SALT

Salt Sustainable Global Shares Fund Fact Sheet – January 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's investment objective is to outperform (after fees and expenses but before tax) the MSCI World (Net) Index in New Zealand dollars on a rolling three year basis. To achieve this, the Fund targets a portfolio of global companies with high total return potential and high Environmental, Social and Governance (ESG) factor scores.

The strategy seeks to provide attractive long-term returns with less long-term volatility than the broader market by reducing the risks associated with poor ESG outcomes. The Fund will seek to achieve its investment objective by investing primarily in global equity.

Fund Facts at 31 January 2022

Benchmark	MSCI World (Net) Index in NZD
Fund Assets	$48.57 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 31 January 2022

Application	1.0783
Redemption	1.0739

Investment Guidelines

The guidelines for the Sustainable Global Shares Fund are:

Global Equities	95% – 100%
Cash	0% – 5%

Target investment Mix

The target investment mix for the Salt Sustainable Global Shares Fund is:

Global equities	100%

Fund Allocation at 31 January 2022

Global equities	98%
Cash	2 %

Fund Performance to 31 January 2022

Period	Fund Return*	Benchmark Return
1 month	-2.33%	-1.27%
3 months	5.64%	5.25%
Since inception	7.61%	7.21%

Performance is net of fees and tax, but not adjusted for imputation credits. Benchmark performance is gross. Past performance is not a guarantee of future results. Data as of 31 January 2021.

Top 10 holdings	
Microsoft (US)	Abbot Laboratories (US)
Accenture (US)	Baxter International (US)
VISA (US)	Thermo Fisher Scientific (US)
SAP (DE)	Danaher (US)
Reckitt Benckiser (UK)	Becton Dickinson (US)

Source: MSIM, data as at 31 January 2022

Market Review

Developed market equities reversed direction downwards after a positive fourth quarter of 2021, delivering a sharp dip in returns that stopped only barely short of the -10% level that conventionally defines a "correction" in the broad US market. At its weakest point in January, the S&P 500 Index had declined by -9.9%. However, highly-valued Information Technology companies traded on the US NASDAQ were somewhat weaker, leading the NASDAQ-100 Index to have moved down by -10.6% between New Year and the first week of February.

Following a strong 2021, January has been a rough start to 2022 for equity and bond markets. Higher inflation, concerns about central bank tightening, political tensions in eastern Europe and Omicron all contributed to market weakness in January and a sharp increase in volatility. Many countries are seeing some softening in activity indicators. Much of this is Omicron-related and will prove temporary. However, we do expect lower overall global growth this year compared to last, though to remain above trend.

Most central banks are shifting to a more hawkish stance, though not all have yet acted, particularly as measures of core inflation rise and labour markets tighten, rending the transitory inflation narrative erroneous. US consumer price inflation continued to rise, coming in at 7.5% for the year to January 2022, the highest level in the forty years since 1982. At the same time the labour market remained extremely tight, with the unemployment rate at 4.0% in January 2022.

The US Federal Reserve is on schedule to end its bond purchase programme in March. The January meeting of the Federal Open Market Committee (FOMC) all-but-confirmed interest rate lift-off in March and that they are actively pursuing plans to reduce the size of their bloated balance sheet. Investors' concern about significantly tighter overall

monetary conditions, given high equity valuations, translated into a rapid deterioration in sentiment which lasted throughout January.

The high global price of oil is among the factors supporting expectations of more persistent headline and pipeline inflation. Having risen by a hefty 55% in calendar 2021, January saw the WTI Crude price surged another 19% to USD 88/bbl. This supported energy stocks alone, while other sectors were suppressed by interest rate moves. In both the MSCI AC World Index, and in the US market, Energy was the solitary segment to gain in value in January; with rallies of 18.9% in the US and 11.9% in Europe. However, Sustainable investment mandates tend to hold low or no exposures to the Energy complex and thus lagged for the month.

A more robust January month performance was recorded in major markets outside the US, as investors pivoted their portfolio holdings away from the high market capitalization US leaders of recent years and toward those companies and markets where valuations are less prohibitive, given higher interest rates ahead in most developed markets. As a result, the MSCI World Index lost -5.5% for the month with Europe excluding the UK down -4.7% and Japan, by -4.8%.

This contrasts with greater index declines in Australia and New Zealand than were observed internationally, with the ASX 200 lower by -6.4% and the NZX 50 dropping -8.8% in the month of January.

Global corporate growth was insufficiently reassuring to offset inflation fears adding to fresh volatility due to geopolitics between Russia and NATO and in East Asia. The jury is still out on the full implications of the Omicron variant. Sovereign bond yields rose sharply during the month, as central banks turned more hawkish. The US 10 Year Treasury yield jumped 0.27% to 1.79% and the Australian equivalent yield also by 0.27% to 1,88%. New Zealand sovereign bonds were not spared and the 10 Year yield on domestic government debt rose 0.19% to 2.56%.

Portfolio Review

- In January, the Portfolio returned -2.33% (NZD/net), behind of the MSCI World Index which returned -1.27% in NZ dollar terms (gross.) The absolute return to the Sustainable Global Shares Fund's portfolio was cushioned to an extent by a -3.7% decline in the value of the NZD/USD exchange rate and lesser depreciations of NZD against other constituent currencies, especially EUR.

- The Portfolio has returned +5.64% (net) for the three-month period to January 31, and +7.61% since inception (12 July, 2021) outperforming the benchmark by 0.40%.

- Underperformance in the month was due to negative sector allocation, driven by the zero weighting in Energy, the underweight in Financials and the overweights in Information Technology and Health Care.

- Stock selection was roughly neutral. Outperformance in Information Technology and Health Care was offset by negative performance in Consumer Staples and Financials, given the lack of banks which rallied strongly.

- The top contributors to absolute performance during the month were Visa (+48 basis points [bps]), Fidelity National Information Services (+25 bps), Becton Dickinson (+21 bps), Baxter (+16 bps), and Deutsche Boerse (+14 bps).

- The five absolute detractors were Accenture (-58 bps), SAP (-49 bps), ADP (-45 bps), Thermo Fisher (-37 bps) and Danaher (-36 bps).

As of January 31, 2022, the Portfolio's carbon footprint is 83% lower than the MSCI AC World Index.

Portfolio Outlook

It is worth bearing in mind that despite the January fall, the MSCI World Index is still trading on a very high 18x forward earnings, a level never seen between 2003 and 2019. This high multiple is on earnings up more than 50% over the last 18 months (source: FactSet). Given this, investors need to watch where both earnings and multiples go from here.

Inflation is a significant potential threat to both multiples and earnings. On multiples, January has already seen a multiple compression on the more expensive stocks, as higher discount rates have a bigger effect on growthier and therefore longer duration assets. Going forward, inflationary costs pressures may well squeeze margins and thus earnings. Importantly, our view is that the portfolio is positioned to provide some resilience to both threats.

The team's focus on valuation risk over the last few years has contributed to the portfolio's relatively low free cash flow premium relative to the index. Moving on to the earnings risk, **pricing power is one of the key characteristics we look for in our stock selection process**. The companies' intangible assets, be they brands or networks, should allow them to pass on rising input costs to their customers, protecting margins. In addition, in the case where government actions against inflation cause an economic slowdown, or even a recession, recurring revenue, another factor we focus on, should protect the portfolio's earnings just as it did in 2008-9 and early 2020.

Our outlook as always remains cautious. We have seen massive government interventions and the vaccines fuelling a strong economic recovery and earnings growth. Any fall in profitability from here will not just hit earnings for the market but could potentially hurt the currently elevated multiples as well. Cost pressures will make it tough for the broad market to hold on to the forecast peak margins.

Whatever the pace of change in 2022, efforts to create a sustainable future is a game that's played out in decades, not months. As the transition takes place, we believe companies with a strong awareness are more likely to stay on top of their game and deliver long-term returns for clients. As bottom-up stock pickers, we're determined to keep seeking better outcomes, to learn and improve our offering to you, and to keep pressing for progress from the world's best companies.

Greg Fleming, MA

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