SALT

Funds Management

Salt NZ Dividend Appreciation Fund Fact Sheet – August 2018

Manager Profile

Salt Funds Management is a boutique investment management firm wholly owned by its employees which specialises in managing NZ/Australian equity and listed property mandates for wholesale and retail clients.

Investment Strategy

The Salt NZ Dividend Appreciation Fund targets a portfolio of shares of New Zealand companies that may, in our opinion, pay high and sustainable dividends. A considerable body of robust research suggests that stocks with strong and sustained dividend policies tend to generate higher free cash flow than average and outperform their index benchmarks over time. The strategy is not intended to naively generate the highest possible yield but rather to generate a high and sustainable dividend yield.

Benchmark

S&P/NZX 50 Gross Index

Fund Assets at 31 August 2018

$73.0 million

Strategy Assets at 31 August 2018

$154.3 million

Includes all Funds and separately managed accounts that employ the same investment strategy as the Salt NZ Dividend Appreciation Fund.

Inception Date

30 June 2015

Portfolio Manager

Matthew Goodson, CFA

Unit Price at 31 August 2018

Application	1.4496
Redemption	1.4437

Investment Guidelines

The guidelines for the NZ Dividend Appreciation Fund are shown below:

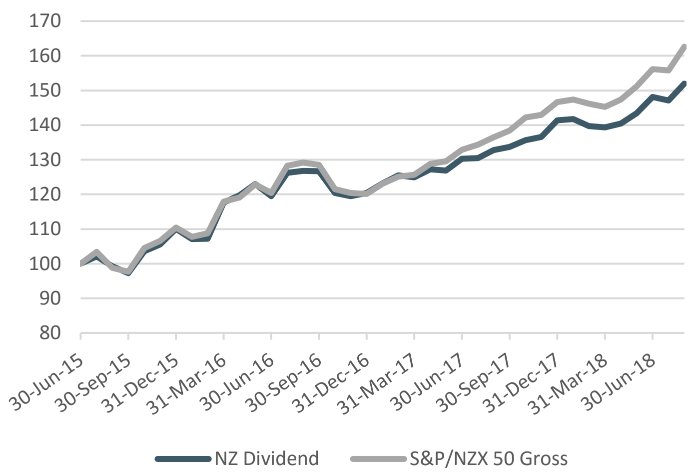
NZ shares	95% – 100%
Cash	0% – 5%
Unlisted securities	0% – 5%
Maximum active position	8%

Fund Performance to 31 August 2018

Period	Fund Return	Benchmark Return
1 month	3.31%	4.38%
3 months	5.98%	7.56%
6 months	8.77%	11.22%
1 year	14.48%	19.14%
2 year p.a.	9.50%	12.19%
3 year p.a.	15.26%	18.08%
Inception p.a.	14.13%	16.60%

Performance is after all fees and does not include imputation credits or PIE tax.

Cumulative Fund Performance to 31 August 2018



Fund performance has been rebased to 100 from inception.
Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

Fund Allocation at 31 August 2018

NZ shares	97.31%
Cash	2.69%

Top Overweights	Top Underweights
Investore Property	Ryman Healthcare
Turners Automotive Group	Fisher & Paykel Healthcare
Scales Corporation	Infratil
Tower	Mainfreight
Metlifecare	EBOS Group

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Monthly Equity Market Commentary

Summary

- The Fund lagged its benchmark in August, returning +3.31% compared to +4.38% by the S&P/NZX 50 Gross Index.
- In NZ, the S&P/NZX 50 Gross Index had a strong month which was led by the high multiple large cap stocks such as a2 Milk & Ryman Healthcare.
- Tailwinds were headed by our underweights in Sky TV, Tourism Holdings & Push Pay.

Global markets were a mixed bag in August with the MSCI World Accumulation Index +1.2% as a strong US market offset a weak Eurozone and extremely weak emerging markets.

US markets struggled in the first half of August as President Trump threatened to lift the tariff on $200bn worth of Chinese exports from 10% to 25% and a significant risk-off move related to a crumbling Turkish currency. Market sentiment improved as news of progress on NAFTA circulated towards the end of the month. The S&P 500 ended the month +3.0% higher, however it was another display of strong performance from the technology stocks that drove the Nasdaq up +5.7% in August to be +17.5% for the year to date.

Trump put tariffs on Turkish steel and aluminium exports sending the Lira down -25% and creating contagion risks given many Turkish companies have foreign currency loans with Eurozone banks. This weakness in banks led European bourses lower over the month with Germany's DAX down -3.4% and France's CAC -1.9%. The UK's FTSE 100 ended down -4.1% as the BoE lifted rates from 0.5% to 0.75% and views oscillated regarding the likelihood of a hard exit from the EU.

In addition to more tariffs, Chinese economic data continued to soften with industrial production and credit growth pointing to a slower GDP growth run rate, leading the Shanghai Composite down by -5.3% and the Hong Kong Hang Seng -2.4% lower.

The Australian S&P/ASX 200 Accumulation Index returned +1.4%, which masked the increased volatility and broad price to earnings multiple expansion seen over reporting season. The best performing sectors were Telecommunications (+13%) as talk of a TPG (+50%) and Vodafone Hutchinson merger would lead to a more rational mobile market, and IT (+12%) as PE multiples expanded on ultra-high PE stocks such as Appen, After Pay, Altium and Wisetech. The worst performing sector was Materials (-4.9%) due to weaker commodities prices.

In NZ, the S&P/NZX 50 Gross Index had a strong month rising +4.4% despite negative consensus revisions for FY19 of around 2% according to UBS analysis. The result was a large expansion in the PE multiple for the market which according to our analysis is only fractionally due to bond yields falling. The market was led by the high multiple large cap stocks such as a2 Milk (ATM, +20.6%) on an in-line result and Ryman (RYM, +15.8%) on no new news apart from signs competitors are seeing inventory building up and senior management selling stock. The key detractors were Sky TV (SKT, -20.7%) after a disappointing subscriber number and Fletcher Building (FBU, -9.5%) after a slightly weaker than expected result.

Monthly Fund Commentary

The Fund lagged its benchmark in August, returning +3.31% after all fees and expenses compared to +4.38% by the S&P/NZX 50 Gross Index.

It was something of a perfect storm for an income and value focused strategy during the month, with a small group of extremely expensive large cap companies accounting for the great bulk of the benchmark's performance. If one strips out the +6.8% return from the S&P/NZX 10 Index, the residual of the S&P/NZX 50 Index saw a return of only +1.2%. NZ's one year forward PE rose from 24.7x to an extraordinary 26.6x (using FNZC data) due to a combination of the market advance and earnings downgrades for 2019. Analysis by JP Morgan in the Australian context showed how the top quintile of stocks with the most expensive PE multiples experienced a PE multiple expansion of 4.2 PE points despite EPS downgrades of 3.9%. Contrastingly, the bottom two quintiles of the cheapest 40% of stocks saw little valuation movement.

Contributors

Tailwinds were headed by our underweight in Sky TV (SKT, -20.7%) whose result showed strong cost control but disappointing subscriber numbers, with the worst of the storm from Netflix and sports rights competition still lying ahead. Having no stakes in Tourism Holdings (THL, -8.2%) and Push Pay (PPH, -7.0%) also assisted. The overweight in Methven (MVN, +8.8%) benefitted from a solid result and this rose further following month-end when the large shareholder, Brendan Lindsay upped his stake. Scales (SCL, +3.4%) delivered a solid interim result and it is benefitting from the weakening NZ$. We await details of how they will reinvest the proceeds from selling their cool-store business at a very attractive price. This could potentially be highly accretive.

The portfolio made few positional changes of any note in the month. Pullbacks were used to close off much of the underweights in Freightways and Summerset, although we remain heavily underweight the retirement sector, which we view as vulnerable to the end of the housing boom. We initiated a very small new position in Steel & Tube as part of its recapitalisation and we lowered Sky City into strength.

Detractors

Almost all of the Fund's lag came from its underweight in the very low yielding Ryman Healthcare (RYM, +15.8%), which caught a powerful bid in line with many other high multiple stocks. Directors and management sold shares and the actual fundamental news in recent weeks has been mediocre. The NZ housing market (and Auckland in particular) remains in the doldrums, with numerous negative measures yet to hit. Melbourne house prices are outright falling according to Corelogic data and Ryman's AGM in late July talked to cost pressures from nurse wage increases. Competitor results from Summerset and Metlifecare were solid enough but showed signs of inventory levels beginning to build, which dovetails with marketing incentives and promotions being particularly aggressive at present.

Other headwinds came from underweights in Fisher & Paykel Healthcare (FPH, +10.7%), Synlait Milk (SML, +17.7%) and Trade Me (TME, +10.7%). The overweight in Turners (TRA, -5.7%) also hurt.

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