Salt Long Short Fund Fact Sheet – April 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 April 2021

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$52.1 million
Inception Date	31 July 2014
Portfolio Manager	Matthew Goodson, CFA
Associate PM/Analyst	Michael Kenealy, CFA

Unit Price at 30 April 2021

Application	1.886
Redemption	1.8783

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 2021

Long positions	54
Short positions	32

Exposures at 30 April 2021

Long exposure	94.09%
Short exposure	45.95%
Gross equity exposure	140.04%
Net equity exposure	48.13%

Largest Longs	Largest Shorts
Tower	Reece
Shaver Shop Group	Premier Investments
Spark NZ	Mercury NZ Limited
Marsden Maritime Holdings	Cochlear Ltd
EQT Holdings	Technology One

Performance[1] at 30 April 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%									11.52%

Period	Fund	Benchmark	NZX 50 G/ASX 200 AI[2]
3 months	10.15%	1.28%	2.21%
6 months	28.96%	2.58%	14.38%
1 year p.a.	38.47%	5.24%	27.99%
2 years p.a.	15.74%	5.65%	13.05%
3 years p.a.	6.71%	6.01%	12.48%
5 years p.a.	6.44%	6.35%	12.06%
Since inception p.a.	9.66%	6.82%	11.45%

[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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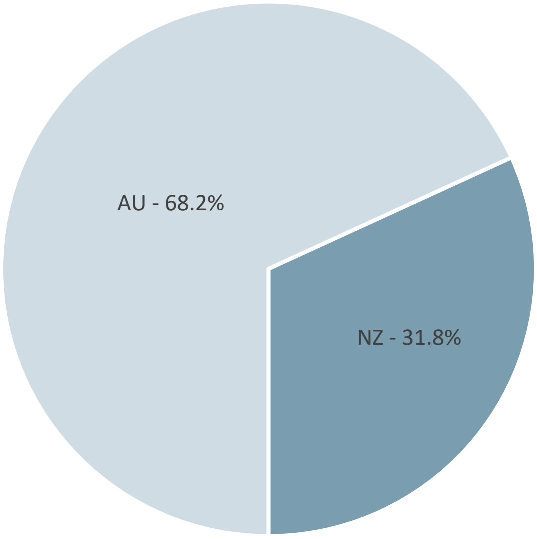
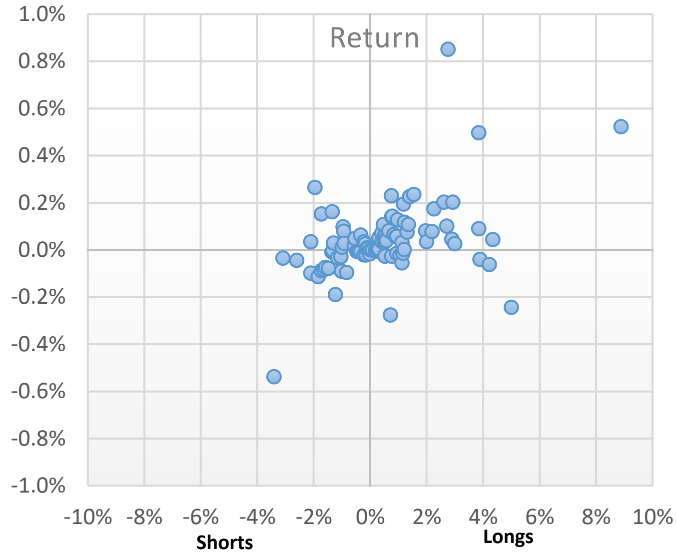
Country Allocation at 30 April 2021 (Gross Equity Exposure)



April 2021 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

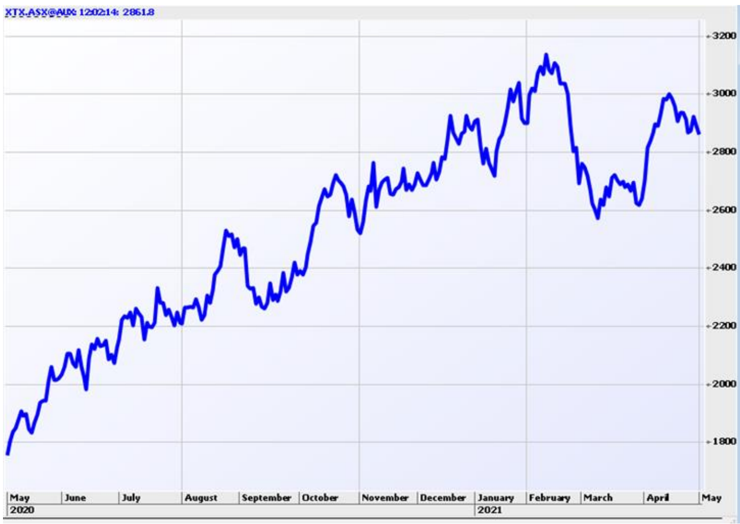
The Fund continued its recent run of success and performed very well over the month of April, with a return of +3.52%. As has been the case in recent months, it was by no means a situation where every position worked in unison. Stock selection from the long side was the main driver, with a number of strong positives being partially offset by a steady headwind from our short book, which cut -0.61% from our returns. This should however provide solid insurance in the event that we encounter tougher times in the period ahead.

The Fund's net length lifted slightly from 46% to 48% over the month, while the gross position was largely unchanged at 140%. These levels are unremarkable and the Fund continued to do its job by consistently adding value on negative days for the market.

In April, there were nine down days for the 50/50 index of Australia and NZ, with an average return on those days of -0.32%. The Fund was up on six of those nine days and it delivered an average return on them of +0.30%. This gives us confidence that our net positioning in the 40-50% region remains appropriate given the types of stocks that we are long relative to those that we are short.

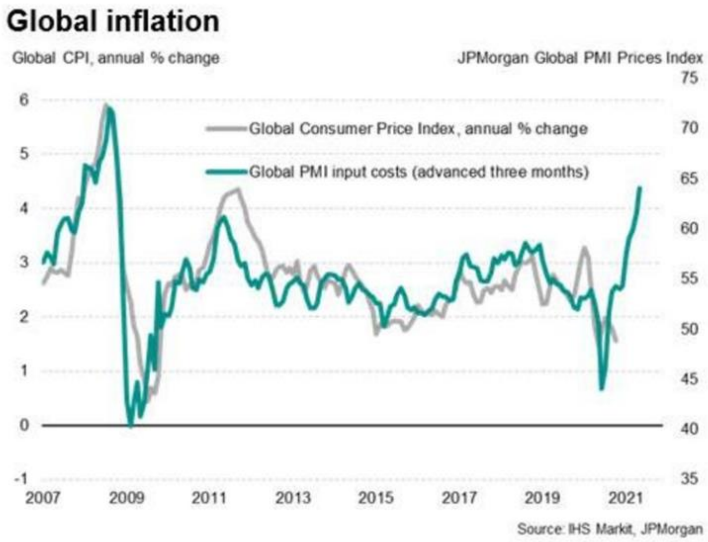
April continued the trend of choppier market drivers that we had commented on in our March commentary. As we will set out in more detail shortly, we continue to believe that cyclical stocks will outperform wider equity markets as rising inflation and bond yields create headwinds for the barbell of GAAP stocks (growth at any price) and TINA yield stocks (there is no alternative) in particular.

In our view, the likelihood of an approaching inflation wave strengthened in April but financial markets did not receive the memo. Bond yields generally rallied, with the NZ 10 year yield falling from 1.78% to 1.62%. In Australia, they similarly rallied from 1.83% to 1.70%. This supported a rebound in growth stocks which had been hard hit in February and the first half of March. The chart below of the S&P/ASX All Technology Index shows how it rallied by 9.4% during the month, with this creating a headwind for our short book although we took advantage of the movement to add to our shorts in some names.



In general, the Fund is net long cyclicals, long a range of eclectic names which are cheap relative to their growth, short expensive growth and price momentum names and slightly net long high yield names, with a strong relative preference for Spark. This combination means we are well positioned for a rise in inflation and bond yields.

The chart below lends credence to this being a reasonable position to hold, with timely lead indicators such as PMI-type surveys having a strong link to future inflation outcomes. Globally, we would suggest this is a five-alarm fire alert.



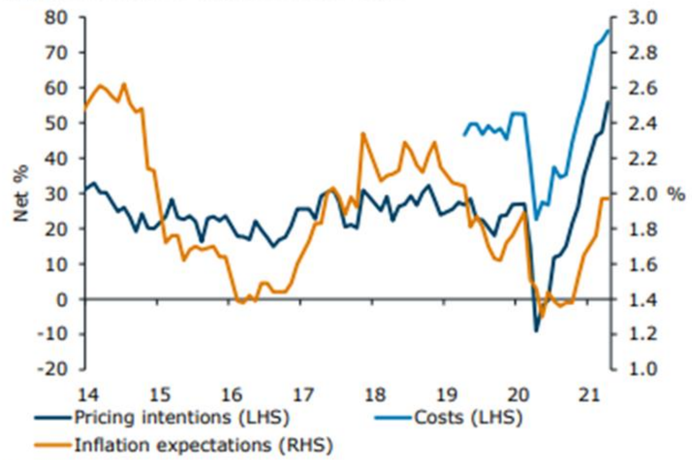
In this vein, we have never been that fond of quoting Warren Buffett, as it always smacks of trying to lend some credence to one's own fund management skills by associating with the oracle. However, the comment below from the annual Berkshire Hathaway meeting over the weekend seemed almost as though Buffett was describing the green line in the chart above.

"We're seeing substantial inflation. We're raising prices, people are raising prices to us. And it's being accepted, we really do a lot of housing. The costs are just up, up, up. Steel costs. You know, just every day they're going up. It's an economy – really, it's red hot. And we weren't expecting it." (Warren Buffett)

An interesting article on the subject was published on Project Syndicate by Nouriel Roubini, titled "Is Stagflation Coming". He argued that unlike the major negative demand shock following the GFC in 2008, the post Covid-19 period is seeing a major negative supply shock and that this has quite different policy implications. He cites supply chain bottlenecks, rising trade hurdles, higher labour costs due to migration restrictions at a time of ageing Western demographics and rising wealth inequalities sparking a populist back-lash (e.g., minimum wages are increasing in a number of countries). Against this, continuing technological deflationary forces are no different than they were prior to the GFC.

The inflation situation is little different in NZ, with the always informative monthly ANZ Bank Business Outlook Survey displaying a very similar picture to that globally. The latest end-April survey showed a staggering 55.8% of businesses intend to lift their prices over the next year, well up on the already high +47.3% at the end of March. At the same time however, only +0.3% expect their own profits to rise over the next year – this is cost-push inflation at work.

Figure 2: ANZBO inflation indicators



Source: ANZ Research

Against this cavalcade of evidence, central banks are for now being obdurate in their defence that inflation is transitory rather than more lasting and that they therefore need to persist with extraordinary levels of accommodation. This was the message from the Fed, the RBA and the RBNZ during the month. Our concern is that their credibility is beginning to falter and that while bond yields were smoothed into somnolence during the month, bond market vigilantes are merely biding their time for a future test of central bank resolve.

The first key test may come in the June Fed meeting, which some investors are viewing as the first "live" one in terms of a potential change in stance. We are beginning to see some pre-positioning, with the hawkish non-voting Dallas Fed President, Robert Kaplan stating on 1 May that, *"we are now at a point where I'm observing excesses and imbalances in financial markets …. I do think, at the earliest opportunity, it would be appropriate for us to start talking about adjusting these purchases."*

Our concern is that financial market positioning is extreme and that any tapering of extraordinary monetary policies would likely lead to a repeat of taper tantrums of the past.

As we examined last month, over-trading on the back of cheap money is rife everywhere. Consider Robinhood-driven meme stocks, record levels of margin debt, record levels of flows into equity market mutual funds, record levels of asset allocation to equities, vast hidden leverage as exemplified by the Archegos Capital disaster, US$99.9bn of blind raisings year to date across

308 different SPAC's (special purpose acquisition companies) versus $83.3bn raised in IPOs across the whole of 2020 and the list goes on….

The widely followed US Citigroup strategist, Tobias Levkovich summed the evidence up with a piece mid-month titled "*Feeling A 1999 Vibe (and That's Risky)*".

As argued above, it seems fairly clear that the imminent arrival of higher inflation readings that force central bank tapering will be the factor that brings the bull market to an end. When that (in)glorious day arrives, we are very focused on this Fund providing at least some degree of diversification from other market movements.

Returning to the performance of the Fund in April, our return of circa 3.87% (pre tax and costs) saw very strong returns from the long book (+4.48%) and moderate losses from the short book (-0.61%). As was the case in March, this is what one would expect in what was a solid month for the NZ and Australian markets. Our stock selection was again very strong, with our overall "winners to losers" ratio being a high 65%.

The largest positive contributor was a repeat of last month in the form of the small environmental and engineering consultancy, Intega Group (ITG, +27.5%). At least some of the price rise has been driven by them aggressively embarking on a share buyback for 10% of the shares on issue which equates to about 24% of their free float. However, business conditions appear strong and it is still only trading on a forward cash PE of circa 8x. We have taken a degree of profit but retain a reasonable holding.

Conversely, we have entirely exited our smaller holding in ITG's cousin, Cardno Group (CDD, +29.5%) which also surged for the third month in a row. We slightly prefer the ITG business and CDD's forward cash PE multiple of circa 10x struck us as being around fair value for this sort of business.

The second largest tailwind was another repeat from last month in the form of our large long in Tower Limited (TWR, +6.1%). No particular new news drove this but TWR continues to be re-rated and still offers cheap growth relative to an expensive market. We believe they are generating strong top-line GWP growth from both volumes and pricing at present. The main headwinds are low investment returns, potential claims cost inflation and the temporary depressionary conditions faced by their Pacific Islands business due to Covid shutdowns. Longer term, their balance sheet remains awash with capital to invest in an array of accretive organic and inorganic growth opportunities.

The third stand-out was our old friend Pacific Edge Biotechnology (PEB, +13.9%) which has been a multi-bagger for the Fund already. They announced that the largest US health insurer, United Healthcare will now cover Cxbladder diagnostic tests. It will still take time and patience for urologists to prescribe the test but it is yet another signpost on the road to success. We expect numerous further announcements and are a little bemused that the market reacts so positively on the day to such news and then drifts thereafter. It is possible to generate a wide plausible fair value range for PEB but significant potential upside remains on scenarios that could quite feasibly occur.

There were a range of other solid positive contributors form the long side, with these being led by Vitalharvest (VTH, +15.2%), where we are getting great pleasure from observing one of the more protracted takeover battles that we can remember. Global Data Group (GDC, +13.5%), Qantm Intellectual Property (QIP, +6.3%), Turners (TRA, +8.2%) and Monash IVF (MVF, +8.2%) were other notables. We re-entered MVF when it sold off temporarily on falling out of the S&P/ASX300 Index. From the short-side, JB Hi Fi (JBH, -10.6%) and Blackmores (BKL, -10.2%) worked out well.

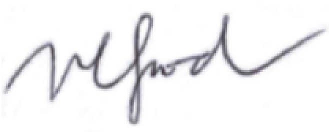
Our largest headwind by some distance came from what we are increasingly regarding as a mistake, being a short in Reece Group (REH, +18.3%). They are benefitting from a raging housing boom in both Australia and the USA but we cannot get our head around this high quality but relatively mature plumbing supplies retailer being on a Jun21 PE of 50.1x and Jun22 PE of 43.0x. We suspect that the Jun22 year may have some upgrades still to come but will constitute a cyclical peak. We initiated the position on the view that the market would surely start to look through the cycle at some point. We were far too early and while we may be right eventually, we will manage this position down.

Our second key laggard was a small long in Coronado Coal (CRN, -33.9%) where we have unsuccessfully tried to time the bottom of the coking coal price cycle. While global steel markets are very strong, the picture for coking coal has been clouded by China's embargo on Australian coal exports. We have taken the view that CRN can export to China from its US mines and that the Australian coal volumes were sold elsewhere in any case. As this is written, CRN has renegotiated its debt facilities and is undertaking a relatively modest equity raising. There is enormous operating leverage if and when the cycle turns.

The final notable headwind was our large and very successful long in Shaver Shop (SSG, -5.6%) which came under pressure late in the month alongside a number of other Australian retail stocks, following a very weak update from the online retailer Kogan.com. The negative contribution from SSG was more than offset by our shorts elsewhere in the sector and we have seen nothing to suggest that SSG is trading anything but strongly.

Thank you for your continued support of the Fund. We are obviously delighted to have repaid that support with strong performance in the last few months and quarters. What we would highlight is that this performance has not come from abandoning our disciplines and getting long and going for a magical mystery ride on the back of the seemingly endless bull market. We are still performing well when the market declines.

We are nervous about the longevity of this bull market and see economies re-opening combined with an imminent rise in inflation as causing a tapering in easy money. This is a logical and overdue set of circumstances which may bring the bull market to an end. We are also conscious that timing such an end requires an indecipherable combination of skill and luck, so we are not going to take the Fund net short and hope that we pick the peak in markets to the exact day. We will continue to invest as we have always done, aiming to grind out positive returns with no correlation to ever more vulnerable equity markets. We continue to see 2021 as being a year when having alternatives such as this Fund may be useful in mitigating the many risks that lie ahead.



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