Salt Sustainable Income 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 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 May 2023

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$43.75 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Prospective distribution yield (cents per unit) / based on Unit Price of 1.6.23	1.125 cents per unit per Quarter / 5.19% per annum

Unit Price at 31 May 2023

Application	0.8657
Redemption	0.8621

Sustainability Metrics

Fund ESG Scores	Portfolio	Category avge
Morningstar ESG score	20.54	21.00

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 30.04.23. 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 May 2023

Global Fixed Interest	27%
Australasian Shares	30%
Global Listed Property	23%
Global Listed Infrastructure	18%
Cash or cash equivalents	2%
Asset allocation to Fixed Interest + Cash	**29%**

Fund Performance to 31 May 2023

Period	Fund Return (after fees)	Gross Reference Portfolio Return
1 month	-1.59%	-2.00%
3 months	-0.53%	-0.19%
6 months	0.08%	-0.15%
1 year	-2.07%	-2.57%
Since inception p.a.	-4.02%	-2.59%

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

Top Individual Holdings at 31 May 2023

Goodman Property Trust	US 5Yr Note (CBT) Sep 23
Fisher & Paykel Healthcare	Argosy Property Trust
Kiwi Property Group	Auckland International Airport
Spark NZ	Property for Industry
Precinct Properties NZ	US 10Yr Note Sep 23

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Market Commentary

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.

- 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. A drop in the unemployment rate to 3.4% in April and strength in core inflation data suggested that a pause might not be the end of the tightening cycle.
- 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.
- 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.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund experienced a negative return in May month and a flat return over the rolling 3-month period, reflecting softer returns in both the equity and fixed interest components of the portfolio. For the month, the fund declined -1.59% (after fees.)

The fund's 3-month return moved slightly negative, at -0.53% (net) as at 31 May. On the rolling six-month basis, the fund is recording +0.08% (after fees), which was 0.23% ahead of its reference portfolio gross six-month return. Annually, the fund return is lower by -2.07% (after fees) and thus outperformed its reference portfolio for the year by 0.5%.

Despite a range of headwinds for markets, 2023 has so far proved a much better investing environment than 2022. The consolidation in both global and domestic share and bond markets in May, however, lowered the short-term returns back to a flet year-to-date result. As inflation shows signs of a definitive peak, we expect component asset classes to improve, as has occurred earlier in 2023. However, volatility across markets is ever-present and sentiment remains fragile.

Higher interest rates around the world in May saw asset prices in most markets again display vulnerability to yield levels. The previously-resilient Global Listed Infrastructure fund was negatively affected last month and made a negative individual contribution of -0.88%– the largest individual "down" returns component last month. The second-weakest contributor in May was the Salt NZ Dividend Appreciation fund, which subtracted -0.50%. The Sustainable Global Property fund detracted -0.10%, and the Enhanced Property fund detracted by -0.06%. On the bond side, the Sustainable Global Fixed Income Opportunities fund subtracted -0.05%.

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 27% vs a 35% SAA. Our next step will be to increase this closer toward a Neutral allocation.

The Reserve Bank of New Zealand continued to lift the Official Cash Rate and inflation is persisting, so domestic yields and discount rates are likely to stay elevated. This is supressing returns from NZ equities this year, and the relative weakness of NZ shares compared to global equities is now notable.

With higher yields now prevailing, nevertheless, 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 inflation conditions stabilize. However, there could well be a 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 from the last part of 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 to be increased to 1.125 cents per unit / quarter

Higher component asset yields have enabled us to again lift the quarterly cents-per-unit distribution from the fund, to 1.125 cpu from the next 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. 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.

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.

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 better-suited to an economically uncertain and 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, as expected, 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.

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Greg Fleming, MA