Salt Sustainable Income Fund Fact Sheet – December 2022

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 strong Environmental, Social and Governance credentials & reliable income generation. The Fund's strategy is to invest in a quality asset mix with an aim to provide regular, sustainable income and a positive return on capital. At times 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 or volatility 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 December 2022

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$45.46 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Current distribution yield (cents per unit) / based on Unit Price of 1 January 2023	1.00 cents per unit per Quarter / 4.56% per annum

Unit Price at 31 December 2022

Application	0.8733
Redemption	0.8697

Investment Guidelines

Sector	Target	Range
New Zealand Fixed Interest	20%	0% – 40%
International Fixed Interest	15%	0% – 40%
Australasian Shares	30%	15% – 45%
Global Listed Property	15%	0% – 30%
Global Listed Infrastructure	15%	0% – 30%
Cash or cash equivalents	5%	0% – 20%

Fund Allocation at 31 December 2022

New Zealand Fixed Interest	0%
International Fixed Interest	19%
Australasian Shares	33%
Global Listed Property	28%
Global Listed Infrastructure	18%
Cash or cash equivalents	2%

Fund Performance to 31 December 2022

Period	Fund Return	Reference Portfolio Return
1 month	-1.29%	-1.25%
3 months	2.12%	1.83%
6 months	-0.11%	-0.33%
1 year	-11.73%	-11.74%
Since inception	-7.40%	-8.00%

Performance is after all fees and does not include imputation credits or PIE tax.
Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

Top Individual Holdings at 31 December 2022

Goodman Property Trust	Argosy Property Trust
Kiwi Property Group	Property for Industry
Fisher & Paykel Healthcare	Auckland International Airport
Precinct Properties NZ	Mainfreight
Spark NZ	Stride Property & Investment Mgt

Holdings stated as at 31.12.22, excludes cash and consolidated International Fixed Interest Fund component of the Sustainable Income Fund due to its large number of securities.

SALT FUNDS MANAGEMENT
Level 3, The Imperial Buildings, 44 Queen Street | PO Box 106-587, Auckland 1143
P: +64 9 967 7276 | E: info@saltfunds.co.nz | www.saltfunds.co.nz

Market Commentary

- December month saw a reversal in sentiment to a more cautious tone, after a tentative recovery earlier in the quarter. Equity markets around the world weakened during the month, led by a 5.8% fall in the US S&P 500 Index.
- The global equity market rally that started early in the December quarter partly reversed in the December month. Global equities lost 3.9% (in USD) in the December month, trimming the gain for the fourth quarter to 9.8%.
- The gains early in the quarter reflected the growing confidence that the worst of the inflation surge was now behind the world's major economies. This optimism was tempered late in the quarter by central banks which, despite reducing the magnitude of rate hikes, signalled they still had more tightening work to do, exceeding markets views of the various terminal rates. This included the US Federal Reserve, the European Central Bank and the Reserve Bank of New Zealand.
- This was exacerbated by a surprise move from the Bank of Japan to adjust its Yield Curve Control policy by allowing a widening of the trading band around 10-year JGBs. This was seen by markets as a de facto tightening in monetary policy.
- Political turmoil continued in the UK as Prime Minister Liz Truss was replaced by her competitor in the earlier selection process, Rishi Sunak.
- China was immune from the global sell-off in markets as the Government, in the face of widespread social unrest, moved swiftly to unwind still-stringent Covid restrictions. We had expected such a move following the conclusion of the 20th National Congress of the CCP, but the pace of this move surprised us and does not come without risks.
- In Australia, the economy is showing signs of slowing and will weaken further in 2023 but is expected to avoid recession.
- In New Zealand, the RBNZ delivered its largest ever interest rate increase of 75bps during the quarter, taking the Official Cash Rate to 4.25%. Cementing the hawkishness even further was the admission the Bank had considered a 100bp hike. The projected terminal rate of the OCR was lifted from 4.1% to 5.5%, higher than was expected by the market.
- NZ GDP growth appears remarkably resilient, rising 2.0% over the September quarter. However, we believe this strength continues to reflect Covid "noise" and the reopening of borders. The latest ANZ Business Outlook survey is a more important indicator of things to come with all key activity indicators moving more negative in the December month. This suggests the New Zealand economy may already be close to recession and that a 5.5% OCR may not be required.
- In summary, the December quarter marked the end of a challenging 2022 for markets and investors as the highest inflation, along with the most aggressive rate hikes from the world's major central banks in decades, put pressure on both equity and bond markets at the same time.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund declined slightly in December, reflecting negative returns in both the equity and fixed interest components of the portfolio, moving lower by -1.29% (after fees.) The fund's 3-month return was positive, at 2.12% (net) as at 31 December which was 0.3% ahead of its reference portfolio quarterly return. On the rolling six-month basis, the fund is recording a decline of –0.11%, annually, the fund return was in line with the reference index at -11.73%, while since inception, the fund's return was -7.40% (on an after fees basis) which was 0.6% ahead of index.

Given recent market conditions, these performance results indicate the present sensitivity of particularly income-yielding asset types to sharp moves in global interest rates. The moderate rebound in both global share and bond markets since recent market lows in October has assisted Income fund components back to positive short-term returns. As inflation shows signs of a definitive peak in the months ahead, we expect component asset classes to improve further, as has occurred in January 2023 to date.

December month saw asset prices in most markets consolidate, following generally better returns in November. The long-resilient Global Listed Infrastructure sector slipped back after its prior resilient performance. Thus, the Listed Infrastructure fund made the largest negative individual contribution to December month returns (-0.6%) but that should be seen in the light of the fund making the second-strongest contribution to Income fund returns for December quarter as a whole (+1.05%.)

Bonds are seen as competing assets for infrastructure due to yield and stability with longer-duration underlying exposures. Bond yields have now moved downwards over the last three months, lifting sector returns. In the medium-term, we do not think Infrastructure's distinctive qualities have changed, and expect that as the international economy cools next year the assets' defensive and inflation-hedging qualities will remain at the fore.

The Property funds, which provide a strong income yield to the Salt Sustainable Income Fund, experienced modest capital returns in the December month and quarter. The Enhanced Property Fund contributed a -0.3% return for the month and -0.7% for the quarter. The Global Property Fund, added at a small initial weighting at the beginning of the quarter, contributed a return of 0.12% for the three-month period. This addition has been useful to increase the Income Fund's range of sources of yield and thus supports the enhancement of its distribution level to investors.

The Salt Sustainable Income Fund's exposures to New Zealand and Australian equities were positive in the December quarter overall, and those markets have recently been more resilient than their global counterparts. While earlier in 2022, domestic assets were not significant drivers of portfolio gain, they contributed via their superior dividend income yields. Recently, NZ equities have broadly been more resilient to bouts of international market weakness. The NZ Dividend Appreciation Fund made a positive contribution of 1.46% in the December quarter, being the strongest component over the quarter (ahead of Global Infrastructure.)

Salt Sustainable Income Fund outlook

As the largest current individual Sustainable Income Fund component, the NZ Dividend Appreciation Fund's quarterly gain has been of substantial benefit to the Sustainable Income Fund 2022 return. All the same, now that the Reserve Bank of New Zealand has indicated sustained interest rate rises ahead, we anticipate trimming the weighting to this fund within our

Sustainable Income portfolio during the current month. A Neutral portfolio weighting is seen as more appropriate than the existing overweight holding, as better Income interest streams have become available within the Fixed Income universe than has been the case for a considerable period. This is also true, albeit to a lesser extent, for domestic property sector allocations.

Although the capital growth element built up in this fund in late 2021 has been reversed by 2022's negative market developments, the income level has been enhanced. We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to resume performance gradually, as international conditions stabilize. However, there could easily be a recessionary period to traverse en route to that outcome. The phase of interest rate reductions from central banks is still sone quarters into the future and we expect a major beneficial capital growth impact of such will only become apparent from the last part of 2023.

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.

The Income Fund remained underweight in the Fixed Interest asset category throughout the 2022 YTD period. Fixed Interest assets are currently at just above half their Strategic Asset Allocation weighting, at 19% versus 35% in the SAA. The bond allocation is being lifted at the beginning of 2023, assuming yields and other factors remain supportive. The quantum of the additional bond investments should then close up the underweighting in this sleeve of the portfolio by around half. Bonds, as a share of the Sustainable Income Fund, will be lifted to 27%.

The Global Fixed Interest fund component within the Income Fund has this year provided largely negative returns, justifying the underweighting that Fixed Interest holds currently with respect to its benchmark weighting. However, Global bonds outperformed their benchmark in the December, quarter, contributing 0.19% for the month to the Sustainable Income Fund's total return. In absolute term, though, Global bonds fell -1.1% in December month, though they gained 1.48% for the quarter. The one-year return from

For 2022 as a whole, the bond components of the Salt Sustainable Income portfolio have dragged on bond valuation returns as interest rates rose; and the Global bond component of the fund contributed a negative impact of -2.44% to the fund's annual return. That is in spite of the substantial underweight position in which Global bonds were positioned last year, indicative of the scale of the sell-off endured by fixed income assets.

However, 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.

It is crucial to note that the Income level from equity dividends and bond coupons received into the fund has been commensurately rising through the recent period of market turbulence and remains well in excess of the Income Fund's distribution rate of 1.00 cents per unit per quarter (4 cents per unit per annum.) This trend exemplifies the incremental return of some "risk premia" into asset classes, though this has further to go.

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 suited to an economically uncertain and inflation-prone period. Defensive merit should be re-asserted in coming quarters through continuing positive demand for these specific equity types, along with the sustainable dividend-payers in the broader Australasian market.

Given the absolute level and degree of differentiation amongst global bond yields, the point at which additional Fixed Income exposure will be added to the Salt Sustainable Income Fund has now arrived. Internationally, major central banks are now communicating the desirable course of carrying through several additional 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.

Greg Fleming, MA