
# Salt Long Short Fund Fact Sheet – April 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 30 April 2024

| | |
|---|---|
| Benchmark | RBNZ Official Cash Rate +5% p.a. |
| Fund Assets | $84.2 million |
| Inception Date | 1 July 2014 |
| Portfolio Manager | Matthew Goodson, CFA |

## Unit Price at 30 April 2024

| | |
|---|---|
| Application | 2.6111 |
| Redemption | 2.6006 |

## 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 April 2024

| | |
|---|---|
| Long positions | 55 |
| Short positions | 32 |

## Exposures at 30 April 2024

| | |
|---|---|
| Long exposure | 102.72% |
| Short exposure | 49.40% |
| Gross equity exposure | 152.12% |
| Net equity exposure | 53.32% |

## Investment Risk to 30 April 2024

| | |
|---|---|
| Fund volatility[1] | 6.53% |
| NZ50G / ASX200AI volatility[1] | 13.50% |
| NZ50G / ASX200AI correlation | 0.062 |

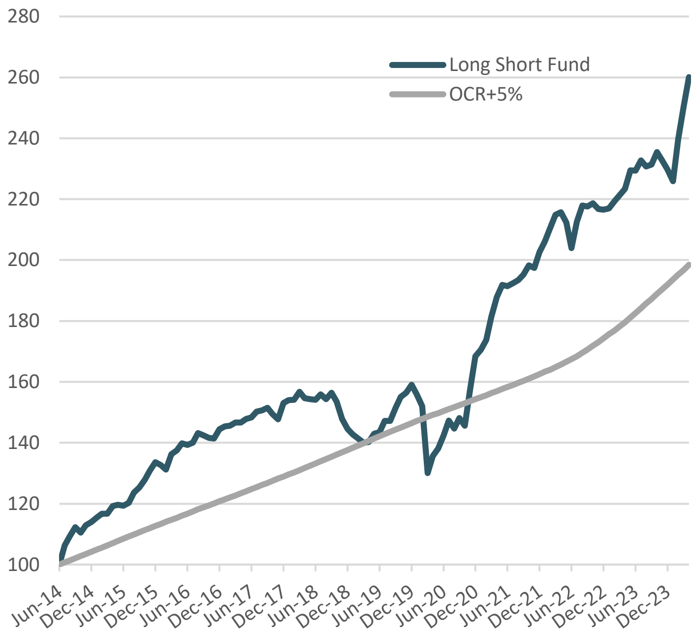
1. Annualised standard deviation since fund inception.

## Fund Performance[2] to 30 April 2024

| Period | Fund Return | OCR+5% Return | NZ50G/ASX 200AI Return[3] |
|---|---|---|---|
| 1 month | 3.92% | 0.90% | -2.08% |
| 3 months | 15.15% | 2.48% | 0.89% |
| 6 months | 10.43% | 5.07% | 13.17% |
| 1-year p.a. | 16.43% | 10.50% | 3.75% |
| 2 years p.a. | 9.79% | 9.44% | 2.85% |
| 3 years p.a. | 11.46% | 8.12% | 2.41% |
| 5 years p.a. | 13.15% | 7.13% | 6.54% |
| 7 years p.a. | 8.53% | 7.02% | 7.69% |
| Inception p.a. | 10.21% | 7.22% | 8.61% |

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 30 April 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 |
| QANTM Intellectual Property | Meridian Energy |
| Servcorp | Breville Group |

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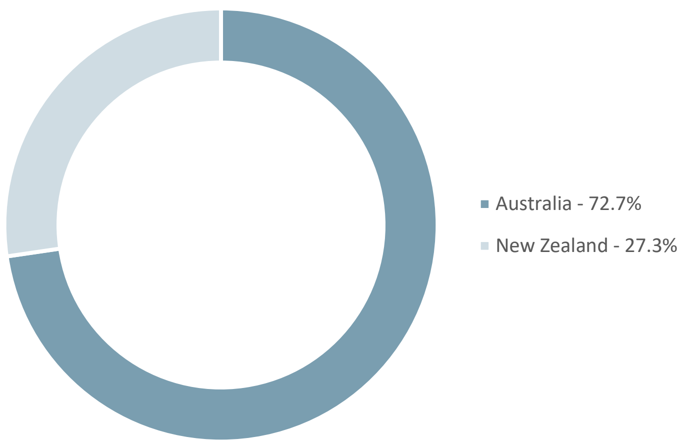
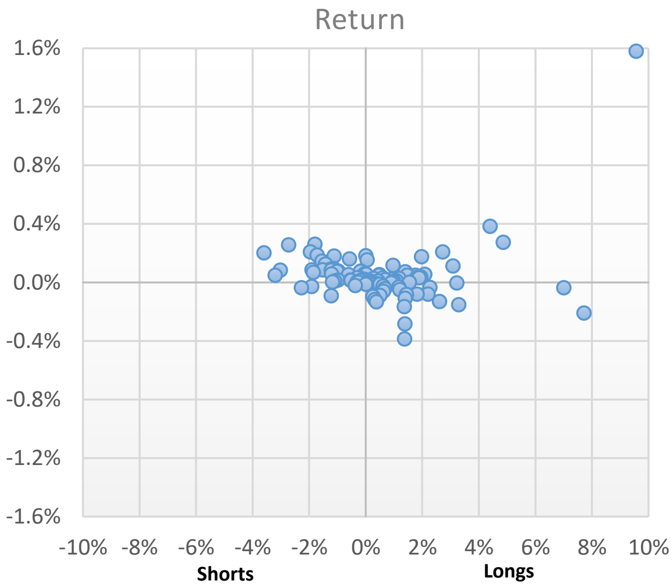
**Country Allocation at 30 April 2024 (Gross Equity Exposure)**




**April 2024 Individual Stock Contribution**




## Fund Commentary

Dear Fellow Investor,

In contrast to soggy equity markets, the Fund delivered another very strong performance in the month of April, with a return of +3.92%. This compares to a decline by the NZ equity benchmark of -1.2%, an even sharper -2.9% fall in Australia, while the MSCI World Index fell by -3.7%. Our short book did well in this gloomy month with a return of circa +2.8%, but the real upside came from our long book, which returned a stellar +1.3% despite the strong market headwinds.

The key theme driving global markets during the month was "higher rates for longer". As we have argued for some time, despite generally softer economic activity, inflation is proving sticky, which is seeing market expectations for easing continually pushed out into the future. The days of markets expecting seven Fed rate cuts in 2024 are but a distant memory.

At the same time, persistent inflation pressures aren't necessarily being accompanied by ongoing economic growth. It's a mixed bag out there, ranging from solid albeit slowing data in the US to extremely gloomy data in NZ. Why has the US economy remained so strong in the face of significant monetary tightening? Our thinking is that monetary policy has merely moved from ultra-easy to slightly tighter than neutral, while fiscal policy is remarkably loose. To put the size of structural US fiscal deficits in perspective, they are running a 7.8% deficit at a time of near full employment. At some point, they will have to bite the bullet.

Inflation data was unhelpful during the month. Australia's overall Q1 CPI inflation of +1.0% was comprised of tradables deflation of -0.2% but very sticky non-tradables inflation of +1.5%. The market quickly removed any rate cuts this year and priced in a 30% chance of another hike.

Similarly, NZ CPI inflation rose by +0.6% in the March quarter, with the annual rate of +4.0% being well down on the 4.7% previously and the 7.3% peak back in June 2022. Under the hood however, tradables inflation was -0.7% in the quarter but non-tradables was +1.6%. Inflation is simply running too hot for the RBNZ to ease any time soon. Lower non-tradables outcomes really require weaker labour markets and there was at least some progress on that front, with the unemployment rate rising from 4.0% to 4.3% and wage inflation measures also easing a little in the March quarter.

The key remaining risk for NZ is that weaker economic activity does not immediately translate into weaker inflation outcomes, i.e., we get stuck in a stagflationary trap. In this vein, the April ANZ Business Outlook was concerning. Firms' own activity outlooks fell from 22.5 to 14.3; cost expectations were stuck at a very high 76.7 (74.6); selling price intentions were a relatively high 46.9 (45.1) and profit expectations were a weak -9.8 (i.e. more firms expect profits to fall than rise over the next year). This is a tough scenario for NZ equities. While markets are forward-looking and will bottom before the economy does, valuations are not yet blindingly cheap.

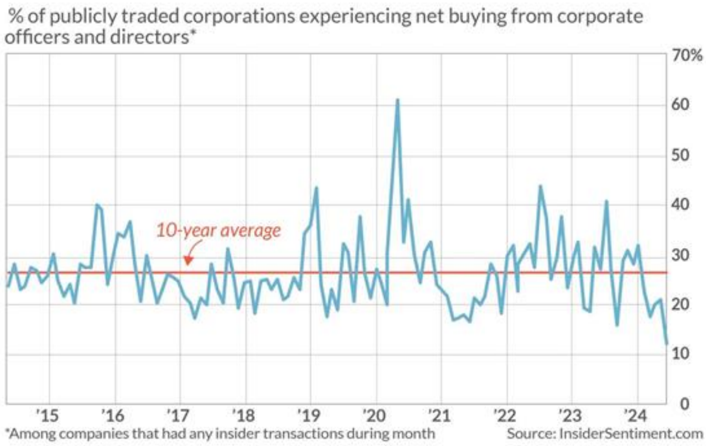
US inflation outcomes were also problematic. March CPI inflation was +3.5% YoY (3.4% expected) but "supercore" inflation ex-food, energy and housing was +0.58% in the month and +4.8% YoY. Similarly, the Fed's preferred measure of the PCE deflator rose +2.7% YoY (+2.5% prior), with the "supercore" PCE +0.39% in the month and +3.5% YoY. It's looking like very hard work to get back to the Fed's 2% inflation target.

The only solace came after month-end, with a weaker than expected non-farm payrolls report, which featured average hourly earnings +3.9% YoY versus +4.0% that was expected. However, this was accompanied by a slightly stagflationary ISM Services report, which had an overall index of 49.4 (was 51.4) but stronger prices paid of 59.2 (53.4 prior).

This is a tricky "in-between" phase for equity markets. Cyclical stocks look challenged as economies slow but bond yield proxies are also under pressure as bond yields remain higher for longer. In theory, this should also hit long-duration growth stocks but the power of the AI thematic has carried all before it. That said, April saw a hiatus in the exponential share price path for many such companies and the "Magnificent Seven" were winnowed to Nvidia, Amazon and Microsoft, although strong results have seen others such as Meta and Apple rise in May.

As shown below, the CNN Greed & Fear measure finally moved out of its unusually long flirtation with extreme greed in the 70-75 region and even had a brief tryst with fear during April. The extreme fear measures of last October are yet to be revisited but sentiment does seem to have moved away from its extended December to March boom.


This broad-based CNN sentiment measure fits well with other evidence of bullish investor positioning. The US Investors' Intelligence Survey shows net bulls as being close to a multi-decade high of near 50%; according to GS Prime, US long/short fund gross leverage of near 200% is at its highest in many years although net leverage is unremarkable at 54%; short interest is as extremely low levels; and the old tell-tale of company insider buying paints a clear picture below.




Put all this together, and our read is that the general market weakness in April wasn't just some temporary profit-taking pullback, it was a combination of negative fundamental macro news which led to modest cracks forming in over-extended investor exuberance.

At this point, the last shoe left to drop is that investors are still getting all weak and giddy with euphoria at the very mention of AI. This feels so 1999. Many extraordinarily clever people and massive companies are uber-bullish on the growth potential, talking about extremely strong demand growth for chips, data-centre capacity etc. Broker reports are uniformly ebullient.

However, one thing conspicuously absent from many discussions about AI is what do investor returns look like? For a dollar invested, what is the revenue, what is the profit and how long does that last before it decays? Our eye was therefore taken by a Wall Street Journal article in late March which quoted a presentation by the venture-capital firm Sequoia Capital, who estimated that the AI industry spent $50bn on Nvidia chips alone in 2023 to train advanced AI models and that this brought in just $3bn of revenue.

Sequoia also found that while users are flocking to generative AI applications with record speed, retention and user engagement are very low. Yes, it's early days, and there will be AI applications developed that we cannot conceive right now, but investors' base assumptions seems to be that everyone will be a winner. Frankly, we have no idea who the long-term winners will be and what the returns profiles will look like. We are wary that the market will lose its initial euphoria and start asking these questions. This could see something of a bust before the ultimate winners emerge.

One interesting way of telling when a hot trend is getting mature is when it finally makes it to NZ. The sudden surge in Being AI (BAI, +467%) in April suggests we might be at that point. Aside from the magic acronym in its name, BAI appears to have limited AI exposure. It owns a couple of schools, the rights to manage a couple of schools and an online education platform (which presumably all schools have post-Covid). However, "they are looking to actively integrate advanced technologies into Being's online and traditional school environments. AI and Spatial Computing are game changers for Education…." In my rare cynical moments, I really hope the BAI share price rises another 50% so that it enters the S&P/NZX50 Index and passive investors are forced to buy it.

This moderate AI scepticism may seem at odds with the success of our Global Data Centres (GDC, -1.3%) investment and with it now being our third largest holding. However, this is a specific situation with near-term catalysts. We were very relieved that they sold their small, dated Perth data centre during the month for close to book value and we now await the enormous sale of Airtrunk, with press reports speculating about a $15bn price. This could potentially see the GDC NTA rise to over $3 versus the current $2.20 share price, with a wind-up crystalising the value gap.

Fund Performance in April

Returning to the Fund's performance in the month of April, our overall return of circa +4.1% pre fees and tax was driven by holdings across the spectrum. Our long book added +1.3%, while our short book delivered +2.8%. The strong headwinds from falling equity markets during the month made the performance by our longs particularly notable. While there was a major skew to one very large winner, the detractors were relatively modest and a pleasing 50% of our longs added value. Our overall "winners to losers" ratio was a very strong 65%.

Our gross exposure continued its recent downward trend. From a very high 177% at end-January, it was 165% at end-February, 162% at end-March and 152% at end-April. This is a relatively normal level for the Fund over its history. However, in contrast to our lower gross position, we sharply lifted our net exposure from 42% to 53%. In a reverse to the prior month, we naturally added to our longs and covered some of our shorts as markets weakened. In addition, we participated in several equity raisings which we viewed as attractive opportunities. We still see our positioning as being relatively neutral on a risk-adjusted basis and this continues to be franked by how our performance has no correlation to equity markets.

There were a very high eleven negative days for the 50/50 index of Australia and NZ in the month. The average return of the market on those days was a nasty -0.51%. However, despite its rising net length, the Fund was up on eight of those eleven days and our average return on all of them was +0.29%. There is always an element of chance as to which days we have our big wins and losses on but the key point is that despite being circa 50% net long, our returns are uncorrelated.

By far the largest winner was our large, long held and at times long-suffering position in Tower (TWR, +18.0%). They delivered a strong guidance update for NPAT to be above $35m compared to the former range of $22m-$27m. Moreover, this assumes the full utilisation of their large event allowance of $45m, with there being no events so far and only five months to go in the seasonally less eventful September half. TWR could potentially deliver NPAT of $67m if there are no large events. This would put them on the remarkably low PE of 3.7x.

It is a fair argument that having no large events is an unusually good outcome and that not much of a multiple should be attached to that part of their earnings. However, every analyst who follows the name assumes they hit their full large event retention every single year into the future. While that was the case over the last two years, there have been many years where they have had no or partial large event deductibles. On top of this excessive valuation conservatism, everything seems to finally be falling into place. Higher for longer rates help returns on their insurance float and after running into powerful headwinds where they couldn't increase their premia fast enough to keep up with claims inflation, this cycle has now reversed. While TWR's share price has risen pleasingly, earnings forecasts have risen much further and this remains a high conviction long. We will be fascinated to see the results of their strategic review.

Our large position in Servcorp (SRV, +8.5%) again worked well. There was no new news aside from the company founder Alf Moufarrige buying modest amounts of shares on-market. SRV is a leading global provider of serviced office space and is benefiting from a combination of strong demand due to the work-from-home phenomenon and cheap supply due to weak office markets in most countries. SRV has over $120m of net cash on a market cap of $410m and is on a forward PE of 9.1x, even after strong advances since we established our position.

Our large holding in Qantm IP (QIP, +5.1%) rose a little as they provided an extension, accompanied by a positive progress update, on the due diligence process being carried out by their private equity suitor. We have no special insights as to whether this takeover bid will actually be consummated, but would highlight that even following its sharp share price advance to $1.68, QIP is still only on a forward PE of 12.8x and has a solid growth outlook. The mooted bid at "no less than $1.817" does not strike us as hugely excessive, so should hopefully be completed in due course.

There were several notable contributors from our short book. James Hardie (JHX, -12.0%) declined as US housing market data was mixed and some of their input costs looked to be rising. It is a classic much-loved high beta name as was another key contributor, Breville Group (BRG, -6.0%). BRG seems to be viewed by Australian investors as a "global compounder" but we see a somewhat cyclical appliance maker which trades on a 30x PE, whose earnings had a huge boost during Covid and which appears to have an aggressive R&D capitalisation policy when it comes to meeting analysts' earnings expectations. Other winners were our shorts in Stockland (SGP, -8.3%) which is a partial hedge to several property longs and our large position in one of the world's most expensive banks, Commonwealth Bank (CBA, -4.8%).

The largest detractor was our moderate long in the small cap, Intelligent Monitoring Group (IMB, -22.5%). Overall, this has been a very successful investment from when we took part in a placement to fund their purchase of ADT Australia/NZ at an extremely attractive price. IMB are building on this to consolidate the security monitoring industry and look to have years of potential growth ahead of them. There was no news that we could see behind the decline but IMB had risen very strongly in prior months.

A second notable headwind came from our moderate long in Omni Bridgeway (OBL, -17.6%), a name that has frequently featured in these pages. We did lighten our formerly quite large holding at much higher levels but still see an interesting investment thesis. OBL are a globally leading litigation funder, and rather than taking balance sheet risk, have set up a variety of funds with varying pay-out formulae. The position of the short-sellers seems to be that OBL's operating costs are too high and that they will run out of cash given the terms of their various funding agreements. While this is not impossible, we think it is very unlikely, with an increasing share of the cashflows coming OBL's way as their various funds and cases mature. We see it as being valued at a sharp discount to their current book of business, let alone a valuation increment for future business growth.

A final detractor of note was our large holding in GDI Property (GDI, -2.4%). They had further positive leasing news, insiders bought shares and they expanded their high-yielding mining co-living business with a further acquisition. While GDI outperformed the 7% fall by the Australian property index, it was not entirely immune to it.

Thank you for your continued support and interest in the Fund. We are very pleased to have delivered three consecutive months of strong returns in the face of wildly varying market conditions. It is obviously impossible to be confident of doing well every month – we simply won't and it is too short a period to offset random share price movements. However, as we have done for nearly ten years now, we will continue to actively position the Fund to benefit from all the opportunities that we see arising. 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