Salt Sustainable Global Shares Fund Fact Sheet – May 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 May 2023

Benchmark	MSCI World (Net) Index in NZD
Fund Assets	$57.00 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 31 May 2023

Application	1.0757
Redemption	1.0713

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 May 2023

Global equities	98.20%
Cash	1.80%

Fund Performance to 31 May 2023

Period	Fund Return*	Benchmark Return
1 month	1.68%	2.02%
3 months	9.99%	7.34%
6 months	8.07%	7.67%
1 year	9.75%	10.85%
Since inception p.a.	3.82%	5.25%
5 year*	13.10%	11.24%

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 May 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). *As of May 31, 2023, the Portfolio's carbon footprint was 85% lower than the MSCI World Index and 88% below AC World.

Top 10 holdings	
Microsoft (US)	Danaher (IS))
Accenture (US)	Reckitt Benckiser (UK)
SAP (DE)	Constellation Software (CA)
VISA (US)	Intercontinental Exchange (US)
Thermo Fisher Scientific (US)	Alphabet (US)

Source: MSIM, data as at 31 May 2023. The Top 10 Holdings represented 470% of the total portfolio.

Market Review

May month saw global stocks down by 1% in USD terms, though they rose in NZD terms. Global markets were constrained by uncertainty over economic growth, still-elevated inflation, central bank policy and US fiscal wrangling. In late May the mood was buoyed by a US debt ceiling debate compromise and expectations for pauses in reduced monetary tightening in the months ahead.

- Worries over the US debt ceiling captured most attention during May, though a deal was reached shortly after the end of the month. Purchasing manager survey data continued to point to further weakness in manufacturing sectors around the world, while services continued to prove more resilient. Labour markets remain tight with unemployment rates at or close to historical lows in the Eurozone, US, UK, Australia. and New Zealand.

- In the US the possibility of a default by the US Government was the key focus. The Fed hiked 25bp as expected, but in a slight but significant change to the wording of the statement, signalled they would likely pause in June. This has proven to be the case, though provisionally. A drop in the unemployment rate and continued strength in core inflation data suggested that a pause might not be the end of the tightening cycle.

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May 2023

- With core inflation still at 5.6% in the Eurozone the ECB tightened again but at the slower pace of 25bp. The central bank said the forceful transmission of past rate hikes into tighter monetary and financing conditions justified the change to a slower pace of hikes. Markets are currently pricing two further 25bp hikes for a terminal deposit rate of 3.75%.

- In the UK, inflation fell from 10.1% to 8.7% in April, but this was significantly higher than market expectations of 8.2%. The BoE voted to hike rates 25bp to 4.5% in a split 7-2 decision. The BoE retained the same forward guidance, highlighting that "if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required".

- After the end of the zero-Covid bounce in activity in China, macro data for April pointed to a renewed slowdown. The latest factory activity reading came in below the benchmark level that separates growth from contraction. Service sector activity, while still positive, expanded at the weakest pace in four months in May. Importantly, the decline in the property market accelerated, prompting speculation of further stimulus for this sector.

- Sector-wise, there was a great deal of variance between sectors. The growth-tilted Information Technology (+8%) and Communication Services (+4%) sectors were both strong in the month, helped by the surge in US AI-led stocks, including Alphabet and Microsoft (both up 14%). By contrast, other than Consumer Discretionary, which was flat, all other sectors were down in the month. Energy (-10%) was particularly weak, while the typically defensive sectors, Consumer Staples (-7%) and Health Care (-4%), also lagged.

- Turning to geographies, Japan led the way (+2% in USD, +5% in local currency), significantly outperforming other Asian markets, as Singapore (-7%, -5%) and Hong Kong (-9%, -9%) both finished near the bottom of the pile. The US. was the only other major market showing a positive return (+1%). Meanwhile, performance in Euroland was weak; Germany, Spain (both -6%, -2%), Italy (-7%, -3%) and France (-7%, -4%) were all behind the index, in USD and local currency. Switzerland (-5%, -2%) and the UK (-7%, -5%) also lagged.

- In Australia a higher-than-expected monthly inflation print raised concern that the Reserve Bank of Australia would need to do more work. While the latest labour market activity data was on the soft side, the inflation pressure from the housing market as well as higher wages is expected to keep core rates of inflation above target for some time.

- It was a busy month in New Zealand with the Government bringing down the 2023 Budget, which was closely followed by the RBNZ's latest Monetary Policy Statement. The Budget was more stimulatory than expected with a significantly higher debt issuance program than the market was expecting.

- The RBNZ hiked 25bp, as was widely expected, but surprised the market by calling time on the rate hiking cycle. We thought the RBNZ had already done enough, but like the RBNZ, we will continue to monitor incoming data closely.

Portfolio Review

- In May, the Portfolio returned +1.68% (after fees), lagging of the MSCI World Net Index which returned +2.02% gross. The Portfolio has outperformed strongly for the three-month period, returning +9.99% after fees versus +7.34% for the benchmark index, gross.) Over the last six months, the portfolio return is 0.40% ahead of its gross benchmark.

- Stock selection was negative in May, largely driven by weakness in Information Technology and, to a lesser extent, Financials. Sector allocation was positive, as the benefit from the Portfolio's overweight to Information Technology and avoidance of Energy and Materials stocks more than offset the drag from the Health Care overweight.

- The largest contributors to absolute performance during the month were Accenture (+76 basis points [bps]), Microsoft (+68bps), Alphabet (+58 bps), TSMC (+56 bps) and Adobe (+28 bps).

- The largest absolute detractors were PayPal (-26 bps), Thermo Fisher (-25 bps), Becton Dickinson (-21 bps), Prudential (-17 bps) and Abbott Laboratories (-17 bps).

Portfolio Commentary & Outlook

It was a strong overall start to the 2023 year for markets, with the MSCI World Index (in NZ Dollar terms) moving up by 14.5% for this year-to-date, as at 31 May. The Portfolio is roughly in line for the year to date (YTD), returning +14.6%. This is despite a wide array of market challenges. Equity markets remain sensitive to the inflation path ahead.

As long-term investors seeking high quality compounders, it's very important that the management teams of companies we own are good allocators of capital. Why is this? Assume a stock trades at approximately a 5% free cash flow yield. Over the next five years, it will generate around 25% of its market cap in free cash flow. From the perspective of a long-term owner, it is absolutely vital that management allocates this free cash flow well, be it in maintaining a prudent balance sheet, paying dividends, making share repurchases or finding sensible acquisitions.

Our investment process favours companies that generate sustainably high, unlevered returns on operating capital employed (ROOCE). For acquisitive companies, we believe it is also important to assess the returns on capital deployed for acquisitions, to establish whether the company is creating or destroying shareholder value. To that end, we measure the returns on "all in" capital invested (ROCE), i.e., returns including all intangibles related to M&A. Capital allocation is very important for long-term investors. M&A is one particular choice for capital allocation. It is typically a high-risk option. However, our thorough research and experience in quality investing has enabled us to establish that a high quality, acquisitive company is not an oxymoron. There are companies out there – and we own some of them – with a track record of relatively low-risk acquisition, adding meaningfully to shareholder returns, and a strategy in place that suggests it is a repeatable process.

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Greg Fleming, MA