SALT

Salt Sustainable Global Shares Fund Fact Sheet – September 2021

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 2021

Benchmark	MSCI World (Net) Index in NZD
Fund Assets	$32.47 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 30 September 2021

Application	1.0047
Redemption	1.0006

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 2021

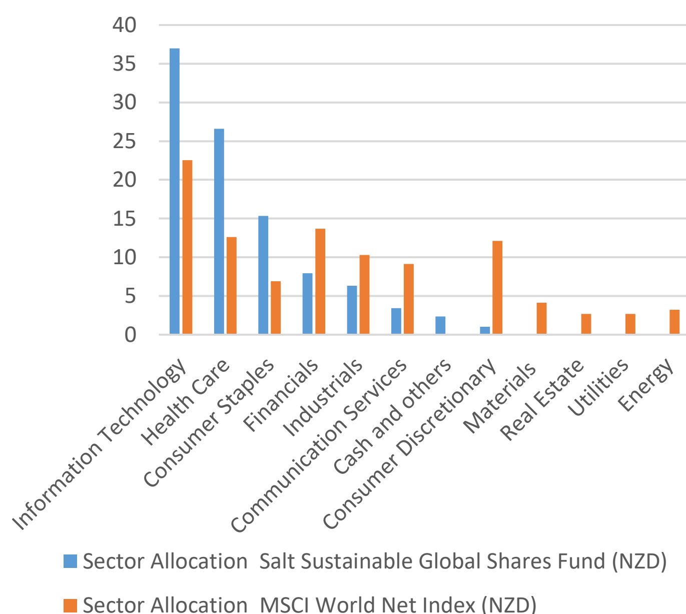
Global equities	97.65%
Cash	2.35%

Fund Performance to 30 September 2021

Period	Fund Return*	Benchmark Return
1 month	-1.65%	-2.21%
Year to Date	0.13%	0.01%
Since inception	0.13%	0.01%

Performance does not include imputation credits or PIE tax. Past performance is not a guarantee of future results. Data as of 30 September 2021

Sector Allocation (%) as at 30 September 2021



Top 10 holdings	
Microsoft (US)	Baxter International (US)
VISA (US)	Becton Dickinson (US)
SAP (DE)	Danaher (US)
Reckitt Benckiser (UK)	Thermo Fisher Scientific (US)
Accenture (US)	Abbot Labs (US)

Market Review

Global equity markets were weaker in the September month, with major country indices declining by 3-5% in quarter's final month, having gained a similar quantum in July and August. This led to a flat quarterly performance from the MSCI World Index (in USD.) Rising supply disruptions continued to prove problematic and inflation pressures rose. As the quarter progressed, concerns emerged about the near-term economic outlook, as it appeared many economies were past the peak of Covid-reopening growth benefits. The MSCI World Index fell during September, returning -4.2% in U.S. dollars (USD) (-3.7% in local currency and -2.2% in NZD). Japan was the clear outlier, up 3% in USD

and 4% in yen, while Singapore (0% USD, +1% local) also held up relatively well. The other major markets were all down at least 2%, with Switzerland (-8%, -6%), Hong Kong (-6%, -6%) and Germany (-6%, -4%) the weakest. The US (-5%) was slightly behind the overall MSCI World Index. Looking at sectors, there was a very clear split in the commodity world, with Energy (+9%) the only sector in positive territory, while Materials (-7%) was the poorest performing sector. Defensive sectors did not outperform despite the market fall. Utilities (-7%) and Health Care (-5%) lagged, while Consumer Staples (-4%) was in line with the index. By contrast the more cyclical Financials (-1%) and Consumer Discretionary (-2%) sectors were ahead of the market.

The MSCI World Index was flat over Q3 as a whole, returning +0.6% in local currency (and 1.3% in NZD). Japan was the only major market to manage a strong return, up 5% in both USD and yen. The US was in line with the overall index, while the other major markets were in negative territory, notably Hong Kong (-9% USD) which reflected uncertainty arising from Chinese policy shifts and the Evergrande saga.

Looking at sectors quarterly performance, there was a very clear split in the commodity world, with Energy (+9%) the only sector in positive territory, while Materials (-7%) was the poorest performing sector. Defensive sectors did not outperform despite the market fall. This was probably due to the nature of the consolidation being fairly transitory and due to specific near-term risks (US policy wrangling in the Senate and Presidency, China and inflation nervousness.) The Utilities (-7%) and Health Care (-5%) lagged, while Consumer Staples (-4%) was in line with the index. By contrast the more cyclical Financials (-1%) and Consumer Discretionary (-2%) sectors were ahead of the market.

Market Outlook

The market remains at a high multiple. Despite September's mild pull-back, the MSCI World Index is still trading on 18.7x next 12 months' earnings, a 26% premium to the average multiple of the last 20 years. It is notable how resilient this multiple has been as earnings have recovered from the June 2020 trough, down only 8% over the last 15 months while the market's forward earnings have gained 48%. This has left the market at a multiple that was never seen between 2002 and 2020. This extreme valuation versus sales is on the back of sharp improvements in profitability, and brings risks for the market. Any fall in profitability will not just hit earnings, but could potentially hurt multiples as well, leading to a double whammy effect on markets.

Company earnings have been helped by the fall in both corporate taxation levels and interest rates. The corporate tax rate has fallen dramatically in many countries, down five percentage points or more over the last decade in France, Italy, Japan and Spain as well as in the U.S. and U.K. (Source: KPMG). This tailwind is very unlikely to be repeated, and may well turn into a headwind, with the UK having announced a six percentage point rise to 25% from 2023, the US discussing a rise in the headline corporate tax rate and more broadly multiple countries pushing for a global minimum tax rate. Interest costs must also be a risk from here, given that rates have been at their lowest levels in recorded history. It is of course possible that investment grade companies will continue to be able to leverage up on virtually free money and 'junk' credits (to borrow at below 3% in Europe and around 4.5% in the US, but any kind of interest rate normalisation will hit profitability for such levered enterprises.

Portfolio Review

In September, the Portfolio returned -1.65%, ahead of the MSCI World Net Index which returned -2.21%. The Portfolio has outperformed since its July inception, returning +0.13% versus +0.01% for the index.

For September month, sector allocation was negative given the lack of Energy stocks in the portfolio and the overweight in Information Technology, while stock selection was positive due to outperformance in the Health Care sector. Since Inception, the picture was reversed: the overweight in Information Technology and the absence of Materials stocks helped deliver positive sector allocation, while underperformance in Consumer Staples, Information Technology and Financials outweighed the benefits of outperformance in Health Care and Communication Services, leading to negative stock selection.

As of September 30, 2021, the Portfolio's carbon footprint is 81% lower than the MSCI AC World Index.

Portfolio Outlook

If there is a sustained reflationary recovery, the resulting healthy sales growth could drive further operational leverage. In addition, earnings estimates tend to be lagging indicators (on the way up as well as the way down), meaning that there may be further earnings upgrades to come, on top of the 48% gains since June 2020. Against this positive view is the potential for significant cost pressures over the next decade.

Morgan Stanley Investment Management added one new name in the quarter: Broadridge Financial Solutions, described by Forbes as the "most important financial firm you have never heard of". Its core offering is the US proxy services business, where it enjoys a 95% market share. Overall Broadridge generates 100%+ returns on operating capital, boasts a 98% client retention rate and has generated a steady 4-8% organic growth over the last decade; it even eked out some growth during the Global Financial Crisis.

During Q3 Morgan Stanley completed the switch of a proportion of L'Oréal holdings into Estée Lauder, a position initiated at the end of Q2. The logic was that Estée Lauder was trading at an unusual discount to L'Oréal, despite its superior growth prospects. Morgan Stanley also took the opportunity to add to Intercontinental Exchange given its attractive valuation and trimmed Microsoft due to its large position size.

Owning high quality has not been a comfortable ride over the last year. The surprising pace of economic recovery from COVID, driven by massive government interventions and the vaccine miracle, has boosted the earnings of lower quality companies, which have therefore outperformed. Optimists see a period of strong economic growth – helped by government fiscal largesse – which will allow the earnings party to continue. Our fear is that even if the macro environment is favourable, which is far from a given, the resulting cost pressures will make it tough for the market to hold on to the forecast peak margins – in the absence of the precious pricing power which is core to our stock selection.

Greg Fleming, MA

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