Salt Sustainable Growth Fund Fact Sheet – July 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 total return (after fees and expenses but before tax) above the Reserve Bank of New Zealand's Consumer Price Index + 5% benchmark on a rolling five-year basis. To achieve this, the Fund targets a diversified mix of growth and defensive assets, with a focus on securities with strong Environmental, Social and Governance credentials.

The Fund also aims to maximise its total return by outperforming, over the long term, the weighted average return of the market indices used to measure performance of the underlying funds/assets in which the Fund invests: the Reference Portfolio.

Medium-term capital growth is prioritized above income 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 2022

Benchmark	NZ CPI +5% over 5 years
Reference Portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$53.34 million
Inception Date	15 September 2021
Portfolio Manager	Greg Fleming

Unit Price at 31 July 2022

Application	0.9665
Redemption	0.9625

Investment Guidelines

Sector	Target	Range
New Zealand Fixed Interest	10%	0% – 25%
International Fixed Interest	5%	0% – 30%
Australasian Shares	24%	10% – 40%
International Shares	35%	20% - 50%
Global Listed Property	10%	0% – 25%
Global Listed Infrastructure	10%	0% – 25%
Alternative Diversifiers	0%	0% - 15%
Cash or cash equivalents	5%	0% – 10%

Fund Allocation at 31 July 2022

New Zealand Fixed Interest	0%
International Fixed Interest	9%
Australasian Shares	25%
International Shares	35%
Global Listed Property	16%
Global Listed Infrastructure	12%
Alternative Diversifiers	2%
Cash or cash equivalents	1%

Fund Performance to 31 July 2022

Period	Fund Return	Reference Portfolio Return
1 month	5.97%	5.32%
3 months	-0.22%	-0.75%
6 months	-3.77%	-4.22%
Since inception	-3.56%	-4.40%

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 31 July 2022

Fisher & Paykel Healthcare	Mainfreight
Microsoft	Accenture
Spark New Zealand	Reckitt Benckiser Group
VISA	Infratil
Danaher Corp	Thermo Fisher Scientific

Holdings stated as at 31.07.22, excludes consolidated International Fixed Interest component of the Sustainable Growth Fund, due to its large number of securities.

Market Commentary

After the significant market weakness experienced in both equities and bonds in the first half of 2022, July saw stabilising investor sentiment and moderate rebounds in most key asset classes. Equities and Real Assets were particularly strong over the month, reflecting a shift down in longer-term interest rates on fears of a period of imminent economic weakness.

- The July month saw further evidence of the slowdown in global economic growth, while at the same time, inflation continued to reach new highs. Labour markets remained strong, a good sign for activity growth, though strong wage growth points to ongoing core inflation pressure.
- The weaker growth outlook during the month contributed to suggestions of a pivot to the less hawkish by central banks, particularly in the US. This contributed to a “risk on” tone in both equity and bond markets, which is premature in our view.
- In the US the Federal Reserve raised interest rates by 75 basis points (bp) for the second time, taking the Fed funds rate to 2.5%, or around the Committee’s estimate of the long run (neutral) rate. GDP printed negative for the second consecutive quarter, meeting the definition of a technical recession. The National Bureau of Economic Research (the US cycle dating agency) is unlikely to confirm this as an economic recession given the narrowness of the weakness and the ongoing strength in the labour market.
- A similar set of circumstances prevailed in Europe during the month as the European Central Bank began its interest rate hiking cycle with a larger than expected hike of 50bp. The ECB also approved the Transmission Protection Instrument (TPI), a tool aimed at supporting orderly conditions across Eurozone government bond markets, in particular the region's peripheral markets such as Italy and Spain. At the same time, the economy remains on the brink of recession given concerns about the security of gas supplies from Russia. The Nordstream1 pipeline restarted following scheduled maintenance at 35% capacity, though this was later cut back to 20%.
- Activity data was more upbeat in China over the month though the authorities continue to grapple with current Omicron outbreak amidst its still stringent Covid-zero policy. While there have been minor steps to ease restrictions, a more fulsome relaxation is unlikely until after the upcoming Communist Party National Congress.
- The Reserve Bank of Australia continued its aggressive rate hikes with a further 50bp hike in July, with expectations of ongoing hikes of this magnitude. This is supported by labour market data showing Australia’s unemployment rate hit a fresh 48-year low of 3.5% in June as the economy added 88,400 jobs over the month, most of them full-time positions.
- Inflation in New Zealand hit a fresh high of 7.3% in the year to June, higher than market and Reserve Bank expectations. All key core measure of inflation pushed higher also, confirming the Reserve Bank of New Zealand still has work to do, especially considering the tightness in the labour market.

July has delivered a rebound in returns, but not a full recovery

Global equity markets staged a substantial rally in July with the MSCI World Index finishing the July month up 7.9% in US dollar terms (7.0% in NZD.)

In contrast to June, every equity market sector logged gains in July month. Perhaps unsurprisingly, given the extent to which the sectors had fallen in the first Half Year, Information Technology (IT) and Consumer Discretionary stocks as well as Industrials provided the top returns in July. IT gained 12.2%; Consumer Discretionary gained 11.9% and Industrials rebounded 9%. However, on the 2022 Year-to Date (YTD) basis, with the continuing exception of Energy, the defensive equity sectors have held up better, with Utilities (-0.9%) Consumer Staples (-6.3%) Health Care (-7.6%) remaining most resilient for 2022 to 31 July. This pattern reflects uncertainty among investors about how much economies need to be cooled to lower inflation.

Turning to geographies, the US market (+9.2%) led the overall World index (+7%) in the month, while Europe lagged (+6%) and Emerging Markets were flat, edging up 0.2% in July. The UK and Japan posted more moderate gains, both rising by 3.7%, while Australia gained 5.8% and New Zealand, 5.7%.

Salt Sustainable Growth Fund Commentary

The Sustainable Growth Fund benefited strongly from the stabilising global investor sentiment in July month, gaining 5.97% (after fees.) The fund is only barely in negative returns territory over a three-month period, at -0.22%. This has brought the since-inception fund return to -3.56% to 31 July, with the negative impacts concentrated in Q2 2022.

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. This is partly because notwithstanding a recent dip, in 2022 bond yields have moved sharply upward, impacting valuations, and slowing demand worldwide. Investors fear profit slippage as economies slow, although internationally profit growth forecasts, whilst lowered, remain positive. We target investments with defensible profits in difficult periods.

As global growth showed more definitive signs of cooling, the price of oil has retreated somewhat from its June highs of above USD 120 per barrel, declining -25% to around USD 90/bbl in August. US Natural Gas prices have slipped but European and Asian gas prices remained elevated, being more influenced by the Russia-Ukraine situation and by unusual temperatures than is the case for American supply. However, the economic outlook and flat performance in broad Energy prices in July and August has led to a part-reversal in the dominance of the Energy equity sector seen earlier in 2022.

Among domestic asset classes, the New Zealand Equity component of the Sustainable Growth Fund participated robustly in July’s global rally. The Salt Core NZ Shares Fund rallied 6.09% for the month, lifting its six-month rolling performance to -3.16% which was ahead of its benchmark by 0.18%. The change in investor sentiment after Central Banks aggressively raised interest rates to control inflation resulted in the NZ 10yr bonds rallying to 3.5%, having touched 4.25% as recently as mid-June. This saw the some of the pressure come off the cyclical and longer-term valuation growth stocks.

The robust returns in the Sustainable Growth Fund’s Global Equities component are indicative of the portfolio structure of the Morgan Stanley Investment Management strategy within this asset class. Due to the prioritisation of low carbon-footprint investments within that fund, the strategy has above-benchmark holdings in Info Tech, Health Care and Consumer Staples sectors. The full benefit of the defensiveness in Staples and Health Care is beginning to positively impact, though this has taken time to emerge, as the evidence on US recession risk is not yet definitive.

As at 31 July, the Salt Sustainable Global Shares Fund - the largest single component within our Sustainable Growth Fund - recorded a gain of 6.28% (after fees) for the month and a rise of 3.27% over the three-month period. For the full 12-month period, the Sustainable Global Shares Fund delivered a very limited gain of +0.73% (after fees), but this was ahead of the MSCI World Equity Index (in NZD) which gained just 0.48% over that period.

We believe that the specific companies favoured in the Sustainable Global Shares Fund will be able to protect their pricing power in an inflationary environment and will give them comparative resilience to changes in the global economic cycle, including higher inflation and interest rate. That is more the focus of this portfolio strategy, rather than directly hedging against shocks to global bond yields. Quality companies are more resilient.

The Sustainable Global Infrastructure Fund, benefits from safe-haven appeal and should continue to diversify the Sustainable Growth Fund risks. The asset class has done well this year, and the Salt Global Listed Infrastructure fund gained 4.82% in July and 5.94% over the last six months. The Sustainable Global Property Fund, which had contributed negative returns in line with global property markets in June, rallied strongly in July and gained 7.72% (after fees) last month. This rebound in Listed Real Estate more than halved the Fund's negative return over the rolling six-month period to -6.86% as at 31 July. Both listed real asset funds are outperforming their benchmarks in 2022 YTD, Infrastructure, by 0.5% and Property by 1.0%, as well as providing valuable diversification benefits.

First Half 2022 returns from Property partially reflected the surge in global long-bond interest rates through the period, as yield competitors for Real Assets. A phase of listed real estate price lag is characteristic of the early stages of a monetary policy tightening cycle such as we are presently seeing develop across the world. Nevertheless, Property's scope for inflation-hedging and other longer-term advantages of the asset class outweighs the near-term impact of bond yield movements on prices.

The International Fixed Interest component of the Sustainable Growth Fund gained 2.92% in July and 0.73% over the three-month period, though Fixed Interest remains a negative returns influence over the full year (-7.3%) and is being held at a below-benchmark asset allocation weighting, given bond risks. Yields are still fairly low, the term premium remains deeply negative, and QT (Quantitative Tightening) dynamics are yet to be reflected in bonds.

The other exposure within the Sustainable Growth Fund with a positive July month's performance was the Salt Carbon Fund, which rose 3.62% for the month and has gained 2.4% for the six months to 31 July. This demonstrates the Carbon Fund's value as a non-correlated diversifier over a volatile period, and we intend to increase the small initial allocation within the Slat Sustainable Growth Fund in coming weeks.

Greg Fleming

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