SALT

Salt Sustainable Global Shares Fund Fact Sheet – July2022

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 July 2022

Benchmark	MSCI World (Net) Index in NZD
Fund Assets	$47.59 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 31 July 2022

Application	1.0191
Redemption	1.0150

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 July 2022

Global equities	98%
Cash	2 %

Fund Performance to 31 July 2022

Period	Fund Return*	Benchmark Return
1 month	6.28%	7.03%
3 months	3.27%	1.74%
6 months	-5.48%	-5.69%
1 year	0.73%	0.48%
Since inception	1.70%	1.64%

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 July 2022.

Fund ESG Scores	Portfolio	Index
Sustainable Global Shares	27T CO_2 /$m	162T CO_2 /$m
Portfolio Carbon Footprint:	17% of MSCI World Index*	

Source: MISM Quarterly Investment Report, 30.6.2022 & Trucost based on the Scope 1 & 2 carbon emissions per $1million of Portfolio companies' sales, and as weighted average carbon intensity (WACI). See p.4 for further ESG details.

Top 10 holdings	
Microsoft (US)	SAP (DE))
VISA (US)	Thermo Fisher Scientific (US)
Reckitt Benckiser (UK)	Abbott Laboratories (US)
Danaher (US)	Baxter International (US)
Accenture (US)	Becton Dickinson (US)

Source: MSIM, data as at 31 July 2022. The Top 10 Holdings represented 46.6% of the total portfolio.

Market Review

After the significant market weakness experienced in both equities and bonds in the first half of 2022, July saw stabilising investor sentiment and moderate rebounds in most key asset classes. Equities and Real Assets were particularly strong over the month, reflecting a shift down in longer-term interest rates on fears of a period of imminent economic weakness.

- July month saw further evidence of the slowdown in global economic growth, while at the same time, inflation continued to reach new highs. Labour markets remained strong, a good sign for activity growth, though strong wage growth points to ongoing core inflation pressure.
- A weaker growth outlook has contributed to suggestions of a pivot to the less hawkish by central banks, particularly in the US. This contributed to a "risk on" tone in both equity and bond markets, which is premature in our view.
- In the US the Federal Reserve raised interest rates by 75 basis points (bp) for the second time, taking the Fed funds rate to 2.5%,

or around the Committee's estimate of the long run (neutral) rate. US GDP printed negative for the second consecutive quarter, meeting the definition of a technical recession. The National Bureau of Economic Research (the US cycle dating agency) is unlikely to confirm this as an economic recession given the narrowness of the weakness and the ongoing strength in the labour market.

- A similar set of circumstances prevailed in Europe during the month as the European Central Bank began its interest rate hiking cycle with a larger than expected hike of 50bp. The ECB also approved the Transmission Protection Instrument (TPI), a tool aimed at supporting orderly conditions across Eurozone government bond markets, in particular the region's peripheral markets such as Italy and Spain. At the same time, the economy remains on the brink of recession given concerns about the security of gas supplies from Russia.
- Activity data was more upbeat in China over the month though the authorities continue to grapple with current Omicron outbreak amidst its still stringent Covid-zero policy. While there have been minor steps to ease restrictions, a more fulsome relaxation is unlikely until after the upcoming Communist Party National Congress.
- The Reserve Bank of Australia continued its aggressive rate hikes with a further 50bp hike in July, with expectations of ongoing hikes of this magnitude.
- Inflation in New Zealand hit a fresh high of 7.3% in the year to June, higher than market and Reserve Bank expectations. All key core measure of inflation pushed higher also, confirming the Reserve Bank of New Zealand still has work to do, especially considering tightness in the labour market.

Despite mounting recessionary fears, global equity markets gained significant ground in the month of July, with the MSCI World Index up an impressive 7.9% in US dollars (USD) for the month (a similar +8.0% in local currency and +7.03% in NZD). Optimism that the US Federal Reserve (Fed) will slow the pace of future rate rises saw the index claim its best monthly performance since November 2020, though it is still down a hefty 14% in USD and off 12% in local currency for the year.

All sectors finished the month in positive territory, with Consumer Discretionary (+15%) and Information Technology (+13%), the worst performing sectors in the first half of 2022 (H1), up double digits on the back of better-than-expected full year earnings forecasts.

Meanwhile, defensive sectors underperformed for the month in a sharply rising market, with Health Care (+3%), and Consumer Staples (+4%) trailing MSCI World. Barring Materials (+4%) and Communication Services (+3%), all other sectors closed within 300bps of the index. Turning to geographies, the US (+9%) was ahead of the overall index in the month, which meant other major markets tended to lag.

In Euroland, France (+9%) outperformed in local currency terms, while Italy (+5%) and Germany +5%) were less strong. Similarly, Switzerland (+4%) and the UK (+4%), although positive, were both somewhat behind the index. These markets are generally more defensive in character.

Meanwhile in Asia, disappointing economic data in China saw Hong Kong (-4%) claim its spot as the July month's laggard, while Singapore (+5%) and Japan (+4%) were stronger, if still behind the overall index.

Portfolio Review

In July, the Portfolio returned +6.28% (NZD after fees), behind the MSCI World Net Index which returned +7.03% in gross terms. The Portfolio has performed ahead of benchmark by 1.5% over the last three months, with an after-fees gain of 3.27% although it has underperformed slightly for the year to date. Over one year, and since inception, the Sustainable Global Shares Fund is marginally ahead of its benchmark (after fees), returning 1.7% versus -1.6% for the gross index return since inception.

• The July month's underperformance was due to stock selection.
Positive Health Care performance was outweighed by weakness in Financials and Information Technology.
• Sector allocation was flat. The benefits from the Information Technology overweight and Communication Services underweight were largely balanced by the drag from the Health Care overweight and the Consumer Discretionary underweight.
• The largest contributors to absolute performance during the month were Danaher (+64 basis points [bps]), Microsoft (+57 bps), Constellation Software (+47 bps), Accenture (+45 bps) and Visa (+42 bps). The largest absolute detractors were Baxter International (-33 bps), AIA (-17 bps), Stanley Black & Decker (-10 bps), Procter & Gamble (-8 bps) and Becton Dickinson (-7 bps).

Portfolio Outlook

The equity markets had a very weak first half of 2022, with the MSCI World Index down over 20% in USD, the worst start to the year in over 50 years. The bizarre element is that the fall has all been down to multiple de-rating, as earnings have not yet been hit. The US Second Quarter earnings season has been mixed, though in aggregate a little stronger than had been expected, allowing elements of relief back in.

There are plenty of grounds to be anxious about earnings, even if inflation helps revenue growth, at least in nominal terms. The major threat in the short term is the prospect of an economic slowdown or recession. Central banks are attempting to counter inflation by dampening demand through higher rates. They are hoping to calibrate their rate rises to achieve a soft landing, and economic forecasts seem to think that this is achievable, with the OECD predicting 1- 2% growth for the USA and the Euro area for 2023, with inflation falling and unemployment only rising marginally.
What is clear is that there are no signs of any risk of downturn in the current earnings numbers, given the continued robustness of the estimates. The potential risk to future earnings is raised by the current record level of margins, which appear stretched at historical highs.

It seems that the excess demand is allowing companies to pass on even more than the rise in their input costs, be it through inflation (raising prices), 'shrinkflation' (reducing product sizes) or 'skimpflation' (trimming the level of services). An end to shortages, or worse still a shift to excess supply, could end this phase of generalised pricing power, with more commoditised companies suffering, while genuine pricing power holds up better. This development would favour Quality.

Given the many risks to earnings, it may be a particularly good time to own compounders, (companies that can grow their earnings steadily across economic cycles) because their pricing power and recurring revenue make their earnings resilient in tough times. In the longer term, there could be further pressures on earnings, be they from rises in interest costs, the need to build more resilient supply chains, companies paying for the negative externalities they create, and even potentially

Disclaimer: The information in this publication has been prepared from sources believed to be reliable and accurate at the time of preparation but Salt Funds Management Limited, its officers, directors, agents, and employees make no representation or warranty as to the accuracy, completeness, or currency of any of the information contained within, and disclaim any liability for loss which may be incurred by any person relying on this publication. All analysis, opinions and views reflect a judgment at the date of publication and are subject to change without notice. This publication is provided for general information purposes only. The information in this publication should not be regarded as personalised advice and does not take into account an individual investor's financial situation or goals. An individual investor should, before making any investment decisions, seek professional advice. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

from higher corporate tax rates as governments look to repair their finances.

Staples companies that sell products we need can even increase prices in this tough environment. Companies such as Reckitt Benckiser have been reporting that their strong portfolio of brands has allowed for "responsible price action", an increase in pricing of 5% in the first quarter across its business. This contrasts with the fortunes of general retailers (which we don't own), which have suffered the mistake of increasing their inventory of home equipment at a time when a post-pandemic consumer is shifting towards leisure and services outside the home.

Mission critical software on subscription models also enjoys fortress-like pricing power and recurring revenues, as Microsoft proved with its announced price increases for commercial products which took effect 1 March 2022. Typically, such announcements are softened with reference to innovative improvements, for example new AI tools or enhanced security being included in the price.
Payments companies such as Visa, which take a clip of every dollar in a rising inflation environment, gaining revenue without having to increase prices, are often overlooked inflation plays – never mind that they have been able to effect increases in merchant fees.
Within MedTech and life sciences, product mix matters, and some categories like nutrition are easier to effect price increases than more commoditized areas. Medical and scientific supplies companies enjoy some protection as hospitals and scientists will continue to prize reliability and quality, raising switching costs. This is particularly the case where the products and services provided are a small part of the customers' cost base.

The team's focus on valuation risk over the last few years has contributed to the portfolio's relatively low free cash flow premium relative to the index. Moving on to the earnings risk, **pricing power is one of the key characteristics we look for in our stock selection process**. The companies' intangible assets, be they brands or networks, should allow them to pass on rising input costs to their customers, protecting margins. In addition, in the case where government actions against inflation cause an economic slowdown, or even a recession, recurring revenue, another factor we focus on, should protect the portfolio's earnings just as it did in 2008-9 and in early 2020.

Greg Fleming, MA

Sustainability metrics provided to Salt by Morgan Stanley Investment Management

As of 31 July 2022, the Portfolio's carbon footprint is 85% lower than the MSCI AC World Index's and 83% lower than the MSCI World's.

Engagement

- We engaged on 94% of our holdings across all strategies – far above the industry average of 19%* for asset managers.
- 62% of meetings with at least one vote against management
- 29% of votes on say-on-pay proposals against management
- 143 of 280 engagement meetings included discussions on ESG topics. Below are some examples.

1. Board composition, executive compensation, and sustainability governance – beverage company.

The challenge: A board composed entirely of white Europeans, reservations about LTIP structure and lack of measurable ESG KPIs in pay plan.

The action: We continued to raise the issue of board diversity, the firm's hiring process and executive compensation structure.

The outcome: Encouraged to see the appointment of a female board member of Indian heritage with business experience from Asia, LTIP now 100% performance-based shares and new ESG-related targets to hold management accountable.

2. Find, Fix, Prevent – biodiversity, circular economy, supply chain management – food processing and retail conglomerate.

The challenge: Complex supply chains can create low visibility and direct control over labour conditions; water usage also a challenge.

The action: We revisited how they monitor labour conditions at suppliers' factories and pressed for more ambitious water use reduction targets.

The outcome: Confirmed our view that the company's sustainability plan is one of the most detailed and transparent in the industry. We will continue to encourage more action on garment recycling and water use.

3. You can't manage what you can't measure – decarbonisation, climate change and executive compensation - consumer credit reporting company.

The challenge: Despite strong progress on their carbon emissions reduction journey, only 34% of electricity is from renewable sources.

The action: We engaged to better understand emissions across the value chain and sought evidence they are on track with targets. We also pressed for E and S KPIs in compensation calculations.

The outcome: They acknowledged our engagement was the most in-depth meeting on decarbonisation they had experienced and were receptive to our suggestions. They outlined proposed solutions to increase renewable energy sourcing in US and EM and supplier engagement to reduce Scope 3 emissions.

* A recent report by the United Nations-supported Principles for Responsible Investment (PRI) suggests the industry average for corporate engagement is just 19% of holdings.

Disclaimer: The information in this publication has been prepared from sources believed to be reliable and accurate at the time of preparation but Salt Funds Management Limited, its officers, directors, agents, and employees make no representation or warranty as to the accuracy, completeness, or currency of any of the information contained within, and disclaim any liability for loss which may be incurred by any person relying on this publication. All analysis, opinions and views reflect a judgment at the date of publication and are subject to change without notice. This publication is provided for general information purposes only. The information in this publication should not be regarded as personalised advice and does not take into account an individual investor's financial situation or goals. An individual investor should, before making any investment decisions, seek professional advice. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.