SALT

Salt Sustainable Global Fixed Income Opportunities 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 primary objective of the Fund is to target to generate an attractive rate of return over a full three-to-five-year market cycle. To achieve this, the Fund targets a portfolio of global fixed income securities with enhanced total return potential and superior Sustainability characteristics.

The objectives of this top-down selection process are to:
1. Reduce exposure to material ESG risk and negative sustainability impacts, through restriction screening of controversial sectors such as weapons, tobacco and some fossil fuels, as well as international norms violations;
2. Tilt the portfolio in favour of the 80% strongest sustainability performers across corporates, by sub- sector, and sovereigns; and
3. Contribute to positive outcomes based on key sustainability themes, with a particular focus on low carbon intensity.

The Fund will invest at least 50% in investment grade bonds, and a minimum of 15% in sustainable bonds. The fund targets its returns to be 100% hedged to the New Zealand dollar.

Fund Facts at 31 March 2023

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$58.38 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 31 March 2023

Application	1.0013
Redemption	1.0002

Investment Guidelines

The guidelines for the Sustainable Global Fixed Income Opportunity Fund are:

Global Fixed Income securities	95% – 100%
Cash	0% – 5%

Fund Allocation at 31 March 2023

Global fixed income securities	97.8%
Cash	2.2%

Fund Performance to 31 March 2023

Period	Fund Return
1 month	1.25%
Since inception cumulative	0.20%

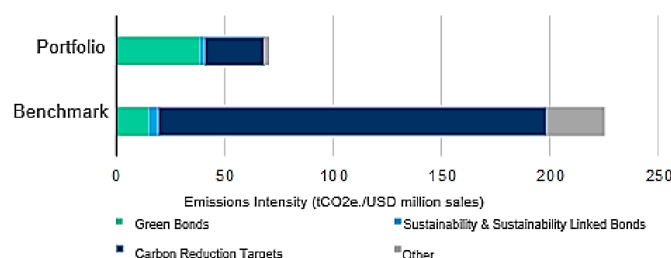
Performance is gross of fees and tax. Past performance is not a guarantee of future results. Data as of 31 March 2023.

Fund ESG Scores	Portfolio	Index	YTD change
MSCI ESG Score (MV%)	96.4%	91.4%	-
MSIM ESG Credit Score	6.14	5.73	-
MSCI ESG Score adj.	7.42	6.38	7.42
- Environment score	7.27	6.21	7.27
- Social score	5.57	5.51	5.57
- Governance score	6.20	5.87	6.20
MSIM ESG Sovereign score	3.20	2.80	-

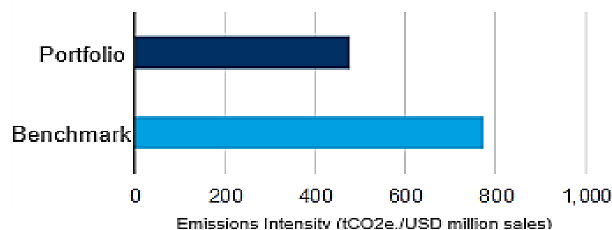
Source: MISM Quarterly Investment Report / MSCI ESG Research as at 31 March.

Fund CO2 Emissions Intensity characteristics at 31 March 2023

Emissions Intensity - Scope 1&2



Emissions Intensity - Scope 3



Source: MISM Quarterly Investment Report / MSCI ESG Research as at 31 March

Labelled sustainable bond major holdings > 1%	MSCI ESG rating
Federal Rep. Germany	AA
European Union MTN (Social)	A
UK Gilt (Green)	A
European Investment Bank (Green)	AAA
Council of Europe Development Bank	AAA
Export-Import Bank of Korea (Green)	BB

Source: MSIM, data as at 31 March 2023.

Portfolio Review

- In the one-month period ending 31 March 2023, the portfolio returned 1.25%. The performance can be attributed to the following factors:
- The portfolio's positioning in duration was the main positive driver (especially US rates) as yields declined last month.
- Within credit, spreads widened with financials underperforming industrials and utilities.
- Hence the portfolio's exposure to investment grade and high yield credit detracted, with most of the losses stemming from the exposure to financials.
- The exposure to government related debt (especially developed markets) also detracted.
- The portfolio's exposure to securitized debt was a positive contributor.

Portfolio Commentary & Outlook

The March price action for developed market rates was staggering and historic. At the start of the month, hawkish language from Fed members including Powell saw yields continue their movement upwards; however, that was quickly reversed as the collapse of Silicon Valley Bank unfolded. As a result, yields sharply fell, with the 2-year yield falling a massive 109bps from 5.07% on March 8th to 3.98% on March 13th.

Given the sharp move on the front end, the curve steepened over the month. After spiking, rate volatility slowly declined from the highs but remained elevated throughout the month as the market digested news and tried to interpret the impact the banking situation will have. Beyond the banking story, key economic data was mixed, but a slightly stronger than expected CPI print showed that inflation was still sticky. In terms of central bank meetings, prior to the SVB collapse, the RBA raised rates 25bps and the Bank of Canada paused. Following the banking situation, there was a shift to more dovish language, but central banks largely remained committed to hikes, with the ECB and Swiss National Bank hiking 50bps, while the Fed, Norges Bank, and Bank of England raised rates 25bps.

The issues in the banking sector have led to more volatility in markets and new uncertainties. At this point, a broader banking crisis reminiscent of 2008 seems highly unlikely; however, it will still affect the economy. While the magnitude of the impact on the economy is unclear at this point, credit conditions are likely to tighten even further as a result. At this point, it seems the market is adjusting for a shift in the tail risks, as scenarios where the Fed goes much higher (i.e., taking rates to 6%) seem much less likely, while a recession has become more likely. Unfortunately for the Fed, while the banking issues will likely be disinflationary, core inflation is still elevated and sticky. Given the uncertainty, it is difficult to concretely express an outright view on interest rates, and it may be wise to be patient for now, awaiting further clarification while taking advantage of more relative dislocations.

Euro Investment Grade (IG) spreads underperformed US IG spreads this month amidst elevated credit market volatility as banking sector concerns dominated both markets. Euro IG closed 22bps wider at 170bps while US IG closed 14bps wider at 138bps. Despite authorities providing solutions that addressed the question of systemic risk, markets demanded a higher risk premium. More broadly markets focused on the risks of higher funding costs impacting profitability, liquidity risk following runs on deposits, the potential that lending standards would tighten impacting future growth, and inflation data continuing to drive terminal rate expectations. Towards month end the market took confidence from no follow on headlines suggesting the events were somewhat idiosyncratic resulting in equity and interest rate volatility falling supportive of tighter credit spreads.

Volatility in the U.S. and global high yield markets leapt higher in March following the collapse of Silicon Valley Bank and Signature Bank and a sharpened focus on the vulnerability of U.S. regional banks and select European banks to a potential rapid withdrawal of deposits.

IG Credit fundamentals can be summarised as "things are better in 2023 but far from good". Despite support for the IG Credit market from numerous sources, multiple headwinds suggest IG Credit warrants an above average risk premium. Recent banking news highlights the idiosyncratic risks in the market, central banks are still raising rates, inflation is likely to be sticky given the strength in the labour market, and corporate profitability will be pressured by higher input costs.

Technical demand for Investment Grade Credit has been a positive factor and we expect IG Credit to benefit from demand for an attractively valued high quality asset in an environment of increased uncertainty. Valuation levels suggest room for spread tightening as well as an attractive running yield. We remain cautious on the high-yield market as we enter the second quarter of 2023.

Securitized credit widened in March as part of the risk-off shift in markets. New issue securitized supply remains very low as loan origination in both residential loans and commercial loans has declined substantially. We continue to believe that the fundamental credit conditions of residential housing loan markets remain sound. We expect home prices to fall another 5-10% for the remainder of 2023. US residential credit remains our favourite sector while we remain more cautious of commercial real estate, which continues to be negatively impacted in the post-pandemic world.

Emerging Markets broadly held up well, especially EM local assets, during the elevated volatility from the US bank fallout. Many EM currencies strengthened during the period particularly, Latin American currencies. We are cautiously optimistic on the asset class as peak inflation and hawkish policy are likely behind us. Bottom-up country and credit analysis will remain crucial to identify pockets of opportunity.

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