Salt Sustainable Global Shares Fund Fact Sheet – July 2024

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 July 2024

Fund Assets	$69.89 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 31 July 2024

Application	1.3356
Redemption	1.3301

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 July 2024

Global equities	98.0%
Cash & sundry items	2.0%

Fund Performance to 31 July 2024

Period	Fund Return	Benchmark Return
1 month	6.54%	4.40%
3 months	8.61%	8.06%
6 months	12.44%	16.45%
1 year	21.57%	23.99%
2 year p.a.	15.97%	19.06%
3 year p.a.	11.12%	12.74%
Since inception p.a.	11.26%	12.70%

Performance is before fees and tax and adjusted for imputation credits.
Benchmark performance is gross.

Fund ESG Scores	Portfolio	Index
Sustainable Global Shares	26T CO2 /$m	162T CO2 /$m
Portfolio Carbon Footprint:	16% of Index*	

Source: MISM Quarterly Investment Report & Trucost based on the Scope 1 & 2 carbon emissions per $1million of Portfolio companies' sales, and as weighted average carbon intensity (WACI). *As at 31 July 2024, the Portfolio's carbon footprint was 84% lower than that of the Index.

Top 10 holdings	
Microsoft (US)	United Health Group (US)
SAP (DE)	Thermo Fisher Scientific (US)
VISA (US)	Aon (US)
Accenture (US)	Relx (UK)
Intercontinental Exchange (US)	Alphabet (US)

Source: MSIM, data as at 31 July 2024.
The Top 10 Holdings represented 41.34% of the total portfolio.

Market Review

- July was a volatile month for markets. Weaker US labour market data and a weaker than expected US CPI set the tone and saw markets bring forward expectations of rate cuts by the US Federal Reserve. The Global Aggregate Bond Index returned 2.8% (in USD) and 1.9% in NZD over the month.

- Equities were more muted as investors became more skeptical about the ability of artificial intelligence and growth stocks more generally to continue to drive markets higher. Developed market equities rose 1.8% (in USD) and 4.4% in NZD over the month.

- In the US the July labour market report showed slowing employment growth, a higher unemployment rate and moderating wage growth. GDP data came in stronger than expected at an annualised 2.8% in Q2, but more recent higher frequency data pointed to a slowdown ahead. June CPI data came in under expectations, and just a few hours later the Fed opened the door to a September rate cut.

- In Europe, Purchasing Manager Index (PMI) data was weak, suggesting a moderation in growth over the summer. This also bolstered expectations of further rate cuts from the European Central Bank.
- The Bank of Japan continued its gradual normalisation of monetary policy in July, raising its policy rate 15 basis points from 0.10% to 0.25%. The BoJ is clearly comfortable with recent developments in wage growth and inflation expectations.
- July was also a busy month for northern hemisphere politics. The second round of French legislative elections turned the first round on its head. In the US there was an assassination attempt on the presumptive Republican nominee Donald Trump and President Biden decided not to see re-election.
- In China, ongoing problems in the property sector continue to impact activity in the broader economy. Private consumption remains particularly weak. The authorities continued their reactive and gradual approach to easing.
- In Australia the focus was on inflation and whether the Reserve Bank of Australia would resume interest rate hikes. It all hinged on the June quarter CPI outcome which was released on the last day of the month. While it came in higher than the most recent set of RBA forecasts, it was below market expectations and probably not sufficiently bad for the RBA to hike in August.
- In New Zealand, the key development was a dovish pivot from the Reserve Bank of New Zealand which was all the more surprising given it was only six weeks after their surprisingly hawkish outing in May. The change in tone clearly reflects the recent run of weak activity data, and signs from business surveys that firms pricing power is dramatically reduced given the weakness in activity. We see no reason why the RBNZ shouldn't start the unwinding of current restrictive monetary conditions in August.

Portfolio Review

- The July outperformance was largely attributable to positive stock selection, given Health Care strength due to generally decent Q2 numbers reported by portfolio companies and Information Technology outperformance helped by the underweight in semiconductors, which more than offset the mild hit from underperformance in Communication Services.
- Sector allocation was also slightly positive thanks to the benefit from the Financials overweight.
- The largest contributors to absolute performance during the month were UnitedHealth Group (+53 basis points) IQVIA (+53 bps), ICE (+49 bps), Accenture (+49 bps) and Aon (+44 bps).

  The largest absolute detractors were Microsoft (-23 bps), UMG (-18 bps), Alphabet (-11 bps), Atlas Copco (-3 bps) and TSMC (-3 bps).

Commentary & Outlook for July2024 (Morgan Stanley Investment Management)

In July, the Portfolio returned +6.54% (Gross/NZD), while the MSCI World Net Index returned +4.40%. The Portfolio has returned +18.16% for the year to date (YTD), versus +21.22% for the index. We seek to deliver attractive long-term absolute returns.

Global equity markets pulled back in the second half of July, with the MSCI World Net Index returning +1.8%, and +14% for the YTD in U.S. dollars.

At the strategy level, the largest contributors to absolute performance during the month were companies with favourable earnings results. IQVIA raised full year revenue guidance on the back of better-than-expected performance in its technology & analytics solutions (TAS) business, UnitedHealth saw quarterly profits top analysts' expectations on the back of stronger-than-anticipated revenue growth in the healthcare services division, ICE beat consensus earnings per share (EPS) estimates and delivered record revenues, Accenture continued to bounce back from earlier weakness having reported strong GenAI bookings and a confirmation of an imminent return to organic growth at their June results, and Aon appears to be back on track after a weak first quarter, with solid organic revenue growth across business segments, including Commercial Risk.

At the strategy level, the largest absolute detractors were Microsoft where, despite double-digit sales and earnings growth for Q2, marginally lower Azure growth (still 30% in constant currency terms) disappointed investors anxious to see payoffs from the hefty AI investments, UMG, which fell double digits on account of its streaming and subscription business (c.~65% of group revenues) missing Q2 targets, Alphabet, which met Q2 earnings expectations but missed on YouTube advertising revenue as well as triggering concerns about the returns on the rising capex, TSMC, which derated alongside the Semis subsector due to nervousness around return potential from Gen-AI despite strong Q2 results, and Roper, on the back of a rare production slip in its water meter business.

Looking at sectors, in a reversal from the YTD pattern, the highly cyclical, growth-tilted Communication Services (-3%) and Information Technology (-2%) sectors were negative in the month, as markets grappled with uncertainty surrounding Tech's return potential on GenAI, with semiconductors particularly weak (-5%).

Meanwhile, the generally cheaper Real Estate and Utilities sectors (both +7%) – which have lagged in the AI-fuelled rally – outperformed, alongside Financials (+6%) and Industrials (+5%). The typically defensive Health Care and Consumer Staples sectors (both +3%) were also ahead, although closer to the overall index.

Turning to geographies, the U.S. (+1%) underperformed the index in the month, which meant other major markets tended to outperform. Expectations of a shrinking interest rate spread between the Federal Reserve (Fed) and the Bank of Japan (BOJ) saw a strengthening Yen, which meant Japan equities did well in U.S. Dollar terms (+6% USD, -1% local), at least up until the end of July.

Switzerland (+5%, +3%) and the UK (+4%, +3%) were also toward the top of the pack, while all other major markets finished within 200 bps of MSCI World.

Niches – searching for the road less travelled

One of the benefits of conducting fundamental research with a well-resourced investment team is the capacity to search far and wide for investment candidates. While many of the companies we own are large businesses with well established, familiar brands, in our experience, excellent companies and investment opportunities can also be found by looking at players focused on specialised niches - particularly those that play a critical role within a market and enjoy close customer relationships. Undeservedly – but perhaps not surprisingly – these companies often sit outside the market limelight and can fall between the cracks of sell-side coverage.

The strengths of niche operators

By niche we mean a specialist market that is served by a modest number of competitors. For a corporate, there are some clear benefits to successfully implementing a focused niche strategy. By virtue of a concentrated market structure, a niche operator should be able to enjoy excellent margins and therefore likely superior long-term returns. The fact that the markets they focus on tend to be fairly modest in absolute size can also reduce the risk of significant competition, as larger and seemingly juicer opportunities are to be found elsewhere. A further benefit of modest size is that there tends to be fewer anti-trust issues.

Arguably most important however, is that a successful niche operator is likely to have a culture that is focused on profits and returns, and not on sales. It will often have a more focused investment strategy, crucially also for M&A. By their very nature, deals will tend to be smaller and "bolt on", rather than higher risk jumbo or "transformational" acquisitions. Deal rationales will often be more focused on important questions such as "why is this an attractive market to operate in for the long term?", rather than the toxic "what is the EPS-accretion that a spreadsheet spits out?"

A criticism levied at niche operators is that they simply lack ways to grow, especially if they already dominate a market segment. However, the reality we typically observe is more nuanced. Niche operators often successfully outcompete less focused peers who are also busy operating in far larger but structurally less attractive end markets. Well-run companies can also be in a position to grow the overall market they operate in. They operate from a position of strength, with the management resources to innovate in new areas and expand the range of products available or the potential customer base.

Successful niche operators

Niches can form high quality pockets within larger, more mature and competitive sectors. From the perspective of an investor, the exchanges form a rich vein of excellence within the financial industry. They operate essential and difficult to displace market infrastructure, typically enjoying very deep moats from a combination of branding and network effects. As a result, exchanges can deliver very attractive profitability and high returns – financial plumbing may not be particularly glamorous, but it can be lucrative. We own three exchanges in the Portfolio: the US-based Intercontinental Exchange, which operates 12 exchanges and six clearing houses globally, the Germany-based Deutsche Boerse, which operates Eurex, Clearstream and other listing, trading, clearing and data businesses, and leading futures exchange CME, with a 90%+ share of U.S. futures in a range of asset classes and which we bought this year.

For a corporate, an appreciation of the benefits of being a niche operator can result in a deep-rooted culture of continuous improvement, even as the underlying business increases in size. A U.S. tech company we own, Roper, has industrial roots, but today its revenues are split ~75% vertical software and ~25% medical & water products. The company is focused on operating "market-leading business in defensible niches" and has consistently become a higher quality business, as measured by returns on operating capital, profitability, cash generation, and markedly reduced cyclicality.

By their very nature, niche operators can often play a vital but less visible role. One U.S. business services company we own (Broadridge) plays a key position as the dominant proxy infrastructure provider. The company is deeply embedded in the U.S. financial markets, as can be seen by its very high and consistent recurring revenue retention rate, which has averaged 98% over the last 15 years. We think this is a company that probably is "under researched" by Wall Street, something almost certainly not helped by the fact that while it considers itself a fintech, and largely serves financial customers, it is classified as an industrial!

Recipe for compounding

Our investment philosophy focuses on high quality companies with a strong and resilient compounding outlook. By focusing on attractive niches, well managed companies can carve out consistently profitable, high return businesses. In our experience, management teams that have an appreciation for niches are often good custodians of shareholder capital. In any given year, the results are unlikely to blow the lights out, but a taste for niches is a good recipe for strong, consistent, long-term compounding.