
# Salt Sustainable Income Fund Fact Sheet – July 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 Environmental, Social and Governance features & reliable income generation. The Fund's strategy is to invest in a quality asset mix to provide regular, sustainable income and a positive return on capital. 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 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 July 2023

| | |
|---|---|
| **Benchmark** | Bank deposit rates (BNZBIL Index) |
| **Reference portfolio** | SAA-weighted component benchmark indices' performance |
| **Fund Assets** | $45.03 million |
| **Inception Date** | 19 June 2021 |
| **Portfolio Manager** | Greg Fleming |
| **Prospective distribution yield (cents per unit) / based on Unit Price of 1.8.23** | 1.125 cents per unit per Quarter / 5.07% per annum |

## Unit Price at 31 July 2023

| | |
|---|---|
| **Application** | 0.8930 |
| **Redemption** | 0.8893 |

## Sustainability Metrics

| Fund ESG Scores | Portfolio | Category avge |
|---|---|---|
| Morningstar ESG score | 20.32 | 22.00 |

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 31.07.23. Sustainalytics provides issuer-level ESG Risk analysis used in the calculation of Morningstar's Sustainability Score. Sustainable Investment Mandate information is derived from the fund prospectus.

## 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"

## Fund Allocation at 31 July 2023

| | |
|---|---|
| **Global Fixed Interest** | 28.0% |
| **Australasian Shares** | 28.5% |
| **Global Listed Property** | 23.5% |
| **Global Listed Infrastructure** | 17.5% |
| **Cash or cash equivalents** | 2.5% |
| **Asset allocation to Fixed Interest + Cash** | **30.5%** |

## Fund Performance to 31 July 2023

| Period | Fund Return (after fees) | Gross Reference Portfolio Return |
|---|---|---|
| **1 month** | 1.68% | 1.05% |
| **3 months** | 1.51% | 0.05% |
| **6 months** | 1.82% | -0.02% |
| **Year to date** | 4.60% | 3.54% |
| **1 year** | -0.12% | -1.29% |
| **Since inception p.a.** | -1.46% | -1.48% |

Performance is after all fees and does not include imputation credits or PIE tax. Reference Portfolio return is gross.

## Top Individual Holdings at 31 July 2023

| | |
|---|---|
| Goodman Property Trust | Argosy Property Trust |
| Fisher & Paykel Healthcare | Infratil |
| Precinct Properties NZ | US 5Yr Note (CBT) Sep 23 |
| Kiwi Property Trust | Auckland International Airport |
| Spark NZ | Property for Industry |

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## Market Commentary

July saw global equities again strengthen sharply, though they rose by less in NZD terms due to a gain in the Kiwi dollar. The mood was buoyed by better growth and inflation signals and by expectations for reduced monetary tightening. Earnings have also surprised positively.

- Market sentiment remained positive in July as developed market headline inflation rates continued to retreat and activity data continued to prove resilient. This continues to support the contention that inflation can be tamed without harming activity.
- Global stocks performed well over the month. Developed market equities delivered a 3.4% return (in USD). Fixed income also recorded positive returns over the month.
- Data in the US supported hopes for a soft landing. The June CPI came in below expectations at 3.0% y/y, though core inflation remains sticky at 4.8% y/y. GDP growth surprised to the upside at 2.4% (q/q annualised), though the weakest part of the cycle is still yet to come. The Federal Reserve raised its key policy rate by 25bp to 5.25-5.50% during the month, with markets signalling this as the likely peak in rates.
- The European Central Bank likewise raised their key deposit rate 25bp, taking it to 3.75%. The messaging was dovish however, probably reflecting lower eurozone inflation and weakening activity data.
- Wage growth remains elevated in the UK with average earnings (ex-bonuses) rising 7.3% y/y. However, inflation came in lower than expected, driving a rally in Gilts. This is the first downside inflation surprise in a year. Markets have brought the expected peak policy rate down from 6.0% to 5.75%.
- Japanese inflation remained strong in June, with the Bank of Japan's preferred measure (CPI excluding fresh food and energy) rising to 4.2% y/y. Later in the month the BoJ further tweaked its Yield Curve Control policy by shifting from a rigid 0.5% upper limit on 10-year government bonds to a "reference point" of 1%.
- In China, June GDP data softened as expected, but the MSCI China Index is now back to a positive return year-to-date. This reflects some policy easing and likely further stimulus to come.
- In Australia there is an ongoing battle between inflation that is slowing, but still too high, and the still tight labour market. The June quarter CPI came in below expectations at 6.0% y/y for the headline rate and 5.9% y/y for core (trimmed mean). The lower inflation data and softer activity growth saw the Reserve Bank of Australia pause on rate hikes at its July meeting, with markets at this stage still pricing in one more 25bp hike.
- New Zealand headline inflation came in at 6.0% y/y in the June quarter, down from 6.7% y/y in March. However, the more problematic non-tradeable measure came in at 6.6% y/y. The economy has already seen a technical recession, with the weakest point in the cycle yet to come. We think the RBNZ has tightened enough, and Q2 labour market data in early August supported that view.

## Salt Sustainable Income Fund Commentary

**The Sustainable Income Fund experienced a positive return of 1.68% (after fees) in July month and a 1.51% net return over the rolling 3-month period, reflecting stronger returns in both the equity and fixed interest components of the portfolio. For the year to date, the fund gained 4.60% (after fees) which was 1.06% ahead of its gross reference portfolio return.**

Despite a range of headwinds for markets, 2023 has so far proved a much better investing environment than 2022. As inflation progressively shows signs of a definitive peak, we expect component asset classes to improve, as indeed occurred in the first part of 2023, with periodic interruptions. Volatility across markets is ever-present and sentiment remains fragile.

July month saw better returns from listed real assets. The top contributor for the second month running was the Salt Enhanced Property Fund with +0.82%. The next-strongest contributor in July was the Salt NZ Dividend Appreciation fund, which added +0.34%. The Global Listed Infrastructure fund made a positive individual contribution of +0.17% while the Sustainable Global Property fund added 0.09%. On the bond side, the Sustainable Global Fixed Income Opportunities fund contributed 0.23%.

## Salt Sustainable Income Fund outlook

We believe bond yields have now adjusted upwards enough, to have lowered our previous underweight bond positions within the Sustainable Income Fund. The allocation to bonds is now 28% vs a 35% SAA. Our next step will be to increase this even closer toward a Neutral allocation.

The Reserve Bank of New Zealand has paused in lifting the Official Cash Rate though core inflation is persisting, so domestic yields and discount rates are likely to stay quite elevated. This is supressing returns from NZ equities this year, and the relative weakness of NZ shares compared to global equities is now notable. July saw a reprieve, with a 1.2% from the domestic market.

The Fund's income level has been enhanced. We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to boost performance, as inflation conditions stabilize. However, there could be a mild recessionary period to traverse en route to that outcome. The phase of actual interest rate reductions from central banks is still some time into the future and we expect a major beneficial capital growth impact of such will only become apparent only from late in 2023, or even early in 2024.

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.

## Distribution increased to 1.125 cents per unit / quarter

Higher component asset yields enabled us to again lift the quarterly cents-per-unit distribution from the fund, to 1.125 cpu from the current quarterly distribution date (paid in August) onwards. This will be updated again in November, dependent on the outlook for fund income at that time.

As noted earlier, 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 which may endure for years, rather than months, ahead.

Internationally, major central banks are now communicating the last phase of interest rate increases, sufficient to anchor inflation expectations, and this does unnerve markets at times. Recently, the balance of evidence has been on the better side internationally, particularly suggesting that the US Federal Reserve is on track to engineer an economic “soft landing.”

While the data-driven market volatility requires fortitude from investors, the objective of securing an inflation-resilient income level 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.

It is crucial to note that the Income level from equity dividends and bond coupons received into the fund has indeed been commensurately rising through the recent periods of market turbulence. This trend exemplifies the incremental return of some “risk premia” into asset classes, though this has further to go. The fund’s income is still modestly above its prospective distribution yield. We regard this as prudent in an uncertain environment.

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 well-suited to an inflation-affected period, once central bank policy rates begin to fall or there is a downward shift at the short end of the yield curve. If global central banks increasingly pause their interest rate tightening cycles, defensive merit should be re-asserted in coming months through continuing positive demand for these specific “Real Asset” equity types, along with the sustainable dividend-payers in the broader Australasian market.

Greg Fleming, MA