SALT

Salt Sustainable Global Shares Fund Fact Sheet – September 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 30 September 2023

Benchmark	MSCI World (Net) Index in NZD
Fund Assets	$57.56 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 30 September 2023

Application	1.0832
Redemption	1.0788

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 30 September 2023

Global equities	98.06%
Cash	1.94%

Fund Performance to 30 September 2023

Period	Fund Return*	Benchmark Return
1 month	-6.03%	-5.17%
3 months	-2.20%	-1.56%
6 months	6.71%	7.39%
1 year	14.00%	14.80%
2 year p.a.	5.17%	6.07%
Since inception p.a.	4.90%	5.45%
5 year*	10.29%	9.39%

Performance is before fees and tax, and adjusted for imputation credits. Benchmark performance is gross. Past performance is not a guarantee of future results. Data as of 30 September 2023. *5 year strategy performance is gross of fees.

Fund ESG Scores	Portfolio	Index
Sustainable Global Shares	26T CO_2 /$m	162T CO_2 /$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). *At September 30, 2023, the Portfolio's carbon footprint was 85% lower than the MSCI World Index and 86% below AC World.

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

Source: MSIM, data as at 30 September 2023. The Top 10 Holdings represented 45.6% of the total portfolio.

Market Review

- The September quarter of 2023 was somewhat reminiscent of the 2022 year as global equities suffered a reality check in the face higher bond yields. Developed market equities fell -3.4% (in USD) over the quarter, though were still up a healthy 11.6% year-to-date. The global aggregate bond benchmark had a similarly tough quarter, falling -3.6% (in USD).
- While the outcome was much like 2022, the reasons behind the moves were different. 2022 was all about the sharp trend higher in interest rates, while the quarter just gone was about the realisation that interest rates would remain higher for longer as central banks sought to tame stubbornly high inflation.
- Fiscal sustainability has been another focus for bond markets, particularly in the United States, where concerns are rising about the amount of issuance that will be required to sustain the large fiscal deficit.
- Oil prices surged higher over the quarter, rising 28%. Higher oil prices present another headwind to consumer demand and will be problematic for central banks as headline inflation reaccelerates.

- In the United States, key activity data including retail sales and industrial production all expanded. Third quarter GDP growth is tracking at a healthy 1.2% (q/q annualised). Headline inflation rose again on the back of higher oil prices, but core declined to an annual 4.3%. The Fed left interest rates unchanged in September, though projections showed one more hike and a tighter stance through next year. A government shutdown was avoided, but only provided funding through to November.

- Business surveys remained subdued across Europe in September. Composite PMIs were still in contraction territory with the euro area index at 47.1 and the UK index at 46.8. On a more positive note, inflation fell more sharply than expected in both the euro area and the UK. The ECB raised its deposit rate by 25bps to 4% but the Bank of England, in a surprise move, left rates unchanged at 5.25%.

- China economic data improved in August with a reacceleration in both retail sales and industrial production and, after a brief flirtation with deflation, the annual rate of CPI inflation rose to 0.1%. Real estate distress remained a key focus, but the authorities have been eager to signal support by easing banks' Reserve Requirement Ratio.

- In Japan, the BoJ kept its policy stance unchanged, maintaining its widened Yield Curve Control. The Statement was at the dovish end of expectations, though in the press conference, Governor Ueda didn't take the opportunity to push back on speculation of further monetary policy normalisation in the months ahead.

- In Australia, both activity and inflation data came in stronger than expected though the RBA, in its first meeting under new Governor Michele Bullock, left rates unchanged for a third consecutive meeting. We see a high chance of a further hike at the November meeting when fresh economic projections will be available.

- In New Zealand GDP growth came in much stronger than expected for the June quarter, though the annual rate of expansion continues to fall. We see annual growth at close to zero when the September quarter data is released- in December. As expected, the RBNZ left interest rates unchanged at the August Monetary Policy Statement but emphasised the higher for longer message.

Portfolio Review

- In September month, the Portfolio returned -6.03% (on a gross of fees basis,) behind the MSCI World Net Index which returned -5.17%. The Portfolio underperformed for the third quarter (Q3), returning -2.20% versus -1.56% for the index, and trails the index for the 2023 year to date (YTD), having returned +16.02% versus +16.94%.

- The September month's underperformance was largely due to stock selection, where outperformance in Information Technology was insufficient to compensate for Health Care and Financials weakness. Sector allocation was also slightly negative, due to the avoidance of Energy in the portfolio and the overweight to Information Technology.

- For Q3 overall, the Portfolio's underperformance was due to both stock selection and sector allocation. In terms of stock selection, outperformance in Information Technology and Communication Services was offset by weakness in Financials and Health Care.

- Within sector allocation, the lack of Energy holdings was the major hit to performance, while the overweight to Information Technology and the underweight to Communication Services also impacted negatively, though the underweight in Consumer Discretionary helped a little.

- The largest contributors to absolute performance during the month were Relx (+5 basis points [bps]), Atlas Copco (+2 bps), Constellation Software (+1 bp), Universal Music Group (+1 bp) and FactSet.

- The largest absolute detractors in September month were Thermo Fisher Scientific (-49 bps), VISA (-41 bps), IQVIA (-41 bps), SAP (-40 bps) and Accenture (-38 bps).

- For the September Quarter, the largest positive contributors were Alphabet (+29 bps), ADP (+23 bps), Danaher (+21 bps), CDW (+18 bps) and Broadridge Financial (+13 bps) while the main negative quarterly impacts came from Equifax (-40 bps), IQVIA (-35 bps), Microsoft (-32 bps), TSMC (-31 bps) and Abbot Labs (-26 bps.)

Commentary & Outlook
(Morgan Stanley Investment Management)

A weak September followed the weak August for global equity markets, with the MSCI World Index returning -4.3% in U.S. dollars (USD) and declining by -3.7% in local currency (-5.2% in NZD) in the month. Other than Energy (+3%), all sectors were negative and within 250 bps of MSCI World. There was also little variation by geography, with Singapore (-0% USD, +1% local), the UK (-1%, +3%) and Japan (-2%, -0%) holding up slightly better than MSCI World, while the US (-5%) was marginally behind.

After a euphoric first half of the year, global equity markets were distinctly weaker in Q3, returning -3.5% in USD and -2.6% in local currency (-1.6% in NZD). The index is now up +11% YTD in USD and +12% in local currency (+17% in NZD). As in the September month, Energy (+11%) was the top performer for the third quarter, outperforming the wider index by almost 15 percentage points, while Communication Services (+2%) was the only other sector to finish in the black.

Disclaimer: The information in this publication has been prepared from sources believed to be reliable and accurate at the time of preparation but Salt Funds Management Limited, its officers, directors, agents, and employees make no representation or warranty as to the accuracy, completeness, or currency of any of the information contained within, and disclaim any liability for loss which may be incurred by any person relying on this publication. All analysis, opinions and views reflect a judgment at the date of publication and are subject to change without notice. This publication is provided for general information purposes only. The information in this publication should not be regarded as personalised advice and does not take into account an individual investor's financial situation or goals. An individual investor should, before making any investment decisions, seek professional advice. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

The interest rate sensitive Utilities (-9%) and Real Estate (-7%) sectors were the laggards. In a reversal from Q2, the growth-tilted Information Technology and Consumer Discretionary sectors (both -6%) lagged, although they remain substantially ahead of MSCI World YTD (+30% and +21% respectively).

Meanwhile, the Portfolio's key defensive sectors, Health Care (-3%) and Consumer Staples (-6%), straddled the index in Q3, and are significantly behind on a YTD basis (-2% and -3% respectively). Turning to geographies, the UK (-2% USD, +3% local), Japan (-2%, +2%) and Italy (-2%, +1%) held up relatively well, managing positive returns in local currency, while Singapore (0% USD and local) was flat. All other major markets were negative and within 300 bps of MSCI World. The US (-3%) return was close to the overall index result in Q3 2023.

The market has gone into reverse, dropping 7% over the last two months after the powerful recovery since September 2022. As on the way up, the decline has been driven by multiple rather than earnings, which have remained roughly flat. The fall has come despite improving macro forecasts in the US, if not in Europe and China, though bears point to early warning signs, such as US trucking employment and pending house sales. The catalyst for the market's fall seems to have been the relentless rise in yields, with the US 10 Year approaching 4.6% at the end of September, up 73 bps in the quarter and 46 bps in a month, even as the Fed raising cycle comes to an end.

There is plenty of speculation about the reason for this sharp rise in yields, be it higher rates for longer or better growth prospects, but it seems probable that it is simply about supply and demand. There is no shortage of supply of Treasuries, with the US running a deficit of near 8% of GDP despite sub-4% unemployment and $7.6 trillion of the existing stock due to mature in the next year, while there are real question marks about the demand appetite of two of the main historical buyers, China and the Fed.

These higher yields put two question marks over the equity market. The first is whether the massively indebted system can deal with far more expensive credit without something breaking, as was the case with UK liability-driven investment (LDI) strategies a year ago and Silicon Valley Bank in the spring. The second is the impact that the yields have on the relative valuation and attractiveness of the equity market versus bonds, as the gap between the market's earnings yield and the risk-free rate has fallen to the lowest level in 20 years, a gap even lower than it was two months ago despite the fall in the equity market.

Even ignoring the fixed income alternative, MSCI World's current 16.0x forward multiple does not look cheap, particularly as it is based on an arguably optimistic 10% earnings growth assumption for 2024, in what is likely to be a slowing economy, even if the authorities do manage to pull off a soft landing. It is difficult to argue that the market is embedding any significant chance of a downturn in either its multiples or earnings. Our thesis, as ever, is that pricing power and recurring revenue, two of the key criteria for inclusion in our portfolios, will once again show their worth if there is indeed a downturn, and the market would once again come to favour companies which have resilient earnings in a tough economy, making Quality a relatively safe haven in these uncertain times.

Portfolio Activity

We initiated a position in Universal Music Group (UMG) in Q3. UMG is the largest of the three major record labels, and benefits from significant barriers to entry given its scale and hard-to-replicate 'must have' content. It has successfully transitioned to digital, with 60% of revenues from digital service providers (DSPs), such as Spotify and Apple Music. The wave of price rises across the DSPs over the last year, along with the significant under-monetisation of music relative to video and print, gives us confidence in the pricing regime going forward.

We also reinitiated a position in FactSet, having exited on valuation grounds at the start of 2022, after the forward PE ratio spiked into the high 30s. The current multiple in the mid-20s looks more reasonable. The company continues to perform, growing subscriptions at around 7%, and gaining some share over time, mainly at the expense of Refinitiv (its competitor, which we do not own). FactSet is part aggregator and part content provider, making its product very tough to replicate. Its data is difficult to collect and clean and has been built over a long period of time, for instance with company fundamentals.

The additions and reductions in the Portfolio have been driven, as is often the case, by valuation, aside from continuing to build the position in Revvity initiated in Q2. We added to Coca-Cola given its derating, with the stock down YTD despite a steady earnings performance, and similarly boosted the AIA position as the multiple was hurt by negative sentiment on China.

On the other side, the biggest reduction was in Adobe, which has risen over 50% this year on AI excitement, while the large position in SAP was also trimmed given its very strong performance this year as the cloud transition shows signs of bearing fruit. We also added to Thermo Fisher and reduced Danaher within Life Sciences, as Danaher was trading on an usually high premium to Thermo Fisher, and reduced the position in Broadridge after it rallied by a quarter over the last six months.

Disclaimer: The information in this publication has been prepared from sources believed to be reliable and accurate at the time of preparation but Salt Funds Management Limited, its officers, directors, agents, and employees make no representation or warranty as to the accuracy, completeness, or currency of any of the information contained within, and disclaim any liability for loss which may be incurred by any person relying on this publication. All analysis, opinions and views reflect a judgment at the date of publication and are subject to change without notice. This publication is provided for general information purposes only. The information in this publication should not be regarded as personalised advice and does not take into account an individual investor's financial situation or goals. An individual investor should, before making any investment decisions, seek professional advice. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.