
# Salt Sustainable Global Shares Fund Fact Sheet – October 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 October 2023

| | |
|---|---|
| **Benchmark** | MSCI World (Net) Index in NZD |
| **Fund Assets** | $57.78 million |
| **Inception Date** | 12 July 2021 |
| **Underlying Manager** | Morgan Stanley Investment Management |

## Unit Price at 31 October 2023

| | |
|---|---|
| **Application** | 1.0869 |
| **Redemption** | 1.0824 |

## Investment Guidelines

The guidelines for the Sustainable Global Shares Fund are:

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|---|---|
| **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 October 2023

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|---|---|
| **Global equities** | 98.04% |
| **Cash** | 1.96% |

## Fund Performance to 31 October 2023

| Period | Fund Return* | Benchmark Return |
|---|---|---|
| **1 month** | 0.45% | 0.30% |
| **3 months** | -2.03% | -2.96% |
| **6 months** | 3.42% | 4.51% |
| **1 year** | 12.11% | 10.34% |
| **2 year p.a.** | 4.54% | 5.26% |
| **Since inception p.a.** | 4.91% | 5.37% |
| **5 year*** | 11.67% | 10.80% |

Performance is before fees and tax and adjusted for imputation credits. Benchmark performance is gross. Past performance is not a guarantee of future results. Data as of 31 October 2023. *5 year strategy performance is gross of fees.

| Fund ESG Scores | Portfolio | Index |
|---|---|---|
| Sustainable Global Shares | 26T CO2 /$m | 162T CO2 /$m |
| Portfolio Carbon Footprint: | 15% of MSCI 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). *At September 30, 2023, the Portfolio's carbon footprint was 85% lower than the MSCI World Index and 86% below AC World.

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

Source: MSIM, data as at 31 October 2023.
The Top 10 Holdings represented 46.0% of the total portfolio.

## Market Review

- Stocks and bonds fell in unison through October as geo-political tensions weighed on market sentiment following the start of Israel-Hamas hostilities. Bond yields rose sharply in response to buoyant economic data which supported the "higher for longer" mantra, coupled with rising concerns about fiscal sustainability. Developed market equities fell 2.9% (in USD) over the month while global bonds were down 1.2% (in USD) over the same period.
- In the United States, markets had to contend with the implications of a plethora of data pointing to the continued resilience of the US economy including strong retail sales, and blowout jobs and GDP reports. Inflation data also came in higher than expected. This resilience in the data suggests the US Federal Reserve may have to keep interest rates at these higher levels longer than investors were anticipating.

- Meanwhile, there are increasing signs of fragility across the Eurozone economies. Latest bank surveys by the European Central Bank highlight a contraction in the supply of credit to businesses and households over the September quarter. At the same time, forward looking indicators such as PMI surveys continue to weaken, with the composite index down a further 0.7 points to 46.5 in October.

- In Japan, 10-year Government Bond yields moved higher over the month as persistent price pressure led markets to question the ongoing sustainability of the Bank of Japan's Yield Curve Control Policy. Despite earlier attempts to defend it accommodative position, the BoJ made a further tweak to its YCC policy with the 1.0% upper limit now being referred to a "reference".

- Better looking industrial production, retail sales and GDP data out of China suggests policy easing efforts are starting to have some stabilising effect on the economy. However, continued weakness in the beleaguered property sector suggests the economy is not out of the woods yet and further policy easing and debt restructuring efforts will be required.

- The Reserve Bank of Australia left interest rates unchanged at the start of the month. This was the first meeting under new Governor Michele Bullock, so a semblance of continuity was not surprising. However, since then activity and inflation data have printed stronger than expected. That has led to the rising expectation over the month that the RBA will move back to interest rate increases at its November meeting.

- In New Zealand the General Election delivered a change of government, although the final shape was yet to be determined by the counting of Special Votes. National's Christopher Luxon will be the new Prime Minister in a coalition with the ACT party. All that remains to be confirmed is the extent to which they will also need to rely on the support of the NZ First Party.

- Economic data continued to soften over the month and the labour market saw a noticeable easing in pressures over the September quarter as the unemployment rate rose from 3.6% in June to 3.9%. This continues to support our view that the RBNZ has tightened enough and now just needs to be patient.

## Portfolio Review

- In October month, the Portfolio returned +0.44% (on a gross of fees basis,) slightly ahead of the MSCI World Net Index which returned +0.30%%. The Portfolio trails the index for the 2023 year to date (YTD), having returned +16. 5% versus the benchmark's +17.3% gain.

- Stock selection was roughly neutral for the month as strength in Financials and Information Technology balanced weakness in Health Care. Sector allocation was positive, owing to a combination of smaller allocation effects.

- The largest contributors to absolute performance during the month were Microsoft (+61 basis points [bps]), SAP (+32 bps), Visa (+31 bps), AIA (+19 bps) and A J Gallagher (+14) bps.

- The largest absolute detractors were Thermo Fisher (-45bps), Danaher (-24 bps), Revvity (-22 bps), Veralto (-16 bps) and ADP (-15 bps).

## Commentary & Outlook
## (Morgan Stanley Investment Management)

Global equity market weakness continued in October, with the MSCI World Index returning -2.9% in USD. However, further softness in the NZD meant that unhedged global equity index returns were +0.3% which the Sustainable Global Shares Fund outperformed by 15 bps.

The index is still up +7.9% for the year-to-date (YTD) in USD and +9.1% in local currency (+17.3% in NZD). There was not much variation by sector; other than Utilities (+1%), all sectors were negative and within two percentage points of MSCI World. The growth-tilted Information
Technology (-1%) and Communication Services (-2%) sectors were marginally ahead of the index in the month, as they have been for much of this year, while the typically cheaper, more cyclical Materials (-3%), Financials and Industrials (both -4%) sectors were a touch behind.

In terms of the portfolio's key defensive sectors, Consumer Staples (-2%) held up slightly better than the overall index, while Health Care
(-4%) struggled, partly due to weakness in its Life Sciences subsector which was off -14%. The geographical performance pattern was similarly condensed: all major markets were negative and within 250 bps of MSCI World, with Italy (-1% USD and local), Hong Kong (-2% USD and local) and the US (-2%) the only major markets to finish ahead of the index in the month.

## Special Topic: Executive Pay
## (Show me the incentive and I will show you the outcome)

Modern capitalism suffers from the "principal-agent problem", given the differing interests of the owners of assets versus the corporate executives who manage them. The executive pay industry, with its complex packages of bonuses and performance shares, has grown up to try to align the interests of the two parties.

As long-term investors, we want the companies our clients own to have pay plans in place that encourage longer-term thinking over short-term opportunism. Our fear is that the wrong incentives, for instance excessive focus on earnings per share (EPS), can encourage management to take decisions that boost profits in the short run at the expense of their companies' ability to compound over the long run.

We use our proprietary Pay X-Ray scoring framework to evaluate pay schemes, engaging with boards to improve them and voting against them where we are unhappy with the structures. Our attempts to effect change on pay schemes for the benefit of shareholders is helped by our well-resourced team and concentrated long-term holdings in the companies we cover.
Pay is a key instrument in incentivising management to operate in the long-term interests of a company and its shareholders, given the principal-agent problem.

It is therefore critical for boards and management teams to get it right, and for active long-term investors to hold company boards accountable for their actions through a programme of monitoring, engagement and voting. This is why we take our fiduciary responsibilities in this area so seriously.

**Assessing pay with the Pay X-Ray**

We created the Pay X-Ray some years ago as a framework for a comprehensive and rigorous analysis of company schemes. We do use proxy vote data providers as resources for our efforts, but are in no way bound by their recommendations, given our in-depth knowledge of the companies and their management.
The Pay X-Ray splits the detailed scoring of the company schemes into the four buckets shown below.

1. Performance metrics – "what is management paid on?"
There are several measures we like, such as organic growth, margin and free cash flows. The ideal balance between them will depend on the strategic position of the company, for instance as it trades off growth and margin improvement. For consumer companies, we like any profit or margin metrics to be before advertising and promotion costs to remove the incentive to cut advertising to meet short-term profit targets.

Generally, we are particularly keen to see Return on Capital included in the metrics, as it forces management to value capital and penalises low return acquisitions.

We are less enthusiastic about Total Shareholder Return (TSR) as a measure, especially when using a broad index as a comparator, as much is driven by sector rather than company performance. We are not fans of EPS, as that can be boosted by 'accretive' acquisitions, even if they are at low returns on capital, or by levering up the company.

2. Delivery mechanisms – "how is management paid?"
Here we prefer the company to issue shares rather than options, as the asymmetry of options can favour excessive risk taking, particularly once they are 'out of the money'. We also want those rewards to be performance shares (PSUs), which require management to hit targets to get rewarded rather than simple restricted shares (RSUs), or 'Pay for Stay', where management merely have to avoid being fired to benefit.

3. Vesting period – "when is management paid?"
This is a case of 'the longer the better', in our view, as it encourages management to strive for the long-term success of the company rather than simply hitting short-term targets. Even a scheme with good pay metrics can be rendered useless by an insufficiently long vesting period. We also like issuance of the shares to be delayed to after the end of the performance period. This is most notable in the case of departing executives, as we have been burnt by management plumping up the business for the point of their exit, with the bill later due for their successors.

4. Shenanigans – "what tricks are management up to?"

Along with the core metrics above, we worry about what we term 'shenanigans' – the games management can play to get paid out. These include: changing targets ex-post where there are 'adverse circumstances' (you will be surprised to hear that we do not find many cases where targets are toughened when the environment helps a company), targets that are too easy or where the numbers are not disclosed, ex gratia payments to management on top of the stated schemes and massive payments for failure when management is dismissed.

Investment team-led engagement and voting are crucial tools
We look for companies to achieve a positive Pay X-Ray score, but also for signs of improvement. The results feed into our engagements with the companies. As much as 25% of our company engagements year to date (to 30 September 2023) have included conversations on executive pay. As mentioned, we are privileged to gain access to management given our significant assets under management within concentrated portfolios: in our global portfolios, we hold at least 0.5% of the companies' free floats in 70-85% of the holdings in our strategies.

In addition to talking to companies about pay, we vote on it. In the first half (H1) of 2023 we voted on 244 compensation-related proposals for 78 of the companies held across strategies we manage. We voted against 51 of these, or 21% of the time. Furthermore, 47% of the time we voted against management on at least one compensation-related proposal (37 companies).

The most common and often high-profile votes involve approving the compensation of a company's executive officers. These can be on an individual basis or for the whole executive team depending on the company's jurisdiction. With occasional eyebrow-raising sums involved, in our view the quantum of pay needs to be assessed both absolutely and relative to stated targets. There were 79 such proposals at companies held across our strategies in H1 and we voted against 35 of these (44% of the time).

We don't restrict our voting to pay plans. If, having previously voted against a compensation proposal, we wish to underline our point, further escalation may include voting against the election of committee members. During the first six months of 2023, we voted against the election of the chair of the compensation committee at three different companies due to ongoing concerns with their pay plans. For one of these companies, our escalation went a step further: We also voted against the election of two directors who were members of the company's compensation committee.