SALT

Salt Sustainable Global Shares Fund Fact Sheet – January 2023

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. Salt examines investments for their environmental and social impact as well as the quality of their governance.

Investment Strategy

The Fund's investment objective is to outperform (after fees and expenses but before tax) the MSCI World (Net) Index in New Zealand dollars on a rolling three-year basis. To achieve this, the Fund targets a portfolio of global companies with high total return potential and high Environmental, Social and Governance (ESG) factor scores.

The strategy seeks to provide attractive long-term returns with less long-term volatility than the broader market by reducing the risks associated with poor ESG outcomes. The Fund will seek to achieve its investment objective by investing primarily in global equity.

Fund Facts at 31 January 2023

Benchmark	MSCI World (Net) Index in NZD
Fund Assets	$52.18 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 31 January 2023

Application	0.9796	0.9954
Redemption	0.9756	0.9913

Investment Guidelines

The guidelines for the Sustainable Global Shares Fund are:

Global Equities	95% – 100%
Cash	0% – 5%

Target investment Mix

The target investment mix for the Salt Sustainable Global Shares Fund is:

Global equities	100%

Fund Allocation at 31 January 2023

Global equities	98.5%
Cash	1.5%

Fund Performance to 31 January 2023

Period	Fund Return*	Benchmark Return
1 month	3.92%	4.79%
3 months	-0.25%	-1.43%
6 months	-3.88%	-0.89%
1 year	-9.15%	-5.95%
5 year*	11.99%	9.43%

Performance is after fees and tax, but not adjusted for imputation credits. Benchmark performance is gross. Past performance is not a guarantee of future results. Data as of 31 January 2023.*5 year performance is gross of fees.

Fund ESG Scores	Portfolio	Index
Sustainable Global Shares	26T CO2 /$m	162T CO2 /$m
Portfolio Carbon Footprint:	13% of MSCI AC World Index*	

Source: MISM Quarterly Investment Report & Trucost based on the Scope 1 & 2 carbon emissions per $1million of Portfolio companies' sales, and as weighted average carbon intensity (WACI). As of January 30, 2023, the Portfolio's carbon footprint was 87% lower than the MSCI AC World Index.

Top 10 holdings	
Microsoft (US)	Thermo Fisher Scientific (US)
VISA (US)	Reckitt Benckiser (UK)
SAP (DE)	Intercontinental Exchange (US)
Accenture (US)	Becton Dickinson (US)
Danaher (US)	Constellation Software (US)

Source: MSIM, data as at 31 January 2023. The Top 10 Holdings represented 46.7% of the total portfolio.

Market Review

January month saw another reversal in sentiment, this time back into a positive tone after a weak December month. Equity markets around the world rose during the month, led by a 6.3% bounce in the US S&P 500 Index, which recovered its December loss. The more constructive market mood lifted growth sectors from sharp 2022 valuation declines.

- Stock markets had a strong start to 2023. Developed market equities rose 6.0% (in USD) over the month. Bonds also rallied as it became evident that inflation had peaked in the key developed economies, with the Global Aggregate bond index returning +3.2% (USD). This aided share sentiment.
- The surprisingly swift end to China's zero-Covid policy bolstered already positive expectations about growth in China this year. That will benefit not only China but also China's main trading partners given the extent of pent-up demand and high savings rates amongst China's consumers.
- China's GDP was weak in the final quarter of 2022; however more recent partial indicators suggest that may be the bottom of the cycle with a recovery expected to unfold over 2023 on the back of re-opening and likely ongoing policy support.
- Softer annual inflation rates in the US and the Eurozone raised hopes that those central banks might soon end their tightening cycles. However, while some central banks have reduced the pace of rate hikes, there isn't

any greater clarity on the level at which interest rates will peak.

- In the US, labour market data was viewed positively by markets in that while employment remained solidly positive, wage inflation also slowed, suggesting a soft landing was indeed possible.
- The cautionary note is that wage inflation remains well in excess of the level consistent with 2% inflation.
- In Europe, the relatively mild winter has led to a decline in energy prices and has seen inflation recede from its peak and has reduced the risk of recession. The average purchase price for natural gas in January was over 50% lower than the average prevailing in H2 2022.
- At the same time, activity data out of the Eurozone has been surprisingly upbeat, indicating a winter recession may be avoided, albeit narrowly. This surprising economic resilience has supported Europe's equity markets at the start of the year.
- Japan's inflation surged to 4% in calendar 2022, its highest level in 31 years. The Bank of Japan loosened its yield curve control policy, widening the band in which 10-year JGBs can trade from +/-25bp to +/-50bp. The Bank then had to intervene with bond purchases through January as markets anticipated a further widening, which did not eventuate.
- Despite recently soft retail sales data in Australia, the Reserve Bank of Australia will likely continue to raise interest rates. Headline inflation came in at 7.8% for the year to December 2022, a 32-year high and ahead of expectations.

Portfolio Review

- In January, the Portfolio returned +3.92% (after fees,) behind the MSCI World Net Index which returned +4.79% The January relative underperformance was due to negative sector allocation. This was mainly driven by the overweight to Health Care and the underweight to Consumer Discretionary. The overweight to Information Technology was a positive, but insufficient to compensate.
- Stock selection was positive as strength in Health Care and to a lesser extent Industrials and Consumer Staples, more than offset the drag from Information Technology weakness, which came as the growthier technology names rallied after their very weak 2022.
- For the three months to 31 January, the portfolio's benchmark relative performance rebounded somewhat from a challenging 2022 and the fund returned -0.25% after fees, 1.18% ahead of benchmark.
- Over the five-year horizon, the Portfolio is 2.56% p.a. ahead of its benchmark return (on a gross of fees basis.)
- The largest absolute contributors for the month were SAP (+62 bps), Visa (+52 bps), TSMC (+50 bps), Prudential (+34 bps) and Constellation Software (+32 bps).
- The largest absolute detractors in the quarter were Baxter International (-38 bps), Proctor & Gamble (-16 bps), ADP (-15 bps), Danaher (-11 bps) and Becton Dickinson (-10 bps).

Portfolio Outlook

In contrast to 2022, the highly cyclical, growth-tilted sectors were January's top performers, with Consumer Discretionary (+15%), Communication Services (+13%) and Information Technology (+10%) all up double digits, recovering some of last year's losses. Materials (+10%) and Financials (+9%) also outperformed MSCI World.
The Portfolio's key defensive sectors were significantly behind the index: Consumer Staples (+1%) was barely positive, while Health Care (-1%) was the only negative sector in the month. Energy (+3%) was also comparatively weak in January, albeit logging a positive return.

Turning to geographies, the key Euro markets did particularly well, with Italy +11% local currency terms), Germany (+10%), France (+9%) and Spain (+9%) all outperforming the index. The US (+7%) was in line, and a touch ahead of the UK (+4%) and Switzerland (+5%), in local currency. In Asia, Singapore also finished in line with MSCI World (+6%), whilst Japan (+5%) and Hong Kong (+4%) were behind.

At the start of 2023, our two worries from 12 months ago (multiples and earnings) have reduced to earnings. The fall in the MSCI World multiple to 16x, now only 4% above the 2003-19 average as against the 35% premium at the start of last year, suggests that the market is no longer clearly overvalued, though of course the multiple could fall below average levels if there is a major economic downturn.

It is earnings that remain the major concern. Inflation should help top-line growth, in nominal terms at least, but the margins do look stretched, with the MSCI World forward EBIT margin at 16%, 100 bps above the pre-COVID peak and a full 300 bps ahead of the 2003-19 average.

It is striking that bottom-up forward earnings estimates still look relatively resilient despite what has been described in various forums as the most predicted recession in history, with 2023 MSCI World earnings estimated to be 1% higher than 2022 despite the headwind from the strong dollar, and revenues to be 2.3% higher. Central Banks are raising rates aggressively to deal with inflation by attempting to slow demand. Companies are defending margins by all means available, but cost pressures remain intense, and margins will retreat from recent peaks.

As the excess demand of 2021 and 2022 shifts towards excess supply in 2023, there is likely to be earnings recession, as margins fall from current peaks. Once again, the market will discover which companies have resilient earnings in tough times. Our bet, as ever, is that pricing power and recurring revenue, two of the key criteria for inclusion in our portfolios, will once again show their worth, as they did in the 2008-9 Financial Crisis and in H1 2020 during COVID. Compounders should continue to compound. The silver lining of the painful de-rating of 2022 is that any compounding is now coming on top of a lower multiple. Given that there are only two ways of losing money in equities – the earnings going away, or the multiple going away – owning a portfolio of resilient earnings at a reasonable multiple does seem a sensible approach in such uncertain times.

Greg Fleming, MA

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