Salt Sustainable Income Fund Fact Sheet – August 2023

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 August 2023

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$43.45 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Prospective distribution yield (cents per unit) / based on Unit Price of 1.9.23	1.125 cents per unit per Quarter / 5.29% per annum

Unit Price at 31 August 2023

Application	0.8540
Redemption	0.8505

Sustainability Metrics

Fund ESG Scores	Portfolio	Category avge
Morningstar ESG score	20.27	22.00

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 31.08.23. 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 August 2023

Global Fixed Interest	28.0%
Australasian Shares	28.5%
Global Listed Property	23.5%
Global Listed Infrastructure	17.0%
Cash or cash equivalents	3.0%
Asset allocation to Fixed Interest + Cash	**31.5%**

Fund Performance to 31 August 2023

Period	Fund Return (after fees)	Gross Reference Portfolio Return
1 month	-3.12%	-2.36%
3 months	-0.06%	-0.32%
6 months	-0.59%	-0.51%
Year to date	1.32%	1.10%
1 year	-2.73%	-2.04%
Since inception p.a.	-2.77%	-2.45%

Performance is after all fees and does not include imputation credits or PIE tax. Reference Portfolio return is gross.

Top Individual Holdings at 31 August 2023

Goodman Property Trust	Argosy Property Trust
Fisher & Paykel Healthcare	Infratil
Precinct Properties NZ	US 5Yr Note (CBT) Dec 23
Kiwi Property Trust	Auckland International Airport
Spark NZ	Vital Healthcare Property Trust

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Market Commentary

August saw global equities retreat after strong July returns, though they rose in NZD terms due to a sharp fall in the Kiwi dollar. Growth and inflation signals remained of concern to investors, undermining expectations for reduced monetary tightening. Higher bond yields caused interest-rate sensitive assets to decline in general last month.

- Volatility returned to global markets In August reflecting fresh strains in the Chinese property market and weakness in a broad range of activity indicators. Developed market sovereign bond yields also moved higher during the month. In this environment developed market equities declined -2.3% (in USD) over the month while the Bloomberg Global Aggregate bond index fell -1.4% (also in USD).
- The credit rating agency Fitch downgraded the US sovereign credit rating from AAA to AA+ during the month, citing unsustainable fiscal settings and increasing political dysfunction. The move was largely dismissed by US politicians and economists alike, though it does highlight our concern that without some form of political intervention the fiscal settings of several key developed economies are on an unsustainable path.
- US data remained solid over the month, keeping markets anticipating the possibility of one final interest rate hike from the FOMC. The jobs market remained strong with payroll gains ahead of forecast and a dip lower in the unemployment rate. Retail sales growth also exceeded expectations. Core inflation remains too high for comfort.
- Eurozone GDP data came in stronger than expected for the second quarter of the year and the labour market remains tight with the unemployment rate at its lowest ever level. The outlook remains uncertain, however, with the August composite Purchasing Managers Index falling to 47. Core inflation moved slightly lower but at 5.3%, markets are continuing to price in more tightening from the ECB.
- In Japan, the economy grew +6.0% q/q annualised in the second quarter, boosted by a strong contribution from net exports. The core CPI rose to 4.3% in July and the spring (Shunto) wage negotiations saw the biggest wage increase in three decades. That will have markets continuing to be alert to further tweaks to Japan's monetary policy settings.
- In China, activity data was much weaker than expected including retail sales and private investment, particularly in real estate. The annual rate of CPI increase turned negative in July. To address these challenges, the PBoC cuts rates twice during the month, though credit demand is yet to respond. China's troubles appear likely to weigh on markets for a few months yet.
- In Australia, data over the month has broadly tracked in line with the RBA's forecasts, with unemployment higher and inflation lower, providing little reason for the RBA to shift from its current "wait and see" approach. Still, we expect somewhat more challenging inflation dynamics over the next few months which will challenge the RBA's position.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund experienced a negative return of -3.1% (after fees) in August month which lowered its return over the rolling 3-month period to -0.06% (after fees.) The fall in August reflects weak returns in both the equity and fixed interest components of the portfolio. For the year to date, the fund gained 1.32% (after fees) which was 0.22% ahead of its gross reference portfolio return.

Despite a range of headwinds for markets, 2023 has so far proved a better investing environment than 2022. As inflation progressively shows signs of a definitive peak, we expect component asset classes to improve, as indeed occurred in the first part of 2023, with periodic interruptions. Volatility across markets is ever-present and sentiment remains fragile.

August, however, saw returns negative from the Income Fund's component assets. The most resilient components were the Sustainable Global Fixed Income Opportunities fund, which contributed -0.05%, and the Salt Sustainable Global Property Fund, which subtracted -0.08%.

The Global Listed Infrastructure fund was impacted in August as world interest rates rose, and made a negative individual contribution of -0.84%. The primary weak influences in the Income Fund in August were domestic, though, with the NZ Dividend Appreciation Fund subtracting -0.99% and the Enhanced Property Fund, -1.21%. The negative returns in these two sizeable components in part reflect global factors, but also the anaemic domestic economy and higher NZ yields alongside pre-Election uncertainties.

Salt Sustainable Income Fund outlook

We believe bond yields have now adjusted upwards enough, to have lowered our previous underweight bond positions within the Sustainable Income Fund. The allocation to bonds is now 28% 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 is supressing returns from NZ equities this year, and the relative weakness of NZ shares compared to global equities is now notable. Diversified Income Funds containing an allocation to domestic equities have generally experienced a downward capital value move, although their income yields may well have been enhanced recently.

We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to boost performance, as inflation conditions stabilize. However, there could be a mild recessionary period to traverse en route to that outcome. The phase of actual interest rate reductions from central banks is still some time into the future and we expect a major beneficial capital growth impact of such will only become apparent only from late in 2023, or even early in 2024.

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

Higher component asset yields enabled us to again lift the quarterly cents-per-unit distribution from the fund, to 1.125 cpu from the quarterly distribution date paid out in August. This will be updated again in November, dependent on the outlook for overall Fund income at that time.

As noted earlier, the silver lining in the bond market's 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 which may endure for years, rather than months, ahead.

Internationally, major central banks are now communicating the last phase of interest rate adjustments, sufficient to anchor inflation expectations, and this does unnerve markets at times. Recently, the balance of evidence has been on the better side internationally, particularly suggesting that the US Federal Reserve is on track to engineer an economic "soft landing."

While the data-driven market volatility 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 the recent 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 an 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 an inflation-affected period, once central bank policy rates begin to fall or there is a downward shift at the short end of the yield curve. As global central banks increasingly pause their interest rate tightening cycles, defensive merit should be re-asserted in coming months through continuing positive demand for these specific "Real Asset" equity types, along with the sustainable dividend-payers in the broader Australasian market.

Greg Fleming, MA