Funds Management

Salt NZ Dividend Appreciation Fund Fact Sheet – May 2018

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 Salt NZ Dividend Appreciation Fund targets a portfolio of shares of New Zealand companies that may, in our opinion, pay high and sustainable dividends. A considerable body of robust research suggests that stocks with strong and sustained dividend policies tend to generate higher free cash flow than average and outperform their index benchmarks over time. The strategy is not intended to naively generate the highest possible yield but rather to generate a high and sustainable dividend yield.

Benchmark

S&P/NZX 50 Gross Index

Fund Assets at 31 May 2018

$68.8 million

Strategy Assets at 31 May 2018

$147.3 million

Includes all Funds and separately managed accounts that employ the same investment strategy as the Salt NZ Dividend Appreciation Fund.

Inception Date

30 June 2015

Portfolio Manager

Matthew Goodson, CFA

Unit Price at 31 May 2018

Application	1.3678
Redemption	1.3623

Investment Guidelines

The guidelines for the NZ Dividend Appreciation Fund are shown below:

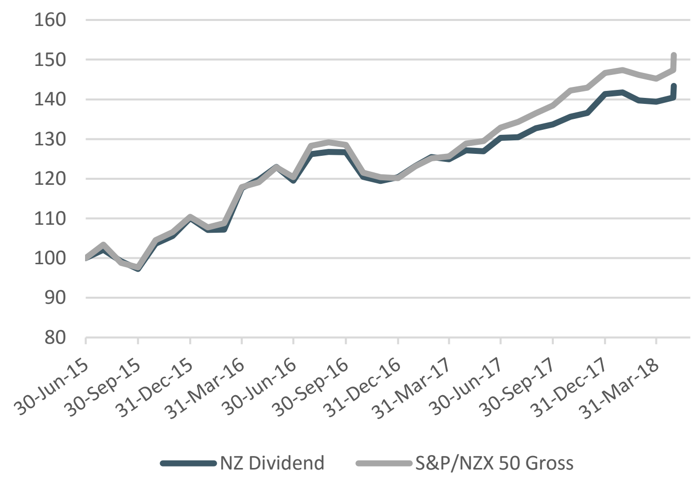
NZ shares	95% – 100%
Cash	0% – 5%
Unlisted securities	0% – 5%
Maximum active position	8%

Fund Performance to 31 May 2018

Period	Fund Return	Benchmark Return
1 month	2.10%	2.55%
3 months	2.63%	3.40%
6 months	4.98%	5.77%
1 year	13.00%	16.71%
2 year p.a.	7.98%	10.91%
Inception p.a.	13.15%	15.23%

Performance is after all fees and does not include imputation credits or PIE tax.

Cumulative Fund Performance to 31 May 2018



Fund performance has been rebased to 100 from inception.
Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

Fund Allocation at 31 May 2018

NZ shares	97.91%
Cash	2.09%

Top Overweights	Top Underweights
Turners Automotive Group	Ryman Healthcare
Investore Property	Mainfreight
Tower	Infratil
Scales Corporation	Trade Me
Metlifecare	Ports of Tauranga

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Monthly Equity Market Commentary

The MSCI World Accumulation Index ended the month up +0.6% lifting the index into positive territory for the year (+0.5%) despite risk-off on political turmoil in Italy as well as pressure across emerging markets due to US$ strength, with Turkey and Argentina being particularly affected. Geopolitics remained in the spotlight with fears of a trade war continued to wax and wane, President Trump ended the nuclear deal with Iran and cancelled and then reinstated the planned talks with North Korea.

US markets were strong, with the S&P 500 rising +2.2%, lifting the year-to-date return to just +1.2%. The NASDAQ surged +5.3% over the month and the return of +7.8% year-to-date highlights how tech generally and the FANGMAN (Facebook, Amazon, Netflix, Google, Microsoft, Apple and Nvidia) club are ever more popular. During the month the FOMC appeared incrementally more confident in the inflation outlook, with the rate hike outlook seeing a tension between possibly letting inflation run above the 2% target for a period while some Governors saw a need to gradually lift rate hikes beyond neutral. US 10-year Treasury yield reached an intra-month high of 3.11% before ending the month at 2.86% on a flight to safety around the Italian election. US unemployment fell to an 18 year low of 3.9% while average hourly earnings were +2.6% on the prior year. Markets are pricing in a high likelihood of the FOMC lifting rates in June.

Over the month the key Asian markets were again influenced by trade discussions between the US and China and the occurrence or otherwise of planned talks between the US and North Korea. The Japan Nikkei 225 was down -1.1% and Hong Kong's Hang Seng returned +1.1%. European markets were mixed with Germany's DAX -0.1%, France CAC -2.2% over the month due to the Italian political changes and with concerns over the pace of the ECB's withdrawal from QE given a slightly lower than expected CPI number while the UK's FTSE was up +2.2% more driven by its exposure to global stocks.

In Australia the S&P/ASX 200 Accumulation Index was up 0.5% driven mostly by Healthcare +5.6%, Discretionary +4.9% whilst Telecoms detracted substantially -10.2% mostly due to an earnings downgrade by Telstra. The RBA kept interest rates on hold at 1.5% reiterating a positive view on the economy, employment and inflation going forward. The Federal Budget confirmed lower corporate tax rates and a lift in infrastructure spending but also a commitment to change income tax brackets by 2024.

The NZ equity market posted a strong +2.5% return for the month, with the biggest contributors bring Ryman Healthcare (RYM, +7.5%) on what we considered a relatively tepid result and Spark (SPK, +5.8%) post an update on its cost out program, whilst the biggest detractor was a2 Milk (ATM, -10.5%) on disappointing guidance.

Monthly Fund Commentary

The Fund slightly lagged a powerful surge in the market during May, rising by +2.10% after all fees and expenses compared to an advance of +2.55% by the Index. This move by the market came despite earnings downgrades by a2 Milk and Fisher & Paykel Healthcare and saw the forward PE for the NZ market rise from 22.9x to a new multi-decade high of 23.9x. The low beta nature of the Fund which focuses on high and sustainable dividends meant it could not quite keep up despite reasonable stock selection over the period. A fascinating analysis by JP Morgan's global strategy team decomposed global returns by "factor" during the month. They found that "valuation" delivered -3.6%, "earnings momentum" +1.6%, "price momentum" +4.6% and "quality" +0.3%. NZ felt very similar.

The largest negative by a long way was the sizeable underweight in Ryman Healthcare (RYM, +7.6%), which rose sharply following their result. We continue to focus on the lack of free cashflow generation, early timing of sales recognition, the sizeable valuation multiple of NTA and the leveraged risks to an equity-light model from weakening house prices and housing turnover. They have also struggled to meet their sales targets. Conversely, the bulls appeared to focus on the sharp rise in NTA from long term house price assumptions being lifted (odd when prices have now peaked) and the massive long-term development pipeline. The bulls are winning for now, but we suspect that future housing market outcomes will determine whether this remains the case. With the latest data showing Auckland prices being anywhere from 3 to 9% off their recent peak and a bevy of Government housing measures yet to come, our view is clear.

Other headwinds came from zero-weights in several high multiple low yielding growth names which performed strongly on the back of the factor thematic described above. These included Mainfreight (MFT, +7.3%), Infratil (IFT, +7.4%), Synlait Milk (SML, +12.5%) and Port of Tauranga (POT, +5.3%).

Unsurprisingly in a strong month, positive contributions came from a series of overweights led by our generally painful long in Evolve Education (EVO, +18.8%), which received a moderate funding boost in the Budget and whose result came in at the top end of downgraded guidance. Other stand-outs were Investore Property (IPL, +4.9%), Scales (SCL +6.1%), Contact Energy (CEN, +7.1%) and Skellerup (SKL, +11.2%).

Cash levels rose slightly from 0.2% to 2.2% over the month as a natural outcome of market strength. This was used to lower Auckland Airport from neutral to underweight, lower NZX and lower Restaurant Brands to neutral after many years of being overweight what has been a very successful call for the Fund – our move was based on valuation and a more difficult outlook for the NZ consumer. We lifted holdings in Spark and in Mercury on pre-MSCI Index exclusion weakness.