

SALT

Salt Sustainable Global Shares Fund Fact Sheet – October 2021

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 October 2021

Benchmark	MSCI World (Net) Index in NZD
Fund Assets	\$33.20 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 31 October 2021

Application	1.0208
Redemption	1.0166

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%
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Fund Allocation at 31 October 2021

Global equities	98%
Cash	2%

Fund Performance to 31 October 2021

Period	Fund Return*	Benchmark Return
1 month	1.60%	1.85%
3 months	0.89%	1.23%
Since inception	1.86%	1.86%

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

Contribution breakdown by security for October 2021

October Stock Attribution		
Top Absolute Contributors	Performance %	Contribution %
Microsoft	13.37	0.98
ICE	16.24	0.46
Accenture	8.43	0.40
ADP	8.26	0.27
Thermo Fisher	6.82	0.26
Top Absolute Detractors	Performance %	Contribution %
Visa	-8.35	-0.44
Medtronic	-7.83	-0.30
Henkel	-7.11	-0.27
Becton Dickinson	-6.06	-0.25
Baxter Int'l	-5.37	-0.23

Source: MSIM

Top Holdings at 31 October 2021

Microsoft (US)	Thermo Fisher Scientific (US)
SAP (DE)	Abbott Labs (US)
Accenture (US)	Baxter International (US)
Reckitt Benckiser (UK)	Danaher (US)
VISA (US)	Becton Dickinson (US)

Source: MSIM

Market Review

After a weak September month, global stock markets regained momentum during October with many indices making new highs during the month. The key catalyst was a solid start to the US earning season, while progress on the problems facing the Chinese property market also helped China and global sentiment. More generally, the economic growth story remains solid. High frequency data including flash purchasing manager indices improved in many countries over the month. Progress in vaccination campaigns also suggested reduced risk of a return to widespread economic and social restrictions. China is the

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main exception as it continues to implement a Covid elimination strategy. The MSCI World index rose 5.7% (in USD terms) over the month to be up 38.5% over the year. However, in NZD terms this monthly return was limited to 2.0% as the kiwi dollar rallied during October in anticipation of a more aggressive Reserve Bank OCR stance.

In the United States Q3 GDP came in at a disappointing annualised rate of 2%, with supply side issues constraining activity. Labour shortages continue to hamper the improvement in the labour market, though the unemployment rate continued to fall while wages continued to accelerate. The combination of supply constraints and wage pressure saw the CPI print at an annual rate of 5.4% with core inflation at 4.0%. This saw heightened expectation of an imminent tapering of the Fed's QE program and the pricing of higher interest rates from late 2022.

The S&P 500 hit fresh all-time highs during the month, ending 6.9% higher (in USD) and up 40.8% over the year. In October it was the cyclical sectors that performed best, with Consumer Discretionary, Energy and Information Technology lifting by 8% (in USD) and Financials gaining 6%. By contrast, the more defensive sectors lagged last month, with Consumer Staples rising 3% and Health Care up 4%. Communication Services (+1%) was the weakest sector. Looking at geography, North America performed well, with the US up 7% and Canada gaining 5% in local currency. Most major European and Asian markets finished behind the World index, barring Switzerland. Political uncertainty took its toll on Japan and Germany while Hong Kong was also a comparative laggard due to policy risks. Emerging Markets lagged, gaining 0.9% in October as Brazil and South Korea weakened.

Market Outlook – Supply Chain Squeeze (MSIM commentary)

The market remains at a high multiple. Despite September's mild pull-back, the MSCI AC World Index is still trading on 18.4x next 12 months' earnings, a 25% premium to the average multiple of the last 20 years. It is notable how resilient this multiple has been as earnings have recovered from the June 2020 trough. This extreme valuation versus sales is on the back of sharp improvements in profitability and brings risks for the market. Any fall in profitability will not just hit earnings but could potentially hurt multiples as well. The US forward PE is now 22.2x.

Eighteen months ago, demand for goods and services collapsed as the Covid-19 pandemic swept over the globe. Many countries suffered their largest GDP contractions ever recorded. Today, with some exceptions (e.g., the travel industry) demand for goods and services in the corporate world is stronger than ever. But companies are facing more operational challenges due to a squeeze in supply chains, from shortages in labour, raw materials and components, as well as tight logistics capacity, all putting upward pressure on costs, and restricting product availability. We are now observing something unusual: profit warnings due to a lack of supply, rather than an unexpected drop in demand. COVID has led to a dramatic shift in the types of goods and services people want over a relatively short space of time. This isn't a huge surprise because the way we live and operate, for the broad population, has changed dramatically. Such rapid shifts in demand are not easily matched by supply chains, which take longer to build up.

The rush to "not miss out" on resurgent consumer demand creates ESG risks, as well. There are well documented supply chain controversies for the sporting goods industry; its constituents need to be careful not to add to the list with the pressure to ramp up production quickly while balancing labour welfare. This could be a good test of how much progress a company has made in making people a priority in their way of doing business. Of course, while sporting goods are a recent victim,

semiconductors were perhaps the earliest category where there was a clear mismatch in supply and demand. Here, increased demand as a result of Covid (work from home, home schooling, etc.) hit up against relatively fixed near term supply. This has had a knock-on effect in many parts of the economy, most notably stalling the automotive sector, which goes to show just how pervasive technology is becoming within the global economy. There is no easy fix to the semiconductor shortage – it can only be addressed by new manufacturing capacity. Here the leading Taiwanese foundry has indicated it will invest \$100 billion over the next three years. The shortage has also shone a light on just how narrow and globalised the semiconductor supply chain has become with capacity provided by only a handful of major chipmakers and equipment manufacturers.

For companies with pricing power, cost inflation can be passed on to the end customer. The strong demand environment today means many companies, even those historically with weak pricing power, are confident they can pass on cost increases, minimising the impact on profits. The difference is, pricing may not stick once this period of supply squeeze abates, for those with weak pricing power.

Pricing power is a vital attribute we seek in the companies we own in our global portfolios. So, while there may be some short-term volatility for their earnings and returns, the earnings potential of these higher quality companies should be re-based higher once this episode is complete, and the gap between the high-quality companies and the low-quality ones widens.

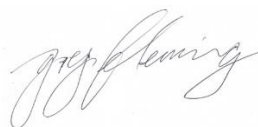
Portfolio Review

In October, the Portfolio returned +1.60% net, slightly behind the MSCI World Net Index which returned +1.85%. The Portfolio is in line since Inception, returning +1.86% versus +1.86% for the index. The slight October month underperformance was driven by negative sector allocation, due to the strong performance by cyclical sectors. In particular, the overweight in Consumer Discretionary and the overweight in Health Care and Consumer Staples were drags on performance, mitigated to an extent by the overweight in Information Technology and the lack of Communication Services stocks. Stock selection was marginally positive in the month, as the outperformance in Communication Services and Financials was almost balanced by the underperformance in Health Care.

Portfolio Outlook

If there is a sustained reflationary recovery, the resulting healthy sales growth could drive further operational leverage. In addition, earnings estimates tend to be lagging indicators, meaning that there may be further earnings upgrades to come. Against this positive view, is the potential for significant cost pressures persisting over the next decade.

Even if the macro environment remains favourable, which is far from a given, the resulting cost pressures will make it tough for the market to hold on to the forecast peak profit margins – in the absence of the precious pricing power, which is core to our stock selection in the Sustainable Global Shares fund.



Greg Fleming, MA

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