Salt Sustainable Income Fund Fact Sheet – March 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 aims to provide a gross fixed quarterly income (after fees and expenses but before tax) in excess of bank deposit rates, along with a positive return on capital on a rolling three-year basis. Deposit rates are proxied by the NZ Bank Bill Index.

A Reference Portfolio is provided, medium-term outperformance of which is a secondary objective, consisting of the weighted sum of components.

The Fund targets a diversified mix of growth and defensive assets, with a focus on securities with strong Environmental, Social and Governance credentials & reliable income generation. The Fund's strategy is to invest in a quality asset mix with an aim to provide regular, sustainable income and a positive return on capital. At times the value of the fund will fluctuate in line with listed market developments, but the primary focus is enhanced income and thus, shorter-term variability or volatility is an expected feature.

Income is prioritized above capital gain in the fund, nevertheless, the allocation to both growth and yielding assets allows for both objectives to operate over the medium- and longer-term horizons.

Fund Facts at 31 March 2023

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$44.15 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Current distribution yield (cents per unit) / based on Unit Price of 1 April 2023	1.00 cents per unit per Quarter / 4.55% per annum

Unit Price at 31 March 2023

Application	0.8819
Redemption	0.8782

Investment Guidelines

Sector	Target	Range
Global Fixed Interest	35%	0% – 60%
Australasian Shares	30%	15% – 45%
Global Listed Property	15%	0% – 35%
Global Listed Infrastructure	15%	0% – 35%
Cash or cash equivalents	5%	0% – 20%

See "Salt Statement of Investment Policy and Objectives, 30 June 2022" for further information.

Fund Allocation at 31 March 2023

Global Fixed Interest	27%
Australasian Shares	30%
Global Listed Property	23%
Global Listed Infrastructure	18%
Cash or cash equivalents	2%
Asset allocation to Fixed Interest + Cash	**29%**

Fund Performance to 31 March 2023

Period	Fund Return (after fees)	Gross Reference Portfolio Return
1 month	0.18%	0.65%
3 months	2.11%	2.28%
6 months	4.28%	5.38%
1 year	-6.27%	-5.99%
Since inception p.a.	-4.01%	-2.39%

Performance is after all fees and does not include imputation credits or PIE tax. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance. Reference Portfolio return is gross.

Top Individual Holdings at 31 March 2023

Goodman Property Trust	Argosy Property Trust
Kiwi Property Group	Property for Industry
Fisher & Paykel Healthcare	Auckland International Airport
Precinct Properties NZ	Infratil
Spark NZ	Vital Healthcare Property Trust

Holdings stated as at 31.03.2023, excludes cash and consolidated International Fixed Interest Fund component of the Sustainable Income Fund due to its large number of securities.

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Market Commentary

March month and quarter saw global stocks edging higher despite periods of heightened volatility. Global markets overcame uncertainty over economic growth, still-elevated inflation, central bank policy and banking industry turmoil to post positive returns for the first quarter. This strength was partially catalysed by sharply lower interest rates and expectations for reduced monetary tightening going forward.

- Global growth has generally surprised to the upside in the first quarter of 2023. This has largely been enabled by lower energy prices (including oil) and has been reflected in upbeat purchasing manager indices (PMI), particularly in Europe and the United States.
- Reflecting the lower energy prices, headline inflation rates continued to ease over the quarter, though in line with our long-held view, core inflation remains stickier. As a result, central banks continued to tighten monetary policy over the period.
- The collapse of Silicon Valley Bank and problems in several finance firms along with a swift response from policy makers set off a wave of finance sector volatility during the quarter. We do not see these issues as systemic, or signalling any kind of generalised finance sector malaise, but rather as symptomatic of idiosyncratic factors relevant to each institution. That said, it serves to illustrate the lags between monetary policy actions and their impact being felt is just as relevant to the finance sector as it is to the real economy.
- In the US, the labour market remains particularly resilient. The economy added 815,000 jobs in the first two months of the year, though the unemployment rate ticked higher in February and wage growth is moderating. The Federal Reserve hiked 25bp in March to a target range of 4.75%-5.00% but left the projected terminal rate at 5.1%.
- Despite the finance sector turmoil, the European economy continued to benefit from lower energy prices, avoiding the much-anticipated contraction in activity expected for the fourth quarter of 2022. Headline inflation fell over the quarter, but core inflation rose. The ECB hiked its deposit rate by 50bp, with the next move data dependent.
- The abandonment of China's Covid-zero policy has led to a sharp rebound in economic activity, while inflation has remained surprisingly in check. 2023 is the first time in four years that economic, regulatory and Covid policies have been aligned in a pro-growth, pro-business fashion. This is being reflected in improving PMIs that are all in expansionary territory.
- Recent data out of Australia has been mixed with GDP surprising to the downside, but the labour market continuing to surprise on the upside. The RBA hiked interest rates by 25 bp in February, but paused the hiking cycle, in their April meeting.
- In New Zealand, the RBNZ remained resolute in raising the Official Cash Rate 50bp to 4.75% in February and again to 5.25% in April. That was despite the devastation of cyclone Gabrielle. December quarter 2022 GDP came in significantly weaker than expected. While possible still reflecting Covid "noise", there are clear signs in the data that tighter monetary conditions are starting to bite.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund had a modest positive return in March month and a positive quarter, reflecting better returns in both the equity and fixed interest components of the portfolio. For the month, the fund gained 0.18% (after fees.) The fund's 3-month return was also positive, at 2.11% (net) as at 31 March which was 0.17% behind its reference portfolio gross three-month return. On the rolling six-month basis, the fund is recording a rise of of 4.28%, while annually, the fund return is lower by -6.27% (after fees,) 0.28% below the reference index' return.

Given recent market conditions, these performance results indicate the present sensitivity of particularly income-yielding asset types to sharp moves in global interest rates. The consolidation in both global share and bond markets since recent market lows in October has assisted Income fund components back to stable short-term returns. As inflation shows signs of a definitive peak in the months ahead, we expect component asset classes to improve further, as has occurred in 2023 to date. However, volatility across markets is ever-present and sentiment remains fragile.

March saw asset prices in most markets stabilise and improve. While in the month of March, the long-resilient Global Listed Infrastructure fund made a positive individual contribution of 0.23%, for the first quarter infrastructure's contribution was lower at 0.08%. The strongest contributor in March month was the Salt Sustainable Global Fixed Income Opportunity fund, which provided a 0.33% positive impact, whilst unsurprisingly given the uncertainty on banking risks, the weakest monthly contributors were the Sustainable Global Property fund which detracted by 0.1% and the Enhanced Property fund which detracted by -0.33%.

For the quarter as a whole, the dominant positive contributor to returns was the Salt NZ Dividend Appreciation fund, which supplied 1.16% of the total quarterly return of 2.11% (after fees.) The second-strongest component over the quarter was the Enhanced Property fund, which supplied 0.54%, and the Fixed Income components which contributed 0.35%. Global Property and Global Infrastructure were minor contributors for the quarter, at +0.03% and 0.08%, respectively.

Salt Sustainable Income Fund outlook

2022 was a watershed for traditional Fixed Interest, with bonds and bond-heavy Income funds experiencing unprecedented price weakness. Mark-to-market capital declines compounded by negative after-inflation returns from bond coupons. We believe bond yields have now adjusted upwards enough, to have halved our previous underweight bond positions within the Sustainable Income Fund. The allocation to bonds is now 27% vs a 35% SAA..

As the Reserve Bank of New Zealand continues to lift the Official Cash Rate and inflation is persisting, domestic yields and discount rates are likely to stay quite elevated. We lowered our overweight position in the NZ Dividend Appreciation Fund to Neutral and trimmed our overweight position in the Enhanced Property Fund (whilst still remaining overweight) in February.

With higher yields now prevailing for longer, the Fund's income level has been enhanced. We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to resume performance gradually, as international conditions stabilize. However, there could easily be a recessionary period to traverse en route to that outcome. The phase of interest rate reductions from central banks is still some quarters into the future and we expect a major beneficial capital growth impact of such will only become apparent from the last part of 2023 or even early 2024.

As the primary objective of the Salt Sustainable Income Fund is to invest in quality sustainable yield payers, minimizing short-term capital price fluctuation is secondary. Market volatility allows us to acquire high quality and defensible dividend-paying assets for the Fund at better prices.

Given the absolute level and degree of differentiation amongst global bond yields, the point at which additional Fixed Income exposure should be incrementally added to the Salt Sustainable Income Fund arrived in the middle of the first quarter. Internationally, major central banks are now communicating the desirable course of carrying through the last additional interest rate increases, sufficient to anchor inflation expectations, and this does unnerve markets at times. While the resultant volatility requires fortitude from investors, the objective of securing an inflation-resilient income level now means that equity market fluctuations and corrections over short periods are inevitable. Over the medium-term, moderate capital gains in addition to income advantages are expected, and the Sustainable Income Fund is positioned to harvest them.

As noted earlier, the silver lining in the bond repricing is that the yield received from bond investments is also now higher and supports the Sustainable Income Fund's forward distribution path. This is characteristic of a transition into a mid-level interest rate regime.

It is crucial to note that the Income level from equity dividends and bond coupons received into the fund has indeed been commensurately rising through the recent period of market turbulence and remains well in excess of the Income Fund's current distribution rate of 1.00 cents per unit per quarter (4 cents per unit per annum.) This trend exemplifies the incremental return of some "risk premia" into asset classes, though this has further to go. We expect to adjust upwards the distribution level slightly, and will announce the adjustment on 30 April as scheduled.

The equity capital value components of the Income Fund have adjusted to weaker economies in the year ahead, yet the Real Asset components of Infrastructure and Property are suited to an economically uncertain and inflation-prone period. Defensive merit should be re-asserted in coming months through continuing positive demand for these specific equity types, along with the sustainable dividend-payers in the broader Australasian market.

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Greg Fleming, MA