Salt Long Short Fund Fact Sheet – May 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 31 May 2024

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$84.8 million
Inception Date	1 July 2014
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 31 May 2024

Application	2.6347
Redemption	2.624

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 May 2024

Long positions	57
Short positions	32

Exposures at 31 May 2024

Long exposure	104.04%
Short exposure	52.19%
Gross equity exposure	156.23%
Net equity exposure	51.84%

Investment Risk to 31 May 2024

Fund volatility[1]	6.57%
NZ50G / ASX200AI volatility[1]	13.50%
NZ50G / ASX200AI correlation	0.058

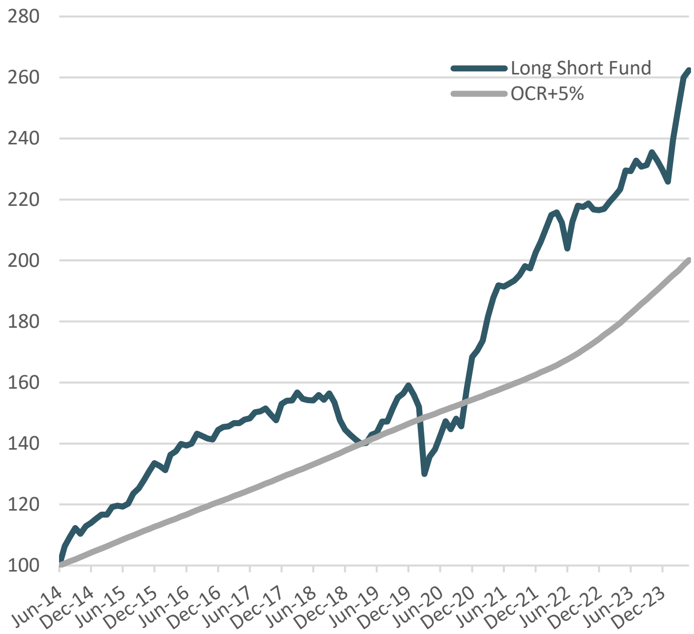
1. Annualised standard deviation since fund inception.

Fund Performance[2] to 31 May 2024

Period	Fund Return	OCR+5% Return	NZ50G/ASX 200AI Return[3]
1 month	0.90%	0.85%	0.08%
3 months	9.53%	2.54%	1.12%
6 months	12.73%	5.10%	7.69%
1-year p.a.	14.36%	10.46%	6.09%
2 years p.a.	11.15%	9.59%	4.86%
3 years p.a.	11.00%	8.27%	2.58%
5 years p.a.	12.92%	7.19%	6.26%
7 years p.a.	8.54%	7.06%	7.87%
Inception p.a.	10.22%	7.24%	8.54%

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 May 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	Meridian Energy
Global Data Centre Group	Wesfarmers
Servcorp	Reece
Heartland Group Holdings	Breville Group

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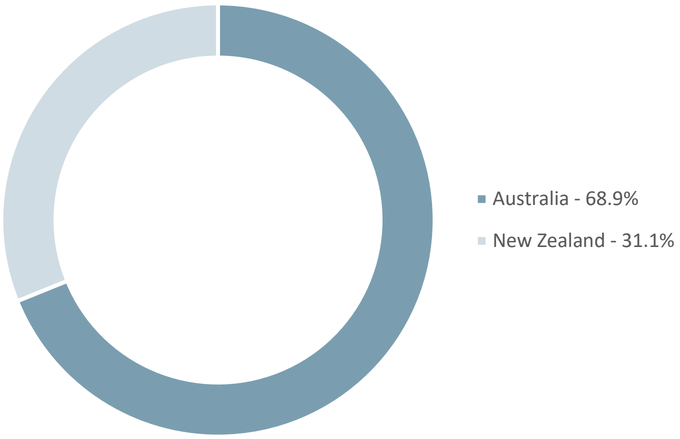
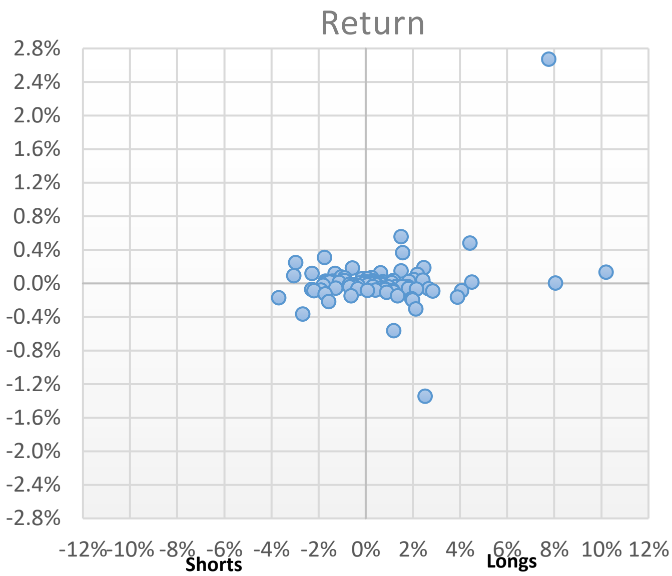
Country Allocation at 31 May 2024 (Gross Equity Exposure)



May 2024 Individual Stock Contribution



Fund Commentary

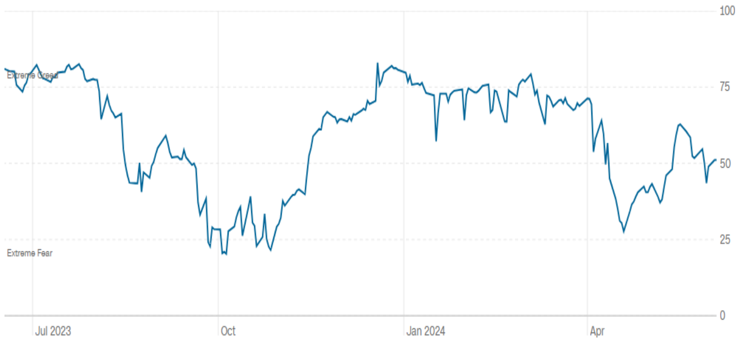
Dear Fellow Investor,

After several extremely strong months, the Fund reverted to a more normal level of performance in the month of May, with a satisfactory return of +0.90%. This end outcome reflected the benefits of diversification, with there being several standouts on both sides of the ledger which saw the Fund move in a relatively wide 4.2% range in the month.

The Fund's return compared to a decline by the NZ equity market of -0.8% and an advance in Australia of +0.9%. However, these muted outcomes belied volatile movements within the month as share prices were moved around by mini-result season and an element of euphoria that is fading but won't quite die.

NZ rose by +2.7% on the last day of the month thanks to MSCI Index changes and passive flows overwhelming the dwindling active investors on the other side. Globally, the Nasdaq 100 Index surged by +7%, led by the mega-cap Nvidia, which rocketed +28% in the month to now be larger than each of the entire German and UK stock markets – hmm.

Our trusty CNN Greed & Fear Index (shown below) has moved well away from the extended period of "extreme greed" above 70 that it witnessed throughout the March quarter. It mainly gyrated around neutrality readings of 50 in May.



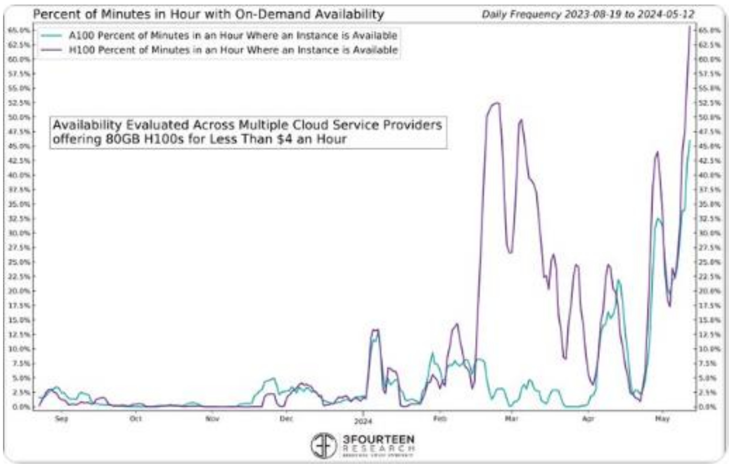
Nevertheless, there are numerous signs that segments of equity markets are still being driven by hope and greed. The pumping by Trader Kitty of meme stocks such as AMC and Gamestop was back with a vengeance in May. Sometimes bubbles need a second shadow-bounce to wipe out the last true believers, so perhaps that's what we're witnessing here.

There are plenty of other numerous anecdotal signs that animal spirits are alive and well, with one that particularly took my eye being that retail net purchases of leveraged ETFs have surged back to the hopey-dopey highs of early 2022. There is a lot of fast money "invested" in the market.

AI euphoria continued unabated and we continue to hold a moderate degree of scepticism as to how much further it might run in the short term. Markets are awash with stories of boundless demand for huge new datacentres and all the equipment that goes into them. Many extremely sophisticated property developers such as Goodman Group are jumping on this bandwagon and see major opportunities.

We would be more convinced if we saw a piece of clear analysis showing the hard financial returns earned by the users and purchasers of all this capacity. Right now, it's a land grab. We suspect there will ultimately be many interesting use-cases but they will take time and the returns to providers may be subject to competitive forces. We're delighted that our major investment in this space via Global Data Centres (GDC, +35.1%) is winding itself up and selling its portfolio of investments at what may be close to the top of the market.

We do wonder if the frenzy of demand being experienced by Nvidia is being exacerbated by a good deal of hoarding and demand front-running. Renting GPU access-as-a-service has suddenly become a big business but we suspect that its longevity may prove akin to opening the oven door on a souffle. To this end, I came across this fascinating chart on my Twitter feed mid-month which suggests that the GPU chip shortage may already be over.



Moving on from market sentiment, the key macro theme underpinning market movements continues to be "higher rates for longer". That said, we are gradually approaching an inflection point as evidence mounts of softer economic activity. While a lot of inflation evidence still points to it proving too sticky for any early rate cuts, we have started to see the odd piece of evidence that inflation is starting to ebb and equity market reactions to this have been very positive.

In NZ, the RBNZ left the OCR unchanged at 5.5% but this came with surprisingly hawkish guidance which revised up the theoretical peak-cycle rate in Dec24 from 5.60% to 5.65% and stated that hiking rates had been a real consideration. They placed little weight on weak labour market data and seemed more concerned than previously about NZ's poor productivity performance limiting our ability to grow in a non-inflationary way. An alternative explanation is that they're crudely trying to crush inflation expectations once and for all. We hope they succeed and that there is some science behind their policy gyrations.

May's RBNZ Statement hasn't aged very well so far, with the ANZ Business Outlook survey at month-end showing firms' own activity expectations mired at a weak +11.8 (was 14.3) and more importantly, firms' selling price intentions retreating to +41.6 compared to +46.9 prior and a peak of +80.5 back in March 2022. Notably at that time, the RBNZ's OCR rate was just 1.0%. What were they thinking? Being forward-looking has not been a strength in this monetary policy cycle.

However, as investors, we must be forward-looking. Share prices will move well in advance of central banks, and even though we are not enamoured with some current valuations, we began to get the sense during the month that equities are looking for an excuse to pre-empt central bank moves. NZ may be further through the cycle than other markets and quality domestic cyclicals such as Freightways (FRW) and Turners (TRA) may be near their lows.

The search for an interest rate peak was seen most vividly in Australia on 16 May, when the market rallied +1.65% (and many darling stocks moved 4%+) on what we saw as a major overreaction to a mixed monthly employment number. The headline rise in unemployment from 3.9% to 4.1% was enough to awaken "animal spirits" in expectation of future rate cuts. Never mind that the monthly data is volatile, that Easter's timing may have had an impact and that the unemployment rate would have stayed at 3.9% without the participation rate rising.

By month's end, the earlier excitement in Australia had proven to be much ado about nothing, with a higher-than-expected inflation number for April dashing hopes of any early rate cuts. Inflation rose from +3.5% YoY in March to +3.6% in April, while the critical "core" and "trimmed mean" measures both rose slightly to 4.1%, suggesting broad-based persistence in inflation pressure. Equities duly fell -1.3%. However, what these knee-jerk equity market reactions illustrate is that even if overall valuations still seem stretched, investors are poised to react positively to any signs that monetary policy easing is on the cards. We aren't at the inflection point yet but markets are searching for it.

US markets rose sharply thanks partly to moderately encouraging data re inflation that raised hopes that we may yet see a rate cut this year. US CPI inflation for April rose +3.4% YoY versus +3.5% in March although "super-core" inflation ex food, energy and housing was actually +4.9% YoY versus +4.8% in March. Focusing on that would have spoilt the story.

The market seized on the inflation narrative that it was wanting to hear and subsequent data in the last two weeks has generally pointed to a gathering economic slowdown. The US Citigroup Economic Surprise Index hit multi-year lows; the US core PCE deflator was as expected at 0.25%; the US manufacturing PMI post month-end weakened to 48.7, with the most forward-looking element of new orders being quite soft at -3.7 to 45.4; and US JOLTS data for April saw new job openings falling to the lowest level in three years.

Forget Goldilocks, the key question now is whether US inflation pressure will ebb in line with a clearly faltering economy. We are very happy having shorts in formerly loved US cyclical exposures such as James Hardie (JHX), Reece Group (REH) and Reliance Worldwide (RWC). While the NZ cycle may be close to its midnight nadir, the USA feels as though it is only at 10pm or 11pm.

Fund Performance in May

Returning to the Fund's performance in the month of May, our overall return of circa +1.0% pre-fees and tax was driven by a couple of huge outliers and a plethora of smaller contributions that generally went in our favour. Our long book added +1.1%, while our short book detracted a minor -0.1%. Our overall "winners to losers" ratio was a satisfactory 57%, with this ratio interestingly being the same across both our long and short books. This is what one would hope for in choppy sideways markets.

Our gross exposure rose slightly from 152% to 156% over the month as volatility created opportunities. Our net exposure was largely unchanged, falling a touch from 53% to 52%. Importantly, despite this length, the results of the Fund suggest that it still has a market-neutral positioning on a risk-adjusted basis, with this reflecting the nature of the stocks that we are long versus those that we have short-sold.

There were a very high twelve negative days for the 50/50 index of Australia and NZ in what was a volatile month that also featured a number of strong positive days. The average return for the market on those days was -0.48%. In contrast to this, the Fund was up on eight of those twelve days and our average return on all of them was +0.17%. There is always an element of chance as to which days we have our major wins and losses on but it is an interesting commentary that despite being more than 50% net long, we happened to do better on negative days than positive ones.

The largest positive contributor by a significant distance was our large, long-held position in Global Data Centres (GDC, +35.1%). It closed the month at $3.04 and it seems like half a lifetime ago when we felt like the only buyer in the market in the $1.10-$1.20 region. Sometimes it is hard to know whether fund management returns come from skill or luck but we do feel that you make your luck by playing in the right places.

It is fair to say that the AI revolution was not on our minds when we were accumulating our large GDC position. Rather we saw a stock that was trading at a steep discount to what seemed a conservative NTA of around $2 and which was operating in a sector that had solid growth thanks to the ongoing expansion of cloud computing. We took a view that the market was never going to value GDC fairly and reached out to other key holders and management to gauge their support for an asset sell-off and capital return.

This strategy was supported and the timing is now looking impeccable given the AI boom that is occurring. The new news during May was GDC selling their investment in Etix, the edge data centre platform, at a price that is 52% above their carrying value. We were confident the carrying value was conservative but this was a brilliant outcome. GDC is now left with cash and a small stake in the massive data centre hyperscaler, Airtrunk, for which the majority owner Macquarie is now running a sales process. It is anyone's guess as to the price but a realistic outcome in the buoyant current market might see a cash backing for GDC in the low-mid $3 region after all incentive fees and expenses are paid. We await this outcome with obvious interest.

The second largest tailwind came from our moderate long in the home security business, Intelligent Monitoring Group (IMB, +30.7%). This featured as a detractor last month but has been a very successful investment from when we first took a placement to fund their purchase of ADT Australia/NZ at an extremely attractive price. IMB is building on this base to consolidate the security monitoring industry and has years of organic and inorganic growth ahead of it. In late May, IMB raised equity to buy two more security businesses at very attractive prices. On our reckoning, the business is still only on a forward PE of around 7x despite the extraordinary growth outlook, so expect this name to feature in the Fund for some time.

A third key positive came from our large holding in the takeover target Qantm IP (QIP, +8.4%). Their competitor, IPH tried to throw a spanner in the works with a competing bid early in the month but this finally drove the private equity suitor to enter a Binding Implementation Deed at a price of $1.815. This settled a few nerves from investors (including us) as to whether the bid would make it from third base to home.

A fourth standout was a renewed foray into OFX Group (OFX, +27.7%) the global foreign exchange transfer firm that we had previously traded very successfully when poor passive investors were forced sellers when it fell out of the ASX300 Index. This time around, they delivered a slightly better-than-expected result and it surged accordingly. We have taken some profits but the valuation remains reasonable.

Two shorts delivered strong returns for the Fund. James Hardie (JHX, -13.7%) is a perennial darling stock of Australian growth investors but we took the view that the US cycle was maturing and that previous cost tailwinds were disappearing. They duly delivered a disappointing result and guidance but we would have to say that the love is yet to truly die from a lot of their fan-club. JHX is still on a Mar25 PE of 19.6x on forecasts that still seems to have lots of hope in them. There could be more downgrades to come. There was no new news on the plumbing retailer, Reece Limited (REH, -6.8%) but we would highlight it is still on forward PE's of 40.2x Jun24 and 39.5x Jun25 – such is the price of true love.

Our largest loser was a very disappointing outcome from our medium-sized holding in Australian Vintage Group (AVG, -8.6%), which went into suspense prior to month-end pending an earnings update and equity raising. We decided to take a mark-down from 34.5cps to 22cps, which we believe will be relatively accurate as to where it may trade when it comes back on.

We owned AVG for three main reasons. Firstly, it was very cheap on anything like a normal mid-cycle earnings performance. Secondly, they appeared to be weathering the wine industry storm well thanks to their strong branding in the UK market and their leadership position in low/no alcohol wine. Thirdly, it was publicly acknowledged that they had been locked in discussions with the unlisted giant, Accolade Group for some time. They have the 2nd and 3rd largest wineries in the Southern Hemisphere which are two hours apart and grossly under-utilised. The synergies would be enormous, potentially dwarfing AVG's market cap in value.

Three things appear to have gone wrong. Firstly, the AVG CEO left for reasons that are apparently unrelated to business performance but have not been satisfactorily explained. Secondly, AVG has not been entirely immune to the industry pressures and we suspect it will deliver a moderate earnings downgrade accompanied by a working capital blowout when it updates the market. Thirdly, the current owners of Accolade are hard-nosed private debt types who bought the debt at forty cents in the dollar. They have onerous take-or-pay contracts with growers that they have no need for. The growers voted against changing these and Accolade may now need to tip itself into receivership to rejig them. A merger with AVG could subsequently come back in a few months and drive tremendous upside, but for now, we have had to take our medicine.

A second notable headwind came from a disappointing repeat offender in Omni Bridgeway (OBL, -32.5%). They lost a high-profile class action that they had funded against CBA and this was the catalyst for market concerns around OBL's funding position to really come to a head despite OBL clearly setting out ample liquidity in the period ahead. We still see OBL as being valued at a sharp discount to their current book of business, let alone a valuation increment for future business growth. However, it is sometimes hard to fight against the market tide and our confidence in being the only boy marching in step would be stronger if they landed some sizeable wins. OBL is now quite a small position which we trade around aggressively given its frequent 4-5% share price movements.

A third detractor was our relatively large short in Meridian Energy (MEL, +12.7%). We model this out as very expensive in its own right and the pair trade relative to our Genesis Energy (GNE) long has never been more extended in all of their listed history. MEL had an absurd 10.5% bounce on the last day of the month. MSCI rebalance flows coincided with the "good news" of the Bluff aluminium smelter signing a new long-term contract. This didn't actually move our valuation by any meaningful amount and it actually saw slight downgrades from a couple of brokers. This contract should have been entirely expected and priced but we have a market that is moving around in the short term on passive flows and headline algos.

Other more modest headwinds were led by our short in a2 Milk (ATM, +15.0%), where fans appear to be extrapolating a bounce in the Chinese birth rate in the year of the dragon rather than viewing it as a one-off; a short in Commonwealth Bank (CBA, +4.4%), which has ground remorselessly higher into uber-expensive territory; a premature new long in Genesis Energy (GNE, -9.7%) which is by far the cheapest of the NZ gentailers; and our modest long in Marsden Maritime (MMH, -13.6%) which fell back with other ports and appeared to be on the end of some transition type selling.

Thank you for your continued support and interest in the Fund. May was a return to more normal levels of return after the extraordinary run of the previous three months. June is always interesting as Australia sees poorly performing stocks sold off to harvest tax losses. This can sometimes create short-term headwinds but we are better placed this year than in the past and we look forward to the opportunities that will be on offer.

The macro backdrop is gradually changing. The NZ economy is in recession, while the US and Australia are showing mixed signs of slowing down. Inflation is remaining sticky but is starting to show some signs of ebbing – especially in NZ. Equity markets will move ahead of central banks and we are getting an increasing sense that NZ may be bumping along the bottom. The overall NZ market is on high multiples but this is due to a handful of large-cap growth stocks. Outside them, it is getting easier to find reasonable quality names at cheap valuations and we are playing in an increasing number from the long side.

Whether our slowly evolving views around the macro backdrop prove right or wrong, we will continue to be flexible and 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