Salt Sustainable Income Fund Fact Sheet – June 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 30 June 2022

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$43.82 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Current yield to 31/10/22	4.00% per annum

Unit Price at 30 June 2022

Application	0.8939
Redemption	0.8902

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 30 June 2022

New Zealand Fixed Interest	0%
International Fixed Interest	18%
Australasian Shares	33%
Global Listed Property	29%
Global Listed Infrastructure	18%
Cash or cash equivalents	2%

Fund Performance to 30 June 2022

Period	Fund Return	Reference Portfolio Return
1 month	-3.30%	-2.87%
3 months	-8.11%	-7.30%
1 year	-8.85%	-8.41%
Since inception	-7.29%	-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 30 June 2022

Goodman Property Trust	Property for Industry
Kiwi Property Group	Argosy Property Trust
Precinct Property	Stride Ppty & Stride Invest Mgmt
Fisher & Paykel Healthcare	Vital Healthcare Property Trust
Spark NZ	Mainfreight

Holdings stated as at 31.06.22, excludes consolidated International Fixed Interest Fund component.

Market Commentary

It has been a tough June quarter for markets following what was already a difficult March quarter. This marks the worst first half of the year for

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developed market equities in 50 years. To make matters worse, bond prices have also fallen significantly, failing to give investors the protection they usually seek from this asset class.

- Central banks continue to play catch-up with inflation, which is contributing to growing risks to growth, though those risks remain greater in Europe than the United States. Labour markets remain tight but negative real wage growth continues to squeeze household incomes. Margins are coming under pressure, especially for consumer-facing companies, with pricing power an increasingly important factor in relative equity performance.
- In the US the Federal Reserve has signalled its clear intention to tame inflation by signalling interest rates will need to rise to 3.8%. Despite unemployment being low and wages increasing, consumer confidence has slumped, contributing to recession concerns. The Fed believes the unemployment rate will need to rise to just above 4% (currently 3.6%) to meet its inflation mandate. U.S. headline inflation came in higher than expected at 9.1% y/y in June.
- Consumer confidence has also slumped in Europe, though the biggest recession risk is the reduction in gas supplies from Russia. Prices have risen sharply, and some form of rationing may have to be implemented. This prospect is already having a negative impact on business confidence.
- The Chinese authorities continue to adopt a Covid-zero strategy, though there has been some easing in quarantine restrictions. With lockdown restrictions easing in some regions, recent economic data has improved. We expect the authorities will continue to back away from Covid-zero, most likely following the Communist Party National Congress later in the year.
- The Reserve Bank of Australia has accelerated its rate hikes, raising the cash rate 50bp in June following the initial 25bp hike in May. Signs are already emerging that the increase in rates thus far is already impacting on consumer behaviour. Despite that, further 50bp hikes are likely.
- The New Zealand economy contracted in the March quarter, in line with weak business and consumer confidence and the "virtual" Covid lockdown over the early months of the year. While the economy will benefit from the reopening of borders and the return of international tourist through the middle part of the year, weak confidence levels point to soft underlying growth. NZ CPI inflation remains above 7% y/y and 6-month Term Deposit rates sit at just 2.75% p.a. in July.

Central Banks' shift in tone to a more inflation-adverse stance, combined with the Ukraine crisis, and energy / food cost spikes, has challenged investor sentiment throughout much of 2022 so far. It appears unlikely that such factors darkening the global growth outlook for the present will clear quickly, and sentiment depends on robustness of corporate earnings and a moderation in cost pressures.

As of mid- July, a shift in market sentient may be taking place, in scaling back slightly the anticipated tightening due to a softer economic outlook.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund again declined moderately in **June**, with a negative monthly return of -3.30% (after fees). Difficult international and domestic conditions persisted, and within this fund's component asset classes, all component assets (excluding Cash) contributed negatively. As has been the recent pattern, the most resilient returns were contributed by Real Asset classes. Global Infrastructure contributed -0.8% and the Salt Enhanced Property Fund, -0.75% for the month. International Fixed Interest, having been a source of negative returns throughout the Quarter, was responsible for -0.64% of the Fund's June month return. Domestic Equities had the primary negative impact, of -1.06% in June. Late in the month, we introduced the Salt Sustainable Global Property Fund into the Income Fund's holding set at a weight of 3.5% due to much better valuations in Global Real Estate given the sharp international asset re-pricing this year. The dividend yield on the sector has now risen to a sufficient level to warrant inclusion in the Sustainable Income Fund, and further internationalises the underlying holdings, adding diversification.

Although the capital growth element previously built up in this fund in late 2021 has been more than reversed by 2022's market developments, the income level has been enhanced. We anticipate the capital growth aspect of the Fund to resume gradually once international conditions stabilize. 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.

In line with the extraordinary weakness in global bond markets in 2022, the Global Fixed Interest Fund was a drag on returns in June month and Quarter, with a monthly bond fund return of -2.36%, and a quarterly decline in total return from bond holdings of -5.03%. The Income Fund remained underweight in the Fixed Interest asset category throughout the period. Fixed Interest assets are currently at just above half their Strategic Asset Allocation weighting, at 18% versus 35% in the SAA. Financial markets were extremely volatile in June, the U.S.

10-year Treasury bond yield beginning the month around 2.84%, hitting 3.48% mid-month before rallying back to close June around 2.97%. Driving volatility was a further U.S. inflation shock, YoY printing at 8.6% in May and 9.1% in June, creating a significant repricing of rate hike expectations especially in the face of ongoing COVID related supply side issues.

Central Banks reacted sharply across the globe with further rises in official rates and further rises signalled. Elsewhere, Russia defaulted on external debt for the first time this century as Western sanctions prevented payments to overseas creditors despite Russia having the funds. It is uncertain how this will play out for foreign debt holders. PIMCO is maintaining its cautious view towards both interest rates and corporate credit, still focusing on relative value positions and diversified alpha strategies. The Fund remains underweight duration with absolute duration currently 6.3 years vs. 7.0 years for the index, the underweights predominantly in the 3-5 year and the 10 year+ sections of the yield curve. PIMCO continues to prefer 5–10-year maturities that appear to be more fairly-priced. PIMCO is generally underweight duration in most regions, particularly the U.S., UK and core Europe although maintains.an overweight to non-core Europe which offers a yield premium while still benefiting from ECB support. The Fund also maintains an underweight exposure to Japan and a slight overweight to the Australia / NZ region.

The Fund remains underweight corporate credit generally, targeting financials and non-cyclicals.

Performance Commentary

Over the rolling three-month period to 30 June and since Inception, the fund's decline has been -8.1% and -7.3%, respectively (after fees.) This is fully explained by the concentrated weakness in both bond and equity markets this year. The bond components of the portfolio have dragged on bond valuation returns as interest rates rose; however, the yield received from those bond investments is also rising rapidly and will support the Sustainable Income Fund's forward distribution path. This is characteristic of a transition period from a low- to 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 and remains in excess of the Income Fund's distribution rate of 4.0% p.a. The equity capital value components of the Income Fund have clearly been marked down but the Real Asset components of Infrastructure and Property are suited to an economically uncertain and inflation-prone period ahead. Defensive merit should be re-asserted in the months ahead through continuing positive demand for these specific equity types, along with the sustainable dividend-payers in the broader Australasian market.

Although the NZ dividend-focussed equity components of the portfolio are yet to make a sustained positive portfolio impact, we expect them to now exert a neutral impact at best on overall Income Fund performance until a catalyst emerges for equity market recovery. Nevertheless, the income yield provided by these assets is important to the Fund's distribution level.

The pricing in of rising interest rates has supressed equity returns in the last several months, but the income yield characteristics of the equity, property and infrastructure sectors continue to strongly support their inclusion at substantial weightings in the fund. By contrast, bond yields, while now higher, are not quite at the level required to make a positive contribution and the risk of mark-to-market valuation declines on many bonds remains.

Nevertheless, given the rapid run-up in global bond yields which has intensified into June, the point at which additional Fixed Income exposure may be added to the Salt Sustainable Income Fund is coming closer. Internationally, major central banks are now communicating the desirable course of carrying through several meaningful interest rate increases, sufficient to anchor inflation expectations, and this will 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 the near-term are inevitable. Over the medium-term, moderate capital gains in addition to income advantages are still expected.

Greg Fleming, MA