Salt Sustainable Income Fund Fact Sheet – January 2024

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 January 2024

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$44.53 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Prospective distribution yield (cents per unit) / based on Unit Price of 1.02.23	1.125 cents per unit per Quarter / 5.16% per annum

Unit Price at 31 January 2024

Application	0.8705
Redemption	0.8669

Sustainability Metrics

Fund ESG Scores	Portfolio	Category avge
Morningstar ESG score	20.98	22.00

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 31.02.24. 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 January 2024

Global Fixed Interest	29.5%
Australasian Shares	29.0%
Global Listed Property	23.5%
Global Listed Infrastructure	17.0%
Cash or cash equivalents	1.0%
Asset allocation to Fixed Interest + Cash	**30.5%**

Fund Performance to 31 January 2024

Period	Fund Return (before fees)	Gross Reference Portfolio Return
1 month	-0.20%	-0.54%
3 months	7.99%	8.76%
6 months	0.07%	1.27%
1 year	1.90%	1.25%
2 years p.a.	-1.55%	-1.45%
Since inception p.a.	-1.16%	-0.74%

Performance is before fees and tax, adjusted for imputation credits.
Reference Portfolio return is gross.

Top Individual Holdings at 31 January 2024

Goodman Property Trust	Kiwi Property Group
US 5Yr Note (CBT)	Infratil
Fisher & Paykel Healthcare	Spark NZ
Precinct Properties NZ	Auckland International Airport
DEGV 0% 15/5/24 (Germany)	Contact Energy

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Market Commentary

- After a strong December month, markets were more circumspect in the New Year. Strong activity data, particularly in the US, was received favourably by equity markets, but that came with push-back from central banks of early expectations of rate cuts, which wasn't viewed favourably by fixed income markets. Developed market equities rose 1.2% (in USD) over the month while the global aggregate bond index was down by -1.4% (also in USD).
- In the US, data was more in line with a "no landing" than a "soft landing" scenario. The first estimate of December 2023 GDP data was exceptionally strong (+3.3%, q/q annualised), as was the December labour market report (unemployment rate unchanged at 3.7%). The euphoria was tempered somewhat later in the month by a hawkish tone to the Fed's January statement.
- The European Central Bank left interest rates unchanged in January and reiterated they would remain data dependent. That was followed by the composite purchasing managers index (PMI) rising to 47.9 in January. That's its highest level in three months, but still well below the benchmark 50 that separates expansion from contraction.
- In Japan, the TOPIX was the best performing major equity market over the month. This was helped by the Bank of Japan leaving monetary policy unchanged amid speculation (including ours) that we would soon see an end to their Negative Interest Rate Policy (NIRP) and Yield Curve Control (YCC). That now appears more likely in April.
- In China, December 2023 quarter GDP growth came in at 5.2% y/y, broadly in line with expectations but soft relative to history. Partial activity data also remained weak. The PBoC continued to add stimulus over the month, but this remains largely reactive and somewhat timid. We expect a fiscal package to support consumption in the next few months.
- In Australia, December 2023 quarter inflation came in below expectations at both the headline and core (trimmed mean) level. This followed weaker-than-expected retail sales and employment data. This combination of news means the RBA is more-than-likely done with interest rate hikes and will adopt a neutral bias at its February meeting.
- In New Zealand, December 2023 quarter inflation data also came in below expectations, but in a somewhat unbalanced fashion. All the downside surprise came in tradeable goods (imported inflation), while non-tradeable (domestic inflation) came in stronger than expected. This prompted a warning to markets from the RBNZ's Chief Economist, that while progress was being made in the disinflation journey, there was still a long way to go, effectively pushing back on early rate cut expectations. We don't expect a first OCR cut until November.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund's rebound paused in January, with a return of -0.20% (before fees) in the month, which led its quarterly return to 7.99% and its one-year return to 1.90% (before fees.) The small decline in January reflected reconsiderations in bond markets as to the likely speed of lower central bank interest rates, which led to declines in the listed Real Asset returns within the portfolio after their strong late-2023 gains.

For the year to 31 January, the portfolio's reference index rose by 1.25% which was 0.65% below the fund's 1.90% one-year gross return. On a two-year annualised basis, the fund's gross return is 0.1% below that of the reference index: -1.55% p.a. compared to -1.45% p.a. for the index.

As inflation progressively shows signs of a definitive down-shift, we expect component asset classes to improve further, as global central banks will ultimately embark on interest rate easings. Volatility across markets is ever-present but sentiment is less fragile. Central banks around the world remain vigilant, but have scope assess the impact of high rates on inflation pressures positively, and incrementally lower rates. We expect value recoveries in interest-rate sensitive assets.

However, markets expressed excessive optimism in late-2023 as to how swiftly those central bank rate cuts are likely to eventuate. A more realistic turn as 2024 got underway explains the softer January returns from the most interest rate-sensitive asset components of the Income fund.

January month saw positive returns from the NZ Dividend Appreciation Fund, with a monthly contribution of 0.24%, and the Salt Sustainable Global Fixed Income Opportunities fund, which contributed 0.07% in January. The Sustainable Global Infrastructure fund weakened as interest rates moved upward, detracting -0.36% from the Income fund for the month. The Sustainable Global Property fund similarly responded to higher rates and contributed -0.11% in January. The Salt Enhanced Property fund made a broadly neutral January impact, at -0.03%.

Salt Sustainable Income Fund outlook

Markets got ahead of themselves in late-2023 in anticipating central bank rate cuts, though these are still expected for later this year. We believe bond yields have now adjusted sufficiently (via a volatile and uncertain route in the last 18 months) for us to move progressively toward a higher bond positioning within the Sustainable Income Fund. We consider inflation risk now poses reduced danger to the capital valuations of bond portfolios. The allocation to bonds is now 29.5% vs a 35% SAA. Our next step will be to increase this even closer toward a Neutral allocation.

The Reserve Bank of New Zealand has paused in lifting the Official Cash Rate though core inflation is persisting, so domestic yields and discount rates are likely to stay quite elevated. This suppressed returns from NZ equities through 2023, and the relative weakness of NZ shares compared to global equities was a notable feature last year. Diversified Income Funds containing an allocation to domestic equities have generally experienced improved capital value moves in the latter months of 2023 and in January 2024, although their income yields remain attractive by historical standards, as the NZ equity market has moved downwards since 2021.

We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to boost performance, as inflation conditions are stabilizing. However, there could still be a mild recessionary period to traverse en route to that outcome (as was the case recently in New Zealand, if not globally.) The phase of actual interest rate reductions from central banks is still some months into the future but when that is underway, we expect more beneficial capital growth impacts. This positive portfolio role will likely be a key feature of total returns in 2024-5.

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 of 1.125 cents per unit / quarter retained

Higher component asset yields enabled us to retain the quarterly cents-per-unit distribution from the fund, at 1.125 cpu, for the latest quarterly distribution to be paid out in February. This will be updated again in late-March 2024, dependent on the outlook for overall Fund's income.

As noted earlier, the silver lining in the bond market's repricing is that the yield received from bond investments have shifted to a higher range and that 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 phase of interest rate adjustments, sufficient to anchor inflation expectations, has been successful. Recently, the balance of evidence has been on the better side globally, particularly suggesting that the US Federal Reserve is well on track to engineer an economic "soft landing." Rate reductions will follow incrementally later this year. In New Zealand, the timing is uncertain, as the Reserve Bank will need to assess the trajectory of inflation in early 2024 and may not actually move the OCR down until the last quarter of the year.

While the data-driven market volatility at times requires fortitude from investors, the objective of securing an inflation-resilient income level 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 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. We regard this as prudent in a still-uncertain environment.

The equity capital value components of the Income Fund have adjusted downward to reflect weaker economies in the year ahead, yet the Real Asset components of Infrastructure and Property are well-suited to the probable subdued period ahead, as central bank policy rates will begin to fall and there has been a downward shift at the short end of the yield curve. Defensive merit should continue to be asserted in coming months through renewed demand for these specific "Real Asset" equity types, along with the sustainable dividend-payers in the broader Australasian market.