

# SALT

## Salt Sustainable Income Fund Fact Sheet – May 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 May 2024

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	\$45.18 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Prospective distribution yield (cents per unit) / based on Unit Price of 1.06.23	1.125 cents per unit per Quarter / 5.26% per annum

### Unit Price at 31 May 2024

Application	0.8575
Redemption	0.8540

### Sustainability Metrics

Fund ESG Scores	Portfolio	Category ave
Morningstar ESG score	21.22	22.00

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 31.05.24. 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 May 2024

Global Fixed Interest	33.5%
Australasian Shares	28.5%
Global Listed Property	20.0%
Global Listed Infrastructure	17.0%
Cash or cash equivalents	1.0%

Asset allocation to Fixed Interest + Cash 34.5%

### Fund Performance to 31 May 2024

Period	Fund Return (before fees)	Gross Reference Portfolio Return
1 month	0.09%	1.20%
3 months	1.53%	1.79%
6 months	4.74%	4.94%
1 year	4.37%	4.42%
2 years p.a.	1.11%	0.87%
Since inception p.a.	-0.67%	-0.33%

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

### Top Individual Holdings at 31 May 2024

US 5Yr Note (CBT) Sep24	Infratil
Goodman Property Trust	Auckland International Airport
UST 0% 27/06/2024	Spark New Zealand
Fisher & Paykel Healthcare	Vital Healthcare Property Trust
Precinct Properties NZ	Kiwi Property Group

### SALT FUNDS MANAGEMENT

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## Market Commentary

- The month of May saw positive returns for both developed market equities and fixed income. Ongoing optimism about a global soft landing supported risk assets while anticipated rate cuts spurred bond markets to a positive return. Developed market equities rose +4.5% (in USD) over the month while the global aggregate bond index was up +1.3% (in USD) over the same period.
- In the US activity data surprised mostly to the downside. Most importantly, April payrolls came in below expectations and the unemployment rate rose. April CPI data was in line with expectations following three months of higher-than-expected numbers. Earlier in the month the Fed kept policy unchanged but highlighted the lack of progress towards the 2% inflation. This was interpreted by markets as a delay in rate cuts, rather than a return to rate hikes.
- Economic activity continues to improve in Europe. PMI data released during the month shows the recovery is being driven by the services sector, but there are also signs of improvement in manufacturing. Despite the annual rates of headline and core inflation accelerating in May, progress over the last few months is expected to still give the ECB sufficient confidence to start cutting interest rates at their June meeting.
- The weakness in the Yen continues to be a key focus in Japan. While this is usually positive for Japan exports and the export heavy Topix, the very low level of the Yen is starting to impact negatively on consumer confidence. Japanese stocks were one of the regions weakest performers in May.
- Activity data in China is generally surprising to the upside, though a look under the hood reveals a strong performance from exports alongside ongoing weakness in domestic demand. Problems in the real estate sector remain unresolved and pose a key risk to the outlook.
- The Reserve Bank of Australia kept monetary policy unchanged at its May meeting and was less hawkish than expected, despite higher-than-expected March quarter inflation. Policy guidance remained unchanged in "not ruling anything in or out".
- Labour market conditions continue to deteriorate in New Zealand. The unemployment rate rose from 4% to 4.3% in March while the annual rate of increase in the Labour Cost Index slowed to 3.8%, its lowest level in 18 months. Despite this, the RBNZ remains concerned about sticky domestic inflation pressures, delivering a hawkish statement during the month. This saw market pricing push the first full rate cut out to February 2025.

## Salt Sustainable Income Fund Commentary

**The Sustainable Income Fund was little changed in May, with a return of 0.09% (before fees) in the month, which led its quarterly return to 1.53%, its six-month gain to 4.74% and its one-year return to 4.37% (before fees.) May's recovery in global equities and bonds reflects reconsiderations in markets as to when lower inflation permits central bank interest rates. Uncertainty on central banks' easing timing has influenced the listed Real Asset and Bond returns within the portfolio, after their strong late-2023 gains. NZ domestic assets continued to underperform global peers.**

For the three-month period to 31 May, the Sustainable Income Fund was behind of its reference index by -0.26% (on a gross basis.) The six-month period since December was positive, with the fund gaining 4.74% (gross) which was slightly behind the reference portfolio. For the year to 31 May, the portfolio's reference index rose by 4.42% which was aligned with the Sustainable Income fund's 4.37% one-year gross return.

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 much less fragile. Central banks around the world remain vigilant but have scope to assess the impact of high rates on inflation pressures positively, and incrementally lower rates. We expect value recoveries in interest-rate sensitive assets to continue in H2 2024.

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 from Q1 2024 explains the moderating returns from the most interest rate-sensitive asset components of the Income fund.

May month saw NZ domestic asset types recording negative returns which almost fully offset the positive returns contributions from the global components of the Income Fund. The NZ Dividend Appreciation Fund, which contributed -0.43% and the Enhanced Property Fund, -0.58% in May. On the positive side of the ledger, the Salt Sustainable Global Infrastructure Fund contributed 0.76% The Global Fixed Interest Opportunities Fund made a positive monthly contribution of 0.22% and the Sustainable Global Property Fund had a smaller positive impact of 0.12%, in May month.

## 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 a reduced danger to the capital valuations of bond portfolios. The allocation to bonds is now almost at the neutral 35% SAA.

Much of the softer recent returns from the Income Fund is due to the still-weak state of the NZ economy, straining under mild recessionary forces.

The Reserve Bank of New Zealand has remained “on hold” with the Official Cash Rate, as core inflation is persisting, so domestic yields and discount rates are likely to stay fairly elevated. This suppressed returns from NZ equities through 2023 and early 2024, and the relative weakness of NZ shares compared to global equities remains a notable feature. There is some scope for improved NZ returns later this year, and the latest RBNZ Monetary Policy Statement indicated a still-restrictive tone, stressing that Domestic inflation pressures are slow to fade out.

Diversified Income Funds containing an allocation to domestic equities have generally experienced low overall capital value gains in early 2024, although their income yields remain attractive by historical standards, as the NZ equity market has moved sideways overall for the last two years.

Until a catalyst for a resumption in NZ equity market performance emerges, much of the medium-term capital growth objective of the Fund will be driven by international assets, which comprise half of the Portfolio at current allocation weightings.

We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to boost performance, as inflation conditions are improving. However, there is still a mildly recessionary period to traverse en route to that outcome (in New Zealand, if not globally.) The phase of actual interest rate reductions from central banks has now begun, with the European Central Bank moving in early June, and when easing is more broadly 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 which was paid out / reinvested in May. This will be updated again in September 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 deliver 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 mid-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 been commensurately rising through periods of market turbulence. This trend exemplifies the incremental return of some “risk premia” into asset classes.

The fund’s modelled income received from coupons and dividends 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 to reflect weaker economies overall, yet the Real Asset components of Infrastructure and Property are well-suited to the subdued immediate period ahead, as central bank policy rates will begin to fall. 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.

In the last rebalancing, we lifted the Fund’s investment in the Sustainable Global Fixed Income Opportunities Fund by 2.5%. This increased the Defensive allocation within the Income Fund to 34.5%, in line with the slowing economic outlook. The yield impact of the Dynamic Asset Allocation bond asset increase was negligible, but we think that Sustainable Global Bonds still have upside potential and display lower volatility risk than Australasian listed property stocks. The latter are retained (at slightly reduced weightings) due to their medium-term scope for capital growth.