
# Salt Sustainable Income Fund Fact Sheet – January 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 January 2023

| | |
|---|---|
| Benchmark | Bank deposit rates (BNZBIL Index) |
| Reference portfolio | SAA-weighted component benchmark indices' performance |
| Fund Assets | $44.50 million |
| Inception Date | 19 June 2021 |
| Portfolio Manager | Greg Fleming |
| Current distribution yield (cents per unit) / based on Unit Price of 1 February 2023 | 1.00 cents per unit per Quarter / 4.45% per annum |

## Unit Price at 31 January 2023

| | |
|---|---|
| Application | 0.8971 |
| Redemption | 0.8934 |

## 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 January 2023

| | |
|---|---|
| Global Fixed Interest | 19% |
| Australasian Shares | 33% |
| Global Listed Property | 28% |
| Global Listed Infrastructure | 18% |
| Cash or cash equivalents | 2% |

## Fund Performance to 31 January 2023

| Period | Fund Return | Reference Portfolio Return |
|---|---|---|
| **1 month** | 2.73% | 2.54% |
| **3 months** | 3.75% | 3.53% |
| **6 months** | -1.90% | -1.88% |
| **1 year** | -5.00% | -5.88% |
| **Since inception** | -4.88% | -5.46% |

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 January 2023

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

Holdings stated as at 31.01.2023, excludes cash and consolidated International Fixed Interest Fund component of the Sustainable Income Fund due to its large number of securities.

## Market Commentary

January month saw another reversal in sentiment, this time back into a positive tone after a weak December month. Equity markets around the world rose during the month, led by a 6.3% bounce in the US S&P 500 Index, which recovered its December loss. The more constructive market mood lifted many sectors from their sharp 2022 valuation declines.

- Stock markets had a strong start to 2023. Developed market equities rose 6.0% (in USD) over the month. Bonds also rallied as it became evident that inflation had peaked in the key developed economies, with the Global Aggregate bond index returning +3.2% (USD). This aided share sentiment.
- The surprisingly swift end to China's zero-Covid policy bolstered already positive expectations about growth in China this year. That will benefit not only China but also China's main trading partners given the extent of pent-up demand and high savings rates amongst China's consumers.
- China's GDP was weak in the final quarter of 2022; however more recent partial indicators suggest that may be the bottom of the cycle with a recovery expected to unfold over 2023 on the back of re-opening and likely ongoing policy support.
- Softer annual inflation rates in the US and the Eurozone raised hopes that those central banks might soon end their tightening cycles. However, while some central banks have reduced the pace of rate hikes, there isn't any greater clarity on the level at which interest rates will peak.
- In the US, labour market data was viewed positively by markets in that while employment remained solidly positive, wage inflation also slowed, suggesting a soft landing was indeed possible.
- The cautionary note is that wage inflation remains well in excess of the level consistent with 2% inflation.
- In Europe, the relatively mild winter has led to a decline in energy prices and has seen inflation recede from its peak and has reduced the risk of recession. The average purchase price for natural gas in January was over 50% lower than the average prevailing in H2 2022.
- At the same time, activity data out of the Eurozone has been surprisingly upbeat, indicating a winter recession may be avoided, albeit narrowly. This surprising economic resilience has supported Europe's equity markets at the start of the year.
- Japan's inflation surged to 4% in calendar 2022, its highest level in 31 years. The Bank of Japan loosened its yield curve control policy, widening the band in which 10-year JGBs can trade from +/-25bp to +/-50bp. The Bank then had to intervene with bond purchases through January as markets anticipated a further widening, which did not eventuate.
- Despite recently soft retail sales data in Australia, the Reserve Bank of Australia will likely continue to raise interest rates. Headline inflation came in at 7.8% for the year to December 2022, a 32-year high and ahead of expectations.

## Salt Sustainable Income Fund Commentary

**The Sustainable Income Fund gained in January, reflecting positive returns in both the equity and fixed interest components of the portfolio, moving higher by 2.73% (after fees.) The fund's 3-month return was positive, at 3.75% (net) as at 31 January which was 0.2% ahead of its reference portfolio three-month return. On the rolling six-month basis, the fund is recording a decline of –1.90%, while annually, the fund return outperformed the reference index at -5.00%. Since inception, the fund's return was -4.88% (on an after fees basis) which was 0.6% ahead of index.**

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 moderate rebound in both global share and bond markets since recent market lows in October has assisted Income fund components back to positive 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.

January month saw asset prices in most markets rally, following generally soft returns in December. The long-resilient Global Listed Infrastructure sector recovered and the Listed Infrastructure fund made a positive individual contribution to January month Income Fund returns (+0.47%.)

The Property funds, which provide a strong income yield to the Salt Sustainable Income Fund, experienced positive capital returns in the January month. The Enhanced Property Fund also contributed a +0.47% return for the month while the Global Property Fund contributed a return of +0.26% for January. This addition has been useful to increase the Income Fund's range of sources of yield and thus supports the enhancement of its distribution level to investors.

Bonds are seen as competing assets for infrastructure due to yield and stability with longer-duration underlying exposures. Bond yields have now moved downwards and consolidated, lifting sector returns. In the medium-term, we do not think Infrastructure's distinctive qualities have changed, and expect that as the international economy cools next year the assets' defensive and inflation-hedging qualities will remain at the fore. Our global bond fund exposure contributed 0.37% to the January monthly return.

The Salt Sustainable Income Fund's exposures to New Zealand and Australian equities were again positive While during 2022, domestic assets were not drivers of any portfolio gain, they contributed via their superior dividend income yields. Recently, NZ equities have broadly been more resilient to bouts of international market weakness. The NZ Dividend Appreciation Fund made a positive contribution of 1.14% in the January month, being the strongest component over the month (ahead of Enhanced Property and Global Infrastructure.)

## Salt Sustainable Income Fund outlook

As the largest current individual Sustainable Income Fund component, the NZ Dividend Appreciation Fund's six-month gain has been of substantial benefit to the Sustainable Income Fund return. All the same, now that the Reserve Bank of New Zealand has indicated sustained interest rate rises ahead, we are trimming the weighting to this fund within our Sustainable Income portfolio during February. A neutral portfolio weighting is seen as more appropriate than the existing overweight holding, as better Income interest streams have become available within the Fixed Income universe than has been the case for a considerable period. This is also true, albeit to a lesser extent, for domestic property sector allocations.

With higher yields now prevailing, 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.

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.

The Income Fund remained underweight in the Fixed Interest asset category throughout the 2022 period, which helped protect returns during the most severe bond market weakness seen in decades. However, the size of this underweight is being halved in February 2023 (from -16% to -8% compared to the Reference Portfolio weighting.) As indicated in the December review, the quantum of the additional bond investments closes up the underweighting in this sleeve of the portfolio, while still maintain an underweight bias. Bonds, as a share of the Sustainable Income Fund, are now lifted to 27% of the portfolio, compared to a 35% neutral allocation.

Additionally, the Global bonds exposure is simultaneously being switched into the newly-launched Salt Sustainable Global Fixed Income Opportunities Fund, managed by our investment partner Morgan Stanley Investment Management. This enhances the sustainability credentials of our Diversified Funds significantly, given their weightings to Global bonds.

The Global Fixed Interest fund component within the Income Fund last year provided negative returns, justifying the underweighting that Fixed Interest holds currently with respect to its benchmark weighting. However, Global bonds outperformed their benchmark in the January 2023 month, contributing 0.37% for the month to the Sustainable Income Fund's total return. In absolute terms, Global bonds rose 2.42% in January month, and gained 3.83% for the three-month period. The one-year return from Global Bonds nevertheless remained negative at -8.66%.

However, 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 been commensurately rising through the recent period of market turbulence and remains well in excess of the Income Fund's 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.

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 quarters through continuing positive demand for these specific equity types, along with the sustainable dividend-payers in the broader Australasian market.

Given the absolute level and degree of differentiation amongst global bond yields, the point at which additional Fixed Income exposure will be added to the Salt Sustainable Income Fund has now arrived. Internationally, major central banks are now communicating the desirable course of carrying through several 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.

Greg Fleming, MA