixed inflationary evidence in the US and Australia, limiting their room for action.
3) Markets positioned themselves for US election outcomes, with the sharp 50bp rise in US 10-year bond yields perhaps reflecting a combination of surprising economic strength and expectations of a Trump victory. We see no good outcomes for equities from the US election, with the least bad perhaps being a Trump victory but Democratic Congress. For what it's worth, this is not our expectation.

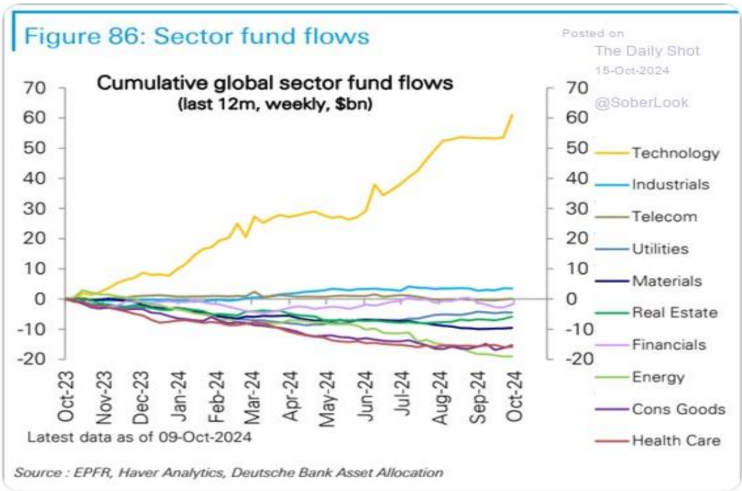
Exposures to the Artificial Intelligence theme continued to soar for most of October until they ran out of steam at month-end. This matters far more to the US market than it does to Australia/NZ. However, we do have exposures via a small Infratil (IFT) long and our large triple bagger long in Global Data Centres (GDC), which is now just a time-value of money play as we wait to be paid post their asset sell-off at what may be top-of-cycle prices. These longs are offset by middling shorts in Goodman Group (GMG), where the market is pricing strong short term data centre development returns as though they will repeat forever, and Homeco (HMC), where the market appears rather over-excited on their establishment of a data centre funds management platform, with an initial fully priced purchase of Global Switch Australia.

Will the AI hype last or will it collapse like a souffle? Our moderate positioning betrays our lack of real conviction but the views of some experts are concerning as to the boom's longevity.

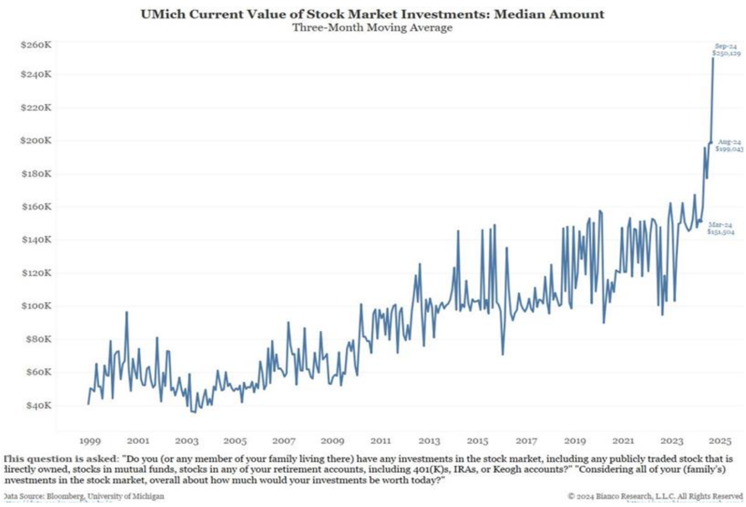
MIT professor, Daren Acemoglu was extensively quoted on Bloomberg that only 5% of all jobs will be taken over or extensively aided by AI in the next decade. He sees three possible scenarios. First, the hype may slowly cool and investments in the space focus in on areas where returns can be made. Secondly, the frenzy collapses and leaves an "AI winter" of disillusionment behind. Thirdly, the frenzy continues for years, with vast sums being wasted as the technology doesn't ultimately pan out in terms of the returns it can generate. A potential bull-case scenario did not feature.

Another alternative expert view was a fascinating article from storied VC investors, Sequoia Capital in the link below. In essence, they argue that we are almost at the end of phase one of vast investments in what are really just pattern recognition models. What comes next is more akin to a decision-tree, where AI models "reason" through the optimal decision given prior and new information. In their view, this may see a distinction between the infrastructure that is being built by hyper-scalers and all the application layers that will follow to make use of this infrastructure. Who wins and whether existing dominant technology players are themselves disrupted becomes a question that is very interesting and beyond our ken at this stage.
https://www.sequoiacap.com/article/generative-ais-act-o1/

Moving on from the views of experts, are excessive money flows chasing the boom?



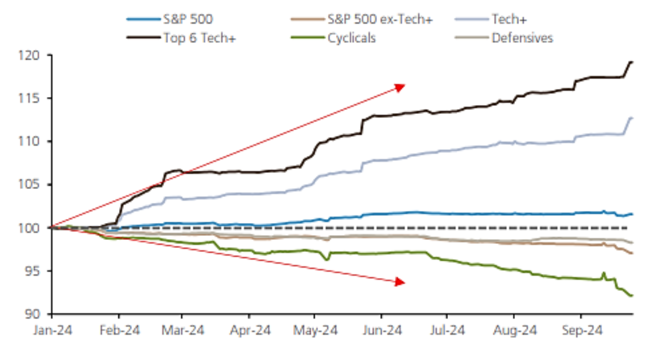
Is this smart money or Uber drivers? The chart below is also somewhat concerning as individual brokerage accounts have soared in a vertical manner. Hmm…



Put all this together and we are very wary on the AI technology theme. Maybe we are just recalcitrant knee-jerk contrarians but there are highly credible expert views which question AI's fundamental premises and vast amounts of both smart and dumb money are already invested.

We also have a nagging concern that the technology sector is driving the bulk of US earnings growth and that its very nature overstates it. Nvidia rightly books the profits from GPU sales upfront but the costs are amortised by their customers over 5-6 years. Magic. As shown below in a chart sourced from UBS, S&P500 earnings revisions ex the tech sector are comfortably negative.

Figure 4: S&P 500 consensus 2025 EPS revisions –



Source: Standard & Poor's, FactSet, Refinitiv, UBS; Cumulative 2025 EPS forecast changes rebased to 100 (YTD); Data a/o 24-Sep-2024

The second key theme for the month was that after earlier over-tightening monetary policy, NZ was able to cut rates 50bp and appears to have plenty of further room to move. This contrasts with far more mixed inflationary evidence in the US and Australia, limiting their room for action.

The RBNZ cut the OCR from 5.25% to 4.75% on 9 October. Thereafter, NZ September quarter CPI came in at 2.2% YoY but with a stark divergence between non-tradeable inflation at +4.9% and tradeable inflation at -1.6%. Allowing for some one-off impacts on non-tradeable inflation, this was largely as expected. While premature to declare victory over inflation, this should open the door for a further 50bp cut in November. There is a slight chance of a 75bp move but this would require extremely weak employment data and wage inflation in the release this Weds 6 November.

By contrast, the RBA cash rate target never went up nearly as far and they are stuck for now at 4.35%, with an economy that is relatively strong but slowing and underlying inflation being persistent. September job data was a strong beat at +64k on the prior month and the unemployment rate being only 4.1%. September quarter inflation did fall to +2.8% YoY but benefitted from large one-offs due to temporary Government subsidies. The RBA's preferred measure of trimmed mean inflation was still +3.5% and services sector inflation rose a touch to +4.6%. The RBA may be on hold until well into next year, marking a sharp policy desynchronisation from NZ. Equity markets are starting to take this on board.

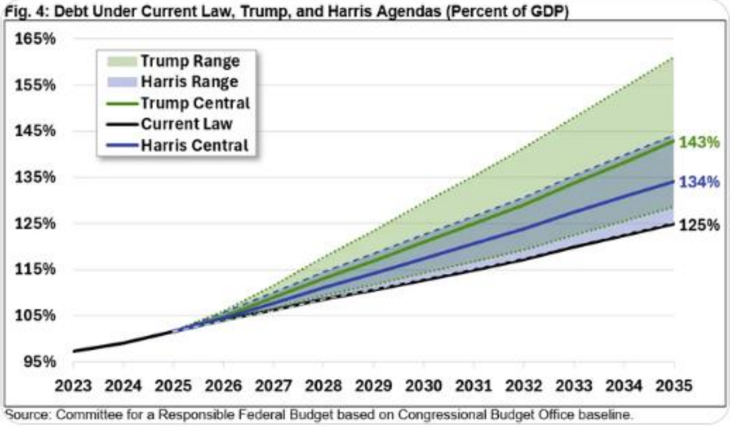
While the Fed cut its rate target by 50bp a few weeks ago, economic evidence and the reaction of the bond market over the last month suggests they may now be regretting it. A combination of election risk concerns and strong economic data saw the US 10-year yield surge from 3.78% to 4.28% in October and it has risen a further 12bp as this is written.

US core CPI inflation surprised for the second month in a row at +3.3% YoY, with services and "supercore" inflation even stronger. At month-end, the Fed's preferred measure of core PCE inflation rose by +0.3% in September (highest since April) and +2.7% YoY. Consensus projections do not have any rapid decline. The market seems to expect a further 25bp rate cut but that may be pretty much it for a while.

The third key theme in the month has been pre-positioning for the US election outcome. It is difficult to discern what exactly has been priced into equities but fears of a deteriorating fiscal situation appear to be behind a portion of the bond yield sell-off.

We see no good outcomes for equities, with the least bad perhaps being a Trump victory but Democratic Congress. The chart below shows the totally unsustainable US fiscal path under both candidates.

Fig. 4: Debt Under Current Law, Trump, and Harris Agendas (Percent of GDP)



Source: Committee for a Responsible Federal Budget based on Congressional Budget Office baseline.

According to Citigroup research, if Trump has sufficient power to implement an across the board 10% tariff (less than he's proposing), then this would slice -0.7% off GDP growth forecasts and add +0.6% to CPI inflation. It would likely be considerably worse than this as the tariffs could be larger and this doesn't assume any retaliation by other countries. The likes of China and Germany would be very hard-hit. Partial offsets would be benefits from deregulation and a corporate tax cut from the current 21% rate. UBS argues that "Value" could outperform "Growth" as the former may benefit from tariffs while the latter would be hurt relatively more by the inevitable rise in bond yields.

Conversely, if Harris succeeds, then her key relevant policy is for the corporate tax rate to lift from 21% to 28%. This would slice 5% off S&P500 earnings forecasts. Other proposals for a lift in the capital gains tax rate for higher income earners would also lift the cost of capital.

You will likely be reading this as the US election results are coming out on Weds NZ time, but our pick for what it is worth, is that we end up with a Harris Presidency, Democratic Congress but a flip in the Senate to Republican, with the latter two being knife-edge. The basic premise behind this is that the Democrats have tended to outperform their polls ever since Roe v Wade was over-turned due to a larger turn-out of Democratic-leaning female voters than assumed in the polling samples. This outcome has not been priced by markets and we suspect the short-term reaction would be a modest bond yield rally (Trump tariffs avoided) but an equity market sell-off (higher taxes). Weds afternoon will be fascinating!

Fund Performance in October

Returning to the Fund's performance in the month of October, our overall return of circa +0.8% pre fees and tax was driven by a strong contribution from our short book (+1.2%) offset by a disappointing -0.4% headwind from our longs. Our shorts did as one would hope in the weak Australian market but our longs were disappointing and did not benefit much from the NZ bounce. Our overall "winners to losers" ratio was a solid 58%.

Our gross exposure was again largely unchanged at 141% (142% prior) but our net exposure rose further from 49% to 52%. We remain extremely net long NZ and are relatively more neutral in the expensive Australian market. Moreover, as always, many of our longs march to the beat of their own drum and have little linkage with overall market movements. Our set-up and performance is still very much "market neutral".

As was the case in September, October saw 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 -0.38%. By contrast, the Fund was up on seven of those twelve days and had an average return on all of them of +0.08%. As always, there was no measurable correlation between the performance of the Fund and that of the market. The Fund continues to be "market neutral" and is well-placed irrespective of the direction in which markets move next. It is stock selection rather than markets that drive returns – that is the whole point of the Long Short Fund.

The largest positive contribution by some distance was our relatively large short in Reece Limited (REH, -20.0%). Going up against the prior unadulterated love had made this a painful holding at times but fundamentals always win in the end. REH delivered a moderate downgrade from their Australian and particularly their US businesses. We cannot see the macro forces that drove those reversing any time soon. While the share price decline outweighed the earnings downgrades, REH still trades on eye-watering PE multiples of 37.8x Jun25 and 33.1x Jun26 and is right at the upper-end of the multiples that it's ever traded at relative to market.

Another short that did well for the Fund was a moderate position in Lovisa (LOV, -17%). We understand the extremely high gross margins, the incredible sales/m2 metrics and the global roll-out story. However, the entry barriers in the "junk" jewellery trade are low and investors were reminded of this when a former CEO announced plans to open a new business. In itself, this may not amount to much but our thesis is more around the likes of Temu growing rapidly in this market and the store roll-out numbers being a little weak. LOV is on a Jun25 PE of 31.5x.

A number of other shorts were solid positive contributors and they tended to share a combination of having out-sized valuation multiples meet the beginnings of potential macro headwinds. Examples here included ARB Corporation (ARB, -12.6%), James Hardie (JHX, -14.9%) and Breville Group (BRG, -6.9%). They are all "good" companies but have lost their fundamental valuation anchor.

The largest winner from the long side of the ledger was a moderate position in Scales (SCL, +14.6%) which bounced hard following the removal of the long-standing overhang from the 15% stake held by China Resources Enterprise. Our thematic of holding quality cyclicals in the NZ economy did well in the month via a mid-sized Freightways long (FRW, +15.3%), a large Turners holding (TRA, +3.4%) and a mid-sized NZME position (NZM, +2.9%). The only other large contributor amongst our longs was our very successful investment in Superloop (SLC, +8.4%).

One final name of note was our very large holding in Tower (TWR, -0.7%), where we lightened the position somewhat into its S&P/NZX50 Index inclusion. We are looking forward to the result later this month. We believe the business is likely to still be performing extremely well and we are not concerned by the resignation of the successful CEO, Blair Turnbull. We view it as a case of job done in putting in place a strong core business, which has made enormous strides from when he arrived four years ago.

The largest headwind came from an oft-mentioned name in the highly volatile DUG Technology (DUG, -26.5%). We had lightened into earlier strength but have been buying back to build this up into a solid holding in the current pullback. It was hit by an equity raising at $1.90 and relatively weak Q1 trading in what is always a seasonal low-point. We are encouraged that the reason for the raise was to fund growth and that they are seeing exceptional levels of interest in their new industry-leading seismic technology. It is not often that the holdings in this Fund overlap with those of go-go growth momentum funds in Australia but we suspect that they momentarily may have when the stock was in the high $2 region and we suspect they may again when it hopefully gets back there.

A second long which caused us a degree of grief was our large position in GDI Property (GDI, -7.4%), which was weak in common with many other property stocks due to higher bond yields. The pain was only partially offset by shorts elsewhere in the sector. There was no major news aside from a conference presentation that pointed to solid leasing progress continuing.

Other longs which detracted from performance were led by a mid-sized position in Challenger Group (CGF, -6.9%), where we see long term structural growth in the annuities market on valuation multiples of 9.9X Jun25 and 9.3x Jun26, with a solid capital base. Our large holding in Monash IVF (MVF, -4.1%) was also weak. This was on fears of short term weakness but we see strong future growth both in IVF generally and a catalyst in the form of new funding for genetic carrier screening specifically. We will be patient.

Shorts that detracted were led by a moderate position in HMC Capital (HMC, +24.0%), where we think the market is getting over-excited at their entry in the data centre business at what may be 11.30pm in the boom. They paid a very strong price in a competitive bidding situation for Global Switch Australia and intend to use this as the seed asset for a major new fund. This may work if the cycle extends for years but HMC is on very extended multiples of recurring earnings. We admire HMC's capital market skills and have even been long in the past but view it as very full up here.

The other shorts that detracted were led by the relentless rise and rise of Hub24 Limited (HUB, +18.4%). We have successfully traded this in the past but recent months have seen a one-way ascent just as the business may be getting a little closer to maturity over the next several years. We cannot resist a Jun25 PE of 62.1x. That is $93m of forecast NPAT on a $5.7bn market cap. The final name of note was our old friend Commonwealth Bank (CBA, +5.4%), which rose for no reason that we could discern.

Thank you for your continued support and interest in the Fund. October was a little choppier than the last few months but we were pleased to still grind out a positive return. November will be interesting. We have vivid memories of the extraordinary swings after recent US elections. We believe we are well-hedged but the next few days will tell. 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