Salt Long Short Fund Fact Sheet – February 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 July, 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 29 February 2024

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$77.6 million
Inception Date	1 July 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 29 February 2024

Application	2.4053
Redemption	2.3956

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 29 February 2024

Long positions	56
Short positions	34

Exposures at 29 February 2024

Long exposure	109.11%
Short exposure	55.76%
Gross equity exposure	163.89%
Net equity exposure	53.35%

Investment Risk to 29 February 2024

Fund volatility[1]	6.51%
NZ50G / ASX200AI volatility[1]	13.56%
NZ50G / ASX200AI correlation	0.069

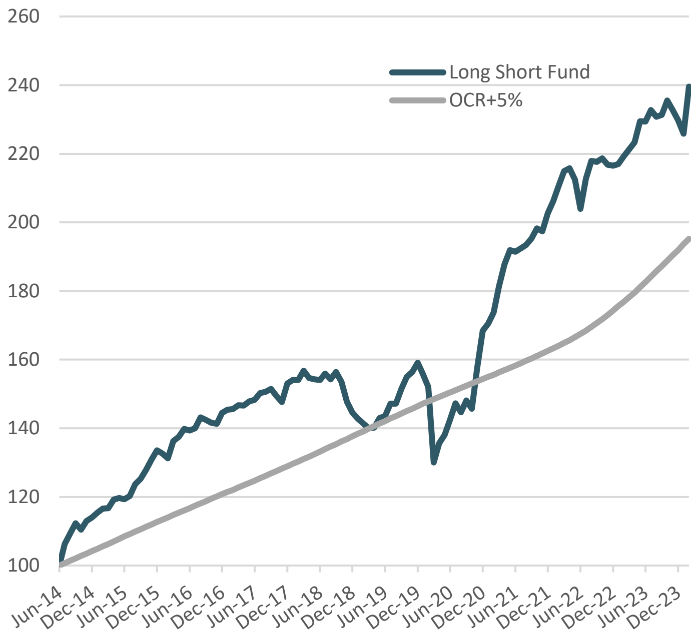
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 29 February 2024

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	6.07%	0.79%	-0.15%
3 months	2.92%	2.51%	6.49%
6 months	3.82%	5.08%	4.50%
1-year p.a.	9.26%	10.38%	4.08%
2 years p.a.	6.65%	9.08%	3.63%
3 years p.a.	11.30%	7.85%	3.74%
5 years p.a.	11.12%	7.01%	7.41%
7 years p.a.	7.37%	6.94%	8.09%
Inception p.a.	9.46%	7.16%	8.65%

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 29 February 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	Wesfarmers
Superloop	Breville Group
Servcorp	Fortescue Metals Group

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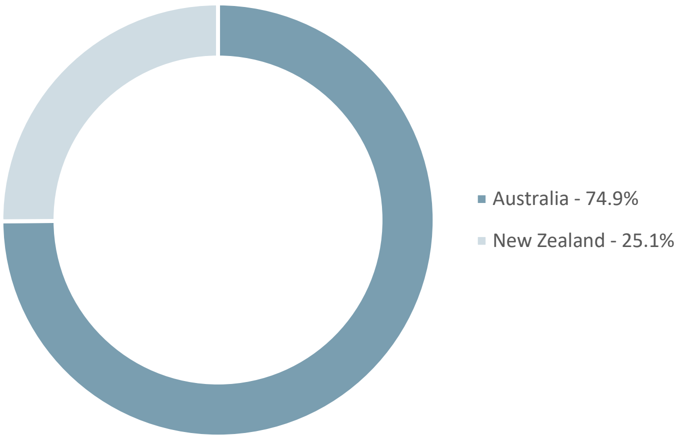
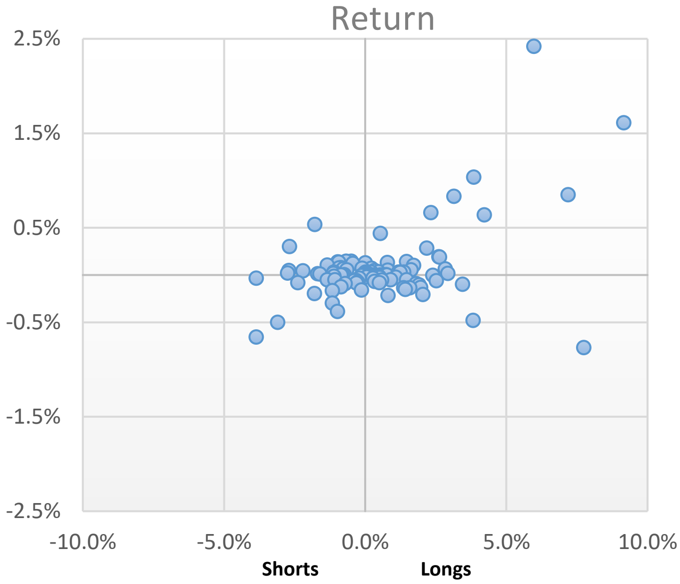
Country Allocation at 29 February 2024 (Gross Equity Exposure)



February 2024 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

The Fund delivered an exceptional performance in the month of February with a return of +6.07%. This was our strongest month since the post-Covid rebound period and it compared to returns from the NZ and Australian benchmarks of -1.1% and +0.8% respectively.

We by no means escaped result season unscathed but we were right more often than we were wrong and several of our key long-held positions began to work for us, with a couple of mooted takeovers being rather helpful. These are yet to fully consummate, and we see considerable further upside as being possible from our key names.

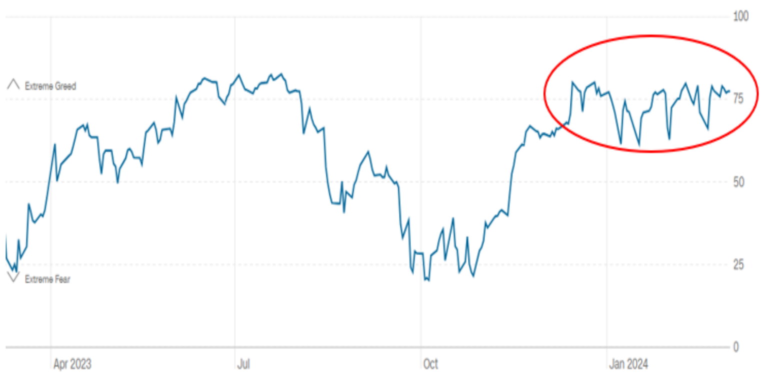
Bullishness continued to provide markets with a combination of a continued belief in “Goldilocks” outcomes and a frenzy for the AI story being the main drivers. A slightly weak result season in the Antipodes saw our markets lag the +4.2% surge by the MSCI World Index. The “Magnificent Seven” were again at the forefront but they did begin to fragment with Tesla, Apple and Alphabet lagging behind.

We continue to be surprised at just how much “liquidity” seems to be sloshing through financial markets globally, even as central banks have tightened monetary policy, QT continues and reverse repos deposited with the Fed decline.

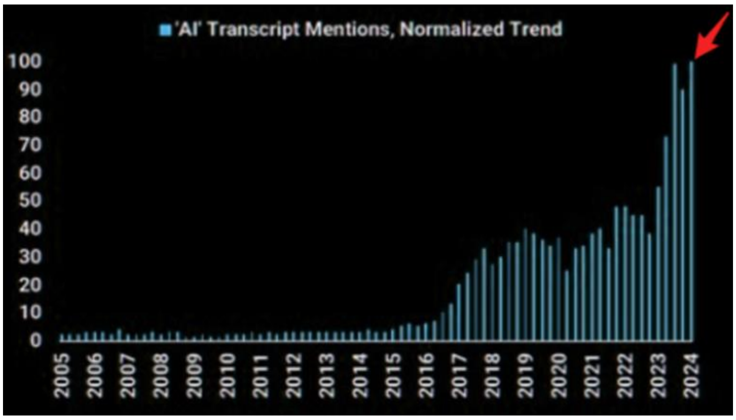
Maybe it is ultra-loose US fiscal policy, but whatever the driver, optimism continues to reign supreme.

Last time around in the free money era, Bitcoin peaked in November 2021, one month before the S&P500 in December. It may again be an interesting tell as to how much liquidity is sloshing around as it rose by a staggering +44% in the month of February, with its cousin Ethereum rising +47%. Their second cousin once-removed, the Australian Technology Index, rose by +19.7% in the month – a mere 19% outperformance of the broader index. We have started to carefully short some of the more egregious moves. Globally, technology short interest is at extremely low levels and hedge fund exposure to momentum is at all-time records. What could possibly go wrong?

Unsurprisingly, our CNN Greed & Fear measure shown below continues to register extreme greed. Both the level and the duration of this greed are strong contrarian signs.



Aside from "liquidity" continuing to slosh around financial markets, a key reason for the surge in optimism has been the Artificial Intelligence "revolution". The chart over the page sourced from Evans & Partners provides some perspective on just how all-in the market has become on the AI thematic. A lot of companies are suddenly mentioning AI in their result transcripts!



The hardest thing about any potential bubble is knowing ahead of time just how far it is going to inflate and what the catalyst might be for its demise.

Our holdings in the broad AI space include a large long in Global Data Centres (GDC, +11.4%) which is very much an undervalued asset realisation play and a more measured long in the data centre operator, Macquarie Technology (MAQ, +9.1%). Our highly successful long in the super-computing company, DUG Technology (DUG, +25.6%) is also loosely connected to the thematic.

We have sought to short-sell companies who are "fellow travellers" rather than being major direct beneficiaries. Our shorts in the software distributors Data #3 (DTL, -14.0%) and Dicker Data (DDR, +11.8%) had mixed outcomes in the month. They are still largely traditional software distributors but both the Spark NZ and Telstra results showed that IT business with governments and the top-end-of-town is not easy at present.

We are also bemused at the surge in Goodman Group (GMG, +16.8%) on future data centre development excitement. It is certainly another potential use for their well-located land holdings but surely at least some of the excess returns will accrue to those who own what is scarce – water and electricity supply. Mind you, it is a timely story with the industrial property cycle being at five minutes past midnight and it will genuinely be a source of demand – the magnitude of excess returns that accrue to the developer is the question. Thankfully, we left GMG well alone as it also surged from being added to a major global property index in mid-March.

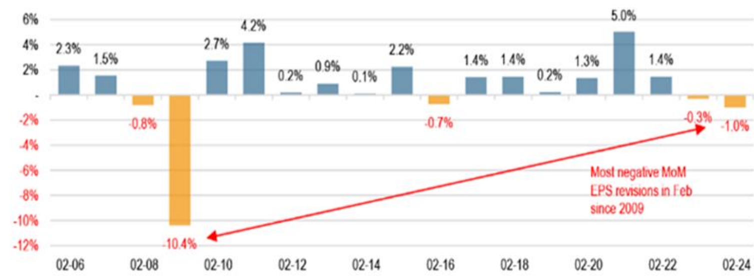
The entire AI space has fascinating echoes of the internet stock surge in 1999 … or maybe it's still only 1997? The point is not about debating whether current and future use-cases for AI exist to justify the huge investments being made, it is that there is a believable "story" which has grown from initial fundamental underpinnings.

In his seminal book, "Irrational Exuberance", famed economist Robert Shiller argued that speculative bubbles can arise from an initial "story" which then creates feedback loops as incremental positive news about that story drives further positive perceptions, attracting ever more investors. It is these feedback loops driven by optimism and perception rather than any calm discounted cashflow analysis of likely future outcomes that inflates bubbles. Just where we are in the feedback loop is anyone's guess but it sure feels like one is underway. We quite like our longs in the space as they have clear upside catalysts and we will sort through the "fellow travellers" and "AI-washers" for potential shorts.

Switching back to the Goldilocks concept, we continue to be deeply sceptical that the temperature of the porridge is just right. It requires a rare combination of economic growth to be just strong enough to drive solid earnings outcomes but not so strong that inflation stays high for an extended period. Evidence during the month was not helpful on either the earnings or inflation fronts.

The outcomes of reporting season were somewhat mixed. In Australia, Goldman Sachs saw a mix of 40% beats and 32% misses as being in line with historical averages. However, JP Morgan's slightly larger universe experienced a mix of 35% beats and 46% misses, with year-ahead downgrades of -1.0% being the most negative since 2009, although as shown in the JP Morgan-sourced chart below, that overdramatises it somewhat. Cost pressures and higher interest costs were the unsurprising villains. The NZ reporting season was similarly sombre.

Figure 1: EPS Revisions | Feb Reporting Season | Weakest since 2009



Source: Bloomberg Finance L.P.

What was most interesting was a plethora of takeover activity, with this being consistent with our analysis that while overall market valuations are expensive, small-mid cap stocks are in the cheap to fair value region. Such is the broken landscape that blind passive buying has wrought. Indeed, according to Bianco Research, the 50% threshold was breached in Dec23 for passive as a percentage of all ETF's/mutual funds in the USA. As a highly active manager, we are both intensely frustrated at these dumb flows but also extremely excited by the opportunities that are created by the paucity of price discovery.

We suspect that plentiful M&A activity will be an ongoing feature in this post-valuation world. Amongst others, bids or potential bids came in for Qantm IP, Superloop, APM Human Services, Altium, Alumina, Boral, Silver Lake Resources and CSR. The first three were good wins for the Fund, while the last one gave us a somewhat unfortunate black eye.

Moving on from earnings to the other leg of Goldilocks in the form of inflation, news during the month was not super-helpful, with bond yields generally rising in most countries despite speculative financial asset prices exploding higher.

The US core CPI for January came in at +0.4% (0.3% expected), with +3.9% YoY core inflation being a long way from the Fed target of 2%. At month-end, the US core PCE deflator rose by +0.4% in January, with core goods being less deflationary than previously at -0.05% and core services rocketing by +0.58%. This does not feel like a set-up where the Fed should be easing any time soon and US 10-year bond yields rose from 4.01% to 4.28% in the month.

In NZ, the RBNZ left the OCR unchanged at 5.50% at end-February, which was slightly dovish relative to market expectations which had pegged a 20% chance of a hike prior to the decision. They noted that core inflation has declined and risks to the inflation outlook have become more balanced but that rates need to remain restrictive for a sustained period of time.

RBNZ Monetary Policy Committee member, Bob Buckle posted an interesting study on LinkedIn by the IMF, which looked at 100 inflation shock episodes in 56 countries since the 1970's. It found that once underway, inflation is persistent; that countries frequently eased too early on initial evidence of slowing price pressures; that successful inflation resolution required tight monetary policy over several years; that monetary policy credibility matters; that those countries who successfully tightened had lower growth in the short term but higher growth and lower inflation in the long term. This doesn't sound like a recipe for aggressive early easing.

Tying all this together, we struggle to believe in Goldilocks. The earnings leg of the fairy-tale is proving mediocre, while all the evidence is pointing to inflation being persistent. This leaves us with apparently abundant liquidity and an AI boom that may be morphing into a bubble. The good news is that small/mid cap companies are relatively cheap and we are starting to see a resumption of M&A activity to crystalise this. We are seeing numerous interesting opportunities, but this remains an environment to invest with caution and zig while others are zagging.

<u>Fund Performance in February</u>

Returning to the Fund's performance in the month of February, our overall return of circa +6.1% pre fees and tax was completely driven by our longs. Our long book added +7.1%, while our short book detracted -1.0%. There was a major skew to several of our longs being large winners, while many of our shorts continued to be all aboard the momentum express. Our overall "winners to losers" ratio was a solid 60%.

Our gross exposure fell quite sharply from a very high 177% to a more normal 165% as a number of names reached our cover and sell targets. However, our net length rose from 45.6% to 53.4% due to a combination of strong relative performance by our longs and quickly covering some of our shorts when they worked. We continue to regard our positioning as being neutral to negatively correlated to the market on a risk-adjusted basis.

Despite the indices being mixed, there were a relatively high 11 negative days for the 50/50 index of Australia and NZ in the month. The average return of the market on those days was -0.38%. While we were up on only five of those days, our average return on all of them was +0.24%. February was one of those glorious months when we had no correlation to the market because we were up irrespective of what the market did!

The strongest contributor was our large long in Superloop (SLC, +46.8%) which delivered a good result and was then subject to a scrip bid by the highly acquisitive Aussie Broadband (ABB). The synergies between these two companies would be considerable. SLC rejected the initial approach out-of-hand but we see the combination as appealing and would expect a stronger bid to be forthcoming. SLC is only back to the levels it traded at in 2021 and it is a far stronger business today.

A second major winner was our largest position, being our old friend Tower (TWR, +19.0%). There has been no news on their strategic review which we presume was initiated to allow Bain to exit their 20% stake but the extraordinary valuation on offer was highlighted by updated guidance. They upgraded this year to at/above the top end of their range on the basis of strong GWP growth, some early signs of improving motor loss experience and strong cost controls. There have been no large claims, with the full $45m retained hit still being assumed. More importantly, TWR gave initial NPAT targets of $40-60m for Sep25 and $60-80m for Sep26, post all large event deductibles. At their mid-points, these put TWR on a PE of 5.3x in Sep25 and 3.8x Sep26. Clearly, no one else believes them. We almost hope their strategic review doesn't lead to a change in control.

A third stand-out was our large holding in Qantm IP (QIP, +22.0%). They had earlier delivered an earnings upgrade in January and we continued our strange addiction to a company with a sub-10x PE and strong double-digit earnings growth and a solid balance sheet. Others clearly agreed as QIP received a bid from a UK IP company, Rouse as well as interest from several private equity shops. They have engaged with Rouse although frustratingly did not disclose the price at which the non-binding indicative interest was lodged other than to say that they saw the businesses as being highly complementary. Our one criticism of QIP in the past is we felt that the Board tended to run it more for management than shareholders and we will just have to trust that a satisfactory outcome will be achieved for all. The share price advanced from $1.09 to $1.33 but a materially higher level than that will be required in our view.

A fourth notable tailwind came from the mid-sized position in the litigation funder, Omni Bridgeway (OBL, +25.4%) which rose for reasons that was just as obscure as to why it had fallen in prior months. Their result was merely satisfactory. The shorters' apparent thesis that they will run out of cash looks well misplaced but we would be more comfortable with the investment thesis if they delivered stronger and more timely results from the cases that they have funded. On balance, their outcomes have been disappointing for quite some time, which leads one to question the true value of their funded book, even though it appears to be materially above current market valuations.

A couple of our larger shorts made strong positive contributions, with the way being led by the previously problematic Data #3 (DTL, -14.0%) whose result contained much more upside from interest earned on their forward payment receipts than core business growth than the market had expected. Investors have leapt on the AI thematic but the current reality is that traditional IT implementation and software sales are hard work. We covered into the weakness and will re-engage if and when it regains darling stock status. Our long-standing short in Fortescue Metals (FMG, -9.7%) also worked well as the iron ore price finally began to buckle.

Other large positives came from our large holding in Global Data Centres (GDC, +11.4%) even though their result contained no new news but an outcome on the sale of Airtrunk in the near future could be a major catalyst; DUG Technology (DUG, +25.6%) surged after a solid result although it concerningly traded in a 35% range on the day, suggesting a degree of "fast money" being present; APM Human Services (APM, +121%) which received private equity interest and in which we retained a moderate holding; and Servcorp SRV, (+15.2%) which delivered a strong result and remains staggeringly cheap in our view, on a PE of 8x and c30% of their market cap being net cash.

The most significant headwind came from our large position in GDI Property (GDI, -9.0%) which drifted lower for no obvious reasons that we could discern aside from slightly higher bond yields. Their result was fine, their leasing progress continues to be solid and they have a couple of large potential catalysts lurking in their managed syndicates which would generate strong performance fees and de-gear their averagely geared balance sheet.

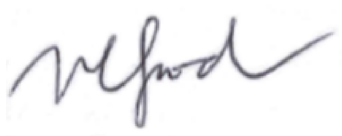
The second key detractor was a little more concerning in the short term in that trading conditions are clearly very tough for Lynch Group (LGL, -10.4%) in China. Their result was a little above earlier downgraded guidance but hopes for any early recovery in the Chinese consumer buying flowers have had to be pushed back. It remains cheap and moderately geared and may prove a great investment when the cycle ultimately turns but we clearly bought this straw hat a couple of winters too early.

Our large short in the plumbing retailer, Reece (REH, +18.0%) proved problematic when they delivered a stronger than expected result. It is crystal-clear that their end-consumer markets are weakening but this has happened a little later than we and other bears expected. They are excellent operators but have very limited growth left in Australia and face far greater competition and risks in the huge US market. A forward PE of 43x for no growth in the next year or two is a bridge too far.

Similarly, our Wesfarmers (WES, +14.6%) short did not work well. Their lithium business will be a problem, Industrial Safety and Bunnings trading were flat but they have executed spectacularly well with K-Mart. Discretionary consumer companies did surprisingly well in the Australian result season but consumer weakness is real and may become more apparent as 2024 unfolds. A forward PE of 29x for WES is easily the most expensive level at which it has ever traded and we saw one fun piece of analysis showing that it is now pricier than CSL for the first time ever.

Other smaller detractors from the short-side included the darling stock, Lovisa (LOV, +40.9%) which jumped after a result that didn't strike us as particularly special; CSR Limited (CSR, +27.2%) which received a takeover bid just as it was looking very expensive as the cycle rolled over; and Cochlear (COH, +15.0%) which delivered a strong upgrade but which had some elements which may not be repeatable and which is on an unsupportable 56x forward PE.

Thank you for your continued support and interest in the Fund. After three moderately difficult months, we are thrilled to have delivered such a strong month of returns. AI euphoria and liquidity continue to drive markets but the thesis behind Goldilocks is looking ever more wobbly. Earnings outlooks are mixed at best, large cap valuations are expensive and inflation is being rather more persistent than the happy money-printers of 2021 could ever have imagined. We will continue to do our level best to extend our long-term track record of delivering equity-like returns, with far less volatility and no correlation to long-only equity markets.



Matthew Goodson, CFA