Salt Long Short Fund Fact Sheet – March 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 31 March 2021

Benchmark	RBNZ Official Cash Rate +5% p.a.
Fund Assets	$50.5 million
Inception Date	31 July 2014
Portfolio Manager	Matthew Goodson, CFA
Associate PM/Analyst	Michael Kenealy, CFA

Unit Price at 31 March 2021

Application	1.8217
Redemption	1.8144

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 March 2021

Long positions	52
Short positions	31

Exposures at 31 March 2021

Long exposure	91.87%
Short exposure	44.78%
Gross equity exposure	136.65%
Net equity exposure	47.08%

Largest Longs	Largest Shorts
Tower	Ryman Healthcare
Shaver Shop Group	Premier Investments
Equity Holdings	Technology One
Marsden Maritime Holdings	Reece
T & G Global	JB Hi-Fi

Performance[1] at 31 March 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%										7.72%

Period	Fund	Benchmark	NZX 50 G/ASX 200 AI[2]
3 months	7.72%	1.27%	0.10%
6 months	22.50%	2.58%	14.59%
1 year p.a.	39.58%	5.24%	35.15%
2 years p.a.	13.83%	5.71%	12.85%
3 years p.a.	4.99%	6.06%	12.59%
5 years p.a.	5.90%	6.38%	12.01%
Since inception p.a.	9.23%	6.84%	11.21%

[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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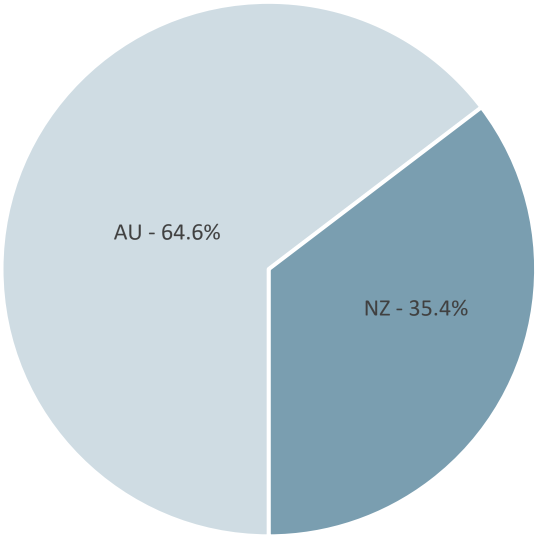
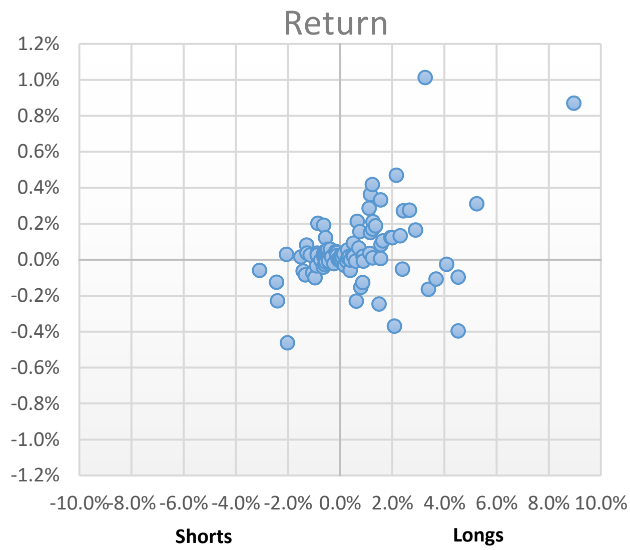
Country Allocation at 31 March 2021 (Gross Equity Exposure)



March 2021 Individual Stock Contribution



Fund Commentary

Dear Fellow Investor,

The run of strong performances by the Fund continued in March with a very pleasing return of +4.42%. While a large proportion of the Fund's holdings worked well, returns were held back from being even stronger by several of our key holdings not contributing. It was by no means the case that everything suddenly worked all at once in the month.

As March progressed, it began to feel as though it was something of a transition month for markets, with the key themes of rising bond yields and cyclical outperformance continuing but starting to get a little choppier as they matured. As discussed shortly, we continue to see inflation risks popping out everywhere in NZ and globally but NZ 10-year bond yields actually retraced a little from 2.02% to 1.78% over the month. The dominant driver of our returns was stock selection rather than simply being long cyclicals and short growth darlings.

The Fund has been running unusually long net length for some months but pulled this back in March from 56% to 46%. This was not so much a conscious decision but more an outcome of how we played the hand of cards that the market dealt us. In particular, we lowered net length by 6% on the last day of the quarter when a number of names staged unusually aggressive advances.

The Fund's gross position had earlier ended February at an unusually low 124% but we lifted this to a more normal 133% at end-March as a number of attractive new opportunities became available at the right prices. It is 139% as this is written.

We remain conscious that a key attraction of the Fund is that it is uncorrelated to long-only equities. With the benefit of hindsight, one would have been better off being maximum leveraged long given the raging bull market of the last few years, However, we believe that being uncorrelated will become very important as markets change. Over the Fund's life, its daily correlation to the 50/50 index of Australia and NZ is just 0.09: statistically indistinguishable from 0.

Having no correlation to equities means that the Fund may rise, fall or do nothing when equities fall.

It does not mean that the Fund will necessarily rise – that would be a negative correlation. That said, our long-term returns are +0.02% on up-days and +0.055% on down-days. We do tend to do better when markets fall and we therefore keep a close eye on our numbers on down days as a cross-check on our net positioning.

In March, there were eight negative days for the 50/50 index of Australia and NZ, with an average return on those days of -0.45%. The Fund did its job by being up on seven of those eight days and delivered an average return of +0.25%. This shows why we remain comfortable with a reasonable degree of 40-50%+ net length overall.

Three important matters are influencing our thinking and positioning at present. Firstly, we think that the global financial system is awash with free money and that this has led to a potentially dangerous build-up of leverage in equity markets.

Secondly, we see inflationary pressures building up everywhere, which leaves investors vulnerable to coming in one day and finding a “shock” high reading hit the tapes. Thirdly, it is some time since we have written about the housing sector and retirement villages but the tax changes during the month put them firmly back on our radar screen.

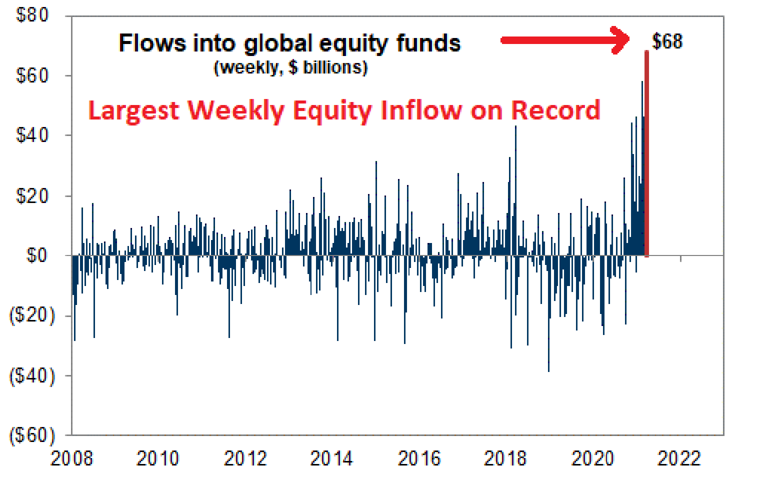
We are concerned that central banks have over-egged the omelette. In seeking to rescue economies with unprecedented levels of monetary easing, they have sown the seeds for the next debacle by building up bubbles in financial and property markets.

Over-trading is rife everywhere. Rather than bore you with more meme-stock war-stories, we found the charts below from the Financial Times very informative. They really do speak for themselves. As a teenager in the mid 1980’s I never thought I would see such retail over-trading repeated but here we are. Even worse, this is before the US stimulus cheques get deployed into quality names such as Hertz, Gamestop and the myriad vapourware growth stocks populating global markets.

It is also notable that retail investors’ margin accounts are getting a very solid work-out. While absolute dollar levels of margin do have to be related to the absolute market level, the chart below shows that margin investing is off the scale, even compared to the Nasdaq bubble and 2007/08.

* Debit balances in margin accounts at broker/dealers.
Source: New York Stock Exchange through December 1996, FINRA thereafter, and Haver Analytics.

Finally, on this subject of over-trading, the chart below shows that it’s not only retail punters engaging in a spot of do it yourself trading. Goldman Sachs pointed out that not only did March see the largest weeks of equity inflows on record but that since the week of the US election, global equity funds have logged US$536bn of net inflows.



Source: GS Research Division as of 3/19/2020. Arjun Menon. EPFR Global. Past performance is not indicative of future r

The fluff and massive hidden leverage that is driving many current share prices was exemplified by the spectacular implosion of Tiger-cub, Bill Hwang’s Archegos Capital during the month. Most readers will by now have seen the story but the pertinent points are that he was running somewhere between $10-$20bn of capital that was leveraged by 6-7x. Nomura and Credit Suisse were left holding most of the kitty when Archegos couldn’t meet margin calls post sharp falls in several of its key holdings in Chinese tech companies and US names such as Viacom and Discovery.

The latter two are particularly interesting as they are somewhat staid old-world media companies. Pre-Covid, Viacom traded around $40 and briefly bottomed at about $12 in March 2020 before steadily rising back to $35 at year-end. It then discovered alchemy and exploded to $100 on 22 March before halving back to $45 today. A number of the Archegos holdings have a similar chart – nothing like buying your own performance. The question is how many fellow travellers there were in the wolf-pack as markets have clearly not yet seen a major leverage unwind.

Is this the Bear Stearns moment of 2021 when a clear initial warning was brushed off as an anomaly and a welcome shake-out of those who fed at the bottom of the heap? History never quite repeats but we are certainly concerned that it might rhyme.

Our second key concern is inflation. If it remains moribund, then the rocket fuel of cheap central bank money will continue to drive financial markets. If inflation spikes, and it does so in a way that has lasting rather transitory elements, then hold onto your hat.

We have argued at length in recent months that evidence is emerging everywhere of price pressure. Rather than regurgitate all of those examples, the chart below looks at how the weighing machine of Mr Market is summarising the various drivers.

Implied 10-year inflation break-evens in the US have soared to 2.37% from a momentary Covid-induced collapse to 0.50%. 2.37% is far higher than pre-Covid, yet central bank policy remains historically loose in a heroic attempt to drive unemployment lower.

A piece that took our eye late in the month came from the UBS global economics team. They see 12-month US inflation spiking in April and May, with the headline CPI hitting 3.7%, the core CPI reaching 2.44% and the core PCE getting to 2.3%. There is clearly some risk of a taper tantrum redux if we see such outcomes. They do view this as fading later in the year and clearly the accuracy or otherwise of that projection will be critical to central banks and markets.

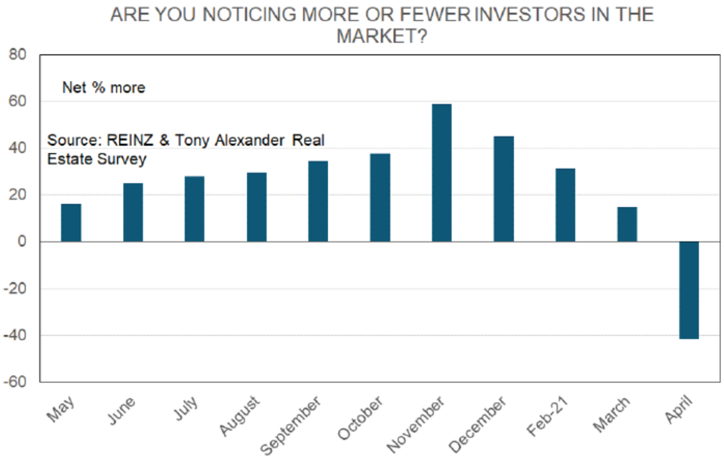
Our third key concern is the great NZ housing bubble. We have not mentioned this for quite some time as it was running hot with no obvious catalyst to end it. We were even slightly net long retirement village stocks at various junctures.

The significant left-field tax moves by the Labour Government against housing investors could really change the calculus. While the decision-making appears ad hoc, it is difficult to deny that there is a problem and that some relatively bold action (by recent NZ standards) has been taken to counter it.

OECD data out in early April looked at real house price movements over the last two decades. NZ comfortably won the gold medal with a +177% advance, with Canada +147%, Sweden +129% and Australia +110%. The OECD average was +39%.

The potential reasons are many, with relatively stronger population growth and relatively more restrictive planning than the OECD average being prime candidates for our outstanding performance in enriching the paper wealth of property owners. Interest rates fell sharply everywhere. The other explanation is we are in a bubble.

If we were to see a reversal, then aside from unpredictable wealth effects, our chief concern is the implication for the retirement sector. We have noticed in the past that the sector tends to move concurrently with house price inflation and activity levels. It is still very early days but the chart below from Tony Alexander's widely followed survey suggests that there will likely be some degree of impact. Real estate agents are already seeing it.



Longer term, analysts and valuers seem to generally be running with 3%-3.5% retirement unit price growth in perpetuity. Note that a fixed retirement unit should under-perform the average house price given continuing quality and size improvements. We therefore guesstimate that the retirement unit price assumption equates to 3.5%-5.0% house price growth. Ask your friendly retirement analyst or valuer to knock 1% off the long-term price growth path and see what that does to valuations. We have returned to being net short the sector but will be light-footed given the enduring nature of the Kiwi love affair with property.

Returning to the performance of the Fund in March, our return of circa 4.54% (pre-tax and costs) saw strong returns from the long book (+4.78%) and modest losses from the short book (-0.25%). This is what one would expect in what was a solid month for the NZ and Australian markets. Our stock selection was extremely strong in the period, with our overall "winners to losers" ratio being a very high 69%.

Our largest contributor was a familiar name in the form of the small environmental and engineering consultancy, Intega Group (ITG, +32.3%). A key driver was that they enthusiastically embarked on a buyback which can go up to 10% of their shares on issue and which will be more like 24% of their free float. Their share price surge now sees them trade on a forward cash PE of circa 7x, with a reasonable growth outlook thereafter. We have taken modest profits but still see sizeable upside.

Our smaller holding in ITG's cousin, Cardno Group (CDD, +39.6%) was also a strong contributor during the month on very similar forces.

The second largest tailwind came from another familiar name - our very large long in Tower Limited (TWR, +10.1%). A further piece of the puzzle fell into place with the RBNZ reducing TWR's minimum required solvency margin from $50m to $25m in recognition of the progress that has been made on settling Christchurch earthquake claims. The remaining $25m overlay will be reviewed in 12 months and we expect it will be removed. This reinforces our thesis of TWR being a company that is awash in capital and which has an array of organic and inorganic growth opportunities with which to invest it accretively.

A third stand-out was our long in Graincorp (GNC, +24.4%) which surged on analyst upgrades due to a strong grain crop, excellent conditions for winter plantings and a strategic plan which is targeting significant profit upside from the use of their spare port capacity. We took some profits into the sharp bounce as some of these factors should have been relatively foreseeable and we are always conscious that one should buy such stocks in poor seasons and sell them in good ones.

There were a number of other notable contributors in what was a strong month for our long selections. Vista Group (VGL, +29.4%) rose sharply on re-opening optimism; Australian Vintage (AVG, +15.1%) continued to rise post a strong interim result in February and on the potential to benefit from lower grape costs due to Chinese tariffs on wine imports; Shaver Shop (SSG, +5.2%) on little new information; and United Malt Group (UMG, +¬11.5%) on re-opening optimism.

Our largest headwind came from a short in Premier Holdings (PMV, +23.4%), which rose sharply post a strong half-year result. That said, we viewed much of the result as being unsustainable due to a mix of Jobkeeper payments, one-off lease benefits and generally strong but likely temporary Covid-19 revenues. A PE of 22.5x forward earnings strikes us as excessive in this context, especially with the former growth engine, Smiggle only performing moderately.

Our long in the mining equipment rental company Emeco Holdings (EHL, -8.2%) weighed on returns for a second month. We like that they are successfully diversifying from coal, that any balance sheet issues have been fixed and that are trading below NTA and generating strong free cashflow. We also surmise that rising equipment prices should be helpful in achieving strong rental outcomes as new contracts are entered. The one point of discomfort is the resignation of the CFO without any real explanation.

Last month's strong returns from Kina Securities (KSL, -15.1%) were reversed in no uncertain terms on what appears to be market concern at a rapidly spreading Covid-19 outbreak in PNG. While economic growth is forecast to rebound strongly this year, there is clearly some risk that this gets pushed back in time although much depends on several major resource projects. We believe that KSL is trading strongly and the key catalyst of massive synergies from purchasing the Westpac PNG & Fiji business lies ahead.

Thank you for your continued support of the Fund. We are delighted to have repaid that support with a very strong period over the last few quarters which has the Fund very much on track in meeting its goal of delivering equity-like returns with much lower volatility than equities and no correlation to them We are concerned that current markets are awash with cheap money and that more accidents such as the Archegos debacle may be lurking. We are also concerned that there is a clear catalyst for a risk-off episode in the next few weeks and months as we could see some sizeable monthly and quarterly inflation prints. We continue to see 2021 as being a year when having alternatives such as this Fund may be useful in mitigating the risks ahead.

Matthew Goodson

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