Salt Sustainable Income Fund Fact Sheet – July 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 July 2024

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$46.85 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Prospective distribution yield (cents per unit) / based on Unit Price of 1.08.23	1.125 cents per unit per Quarter / 5.05% per annum

Unit Price at 31 July 2024

Application	0.8887
Redemption	0.8851

Sustainability Metrics

Fund ESG Scores	Portfolio	Category avge
Morningstar ESG score	18.83	21.00

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 31.07.24. 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 July 2024

Global Fixed Interest	34.5%
Australasian Shares	27.5%
Global Listed Property	20.0%
Global Listed Infrastructure	17.0%
Cash or cash equivalents	1.0%
Asset allocation to Fixed Interest + Cash	**35.5%**

Fund Performance to 31 July* 2024

Period	Fund Return (before fees)	Gross Reference Portfolio Return**
1 month	4.33%	4.30%
3 months	3.72%	5.29%
6 months	4.79%	5.49%
1 year	4.86%	6.43%
2 years p.a.	2.35%	2.50%
Since inception p.a.	0.49%	0.95%

Performance is before fees and tax, adjusted for imputation credits. ** at 31 July.

Top Individual Holdings as at 31 July 2024

US 5Yr Note (CBT) Sep24	Infratil
Goodman Property Trust	Auckland International Airport
US 10YR Ultra Fut Sep24	Spark New Zealand
Fisher & Paykel Healthcare	Kiwi Property Group
Precinct Properties NZ	Argosy Property Trust

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Market Commentary

- July was a volatile month for markets. Weaker US labour market data and a weaker than expected US CPI set the tone and saw markets bring forward expectations of rate cuts by the US Federal Reserve. The Global Aggregate Bond Index returned 2.8% (in USD) and 1.9% in NZD over the month.
- Equities were more muted as investors became more sceptical about the ability of artificial intelligence and growth stocks more generally to continue to drive markets higher. Developed market equities rose 1.8% (in USD) and 4.4% in NZD over the month.
- In the US the July labour market report showed slowing employment growth, a higher unemployment rate and moderating wage growth. GDP data came in stronger than expected at an annualised 2.8% in Q2, but more recent higher frequency data pointed to a slowdown ahead. June CPI data came in under expectations, and just a few hours later the Fed opened the door to a September rate cut.
- In Europe, Purchasing Manager Index (PMI) data was weak, suggesting a moderation in growth over the summer. This also bolstered expectations of further rate cuts from the European Central Bank.
- The Bank of Japan continued its gradual normalisation of monetary policy in July, raising its policy rate 15 basis points from 0.10% to 0.25%. The BoJ is clearly comfortable with recent developments in wage growth and inflation expectations.
- July was also a busy month for northern hemisphere politics. The second round of French legislative elections turned the first round on its head. In the US there was an assassination attempt on the presumptive Republican nominee Donald Trump and President Biden decided not to see re-election.
- In China, ongoing problems in the property sector continue to impact activity in the broader economy. Private consumption remains particularly weak. The authorities continued their reactive and gradual approach to easing with a reduction in the Required Reserve Ratio and cuts to a range of interest rate instruments.
- In Australia the focus was on inflation and whether the Reserve Bank of Australia would resume interest rate hikes. It all hinged on the June quarter CPI outcome which was released on the last day of the month. While it came in higher than the most recent set of RBA forecasts, it was below market expectations and probably not sufficiently bad for the RBA to hike in August.
- In New Zealand, the key development was a dovish pivot from the Reserve Bank of New Zealand which was all the more surprising given it was only six weeks after their surprisingly hawkish outing in May. The change in tone clearly reflects the recent run of weak activity data, and signs from business surveys that firms pricing power is dramatically reduced given the weakness in activity. We see no reason why the RBNZ shouldn't start the unwinding of current restrictive monetary conditions in August.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund gained strongly in July, with a return of +4.33% (before fees) in the month, which took its three-month gain to 3.72% and its one-year return to 4.86% (before fees.) July's return was positively impacted by gains in all component assets; notably, the NZ Dividend Appreciation Fund rebounded sharply from a small June quarter decline. Markets continue to waver as to when lower inflation will permit more central bank interest rate reductions. Uncertainty on central banks' easing timing has influenced the listed Real Asset and Bond returns within the portfolio, but this has now shifted to positive impacts. However, early signs of an easing bias from the RBNZ may assist NZ equity assets through the remainder of this year and allow some catch-up with global returns.

As inflation progressively shows signs of a definitive down-shift, we expect component asset classes to improve further, as more global central banks will 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 Q3 2024.

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

July saw NZ domestic asset types recording positive returns (at last,) which supplemented the positive returns contributions from the global components of the Income Fund. The NZ Dividend Appreciation Fund contributed +1.70% and the Enhanced Property Fund, 0.83% in July 2024. The Salt Sustainable Global Infrastructure Fund contributed 1.05%. The Global Fixed Interest Opportunities Fund made a positive monthly contribution of 0.50% and the Sustainable Global Property Fund had a small positive (+19bps) impact for the month ending July 31.

Salt Sustainable Income Fund outlook

Markets got ahead of themselves in late-2023 in anticipating central bank rate cuts. Now these are expected to broaden 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 much-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 returns patches from the Income Fund were 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, so domestic yields and discount rates were until recently fairly elevated. This suppressed returns from NZ equities through 2023 and early 2024. There is some scope for improved NZ returns later this year, and the latest RBNZ Official Cash Rate Review, while stressing that domestic inflation pressures are slow to fade out, signalled a potential policy rate reduction, whilst markets have priced in even more easing.

Diversified Income Funds containing an allocation to domestic equities 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. NZ equities had a good month in July, but “one swallow doesn’t make a summer,“ as the saying goes.

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 is paid out / reinvested in August. 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 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.