
# Salt Sustainable Income Fund Fact Sheet – February 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 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 Environmental, Social and Governance features & reliable income generation. The Fund's strategy is to invest in a quality asset mix to provide regular, sustainable income and a positive return on capital. 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 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 29 February 2024

| | |
|---|---|
| **Benchmark** | Bank deposit rates (BNZBIL Index) |
| **Reference portfolio** | SAA-weighted component benchmark indices' performance |
| **Fund Assets** | $44.00 million |
| **Inception Date** | 19 June 2021 |
| **Portfolio Manager** | Greg Fleming |
| **Prospective distribution yield (cents per unit) / based on Unit Price of 1.02.23** | 1.125 cents per unit per Quarter / 5.16% per annum |

## Unit Price at 29 February 2024

| | |
|---|---|
| **Application** | 0.8556 |
| **Redemption** | 0.8521 |

## Sustainability Metrics

| Fund ESG Scores | Portfolio | Category avge |
|---|---|---|
| Morningstar ESG score | 20.94 | 22.00 |

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 29.02.24. Sustainalytics provides issuer-level ESG Risk analysis used in the calculation of Morningstar's Sustainability Score. Sustainable Investment Mandate information is derived from the fund prospectus.

## Investment Guidelines

| Sector | Target | Range |
|---|---|---|
| **Global Fixed Interest** | 35% | 0% – 60% |
| **Australasian Shares** | 30% | 15% – 45% |
| **Global Listed Property** | 15% | 0% – 35% |
| **Global Listed Infrastructure** | 15% | 0% – 35% |
| **Cash or cash equivalents** | 5% | 0% – 20% |

See "Salt Statement of Investment Policy and Objectives, 30 June 2022"

## Fund Allocation at 29 February 2024

| | |
|---|---|
| **Global Fixed Interest** | 29.5% |
| **Australasian Shares** | 29.0% |
| **Global Listed Property** | 23.5% |
| **Global Listed Infrastructure** | 17.0% |
| **Cash or cash equivalents** | 1.0% |
| **Asset allocation to Fixed Interest + Cash** | **30.5%** |

## Fund Performance to 29 February 2024

| Period | Fund Return (before fees) | Gross Reference Portfolio Return |
|---|---|---|
| **1 month** | -0.41% | -0.39% |
| **3 months** | 3.16% | 3.10% |
| **6 months** | 2.88% | 3.31% |
| **1 year** | 2.27% | 2.78% |
| **2 years p.a.** | -1.37% | -1.30% |
| **Since inception p.a.** | -1.27% | -0.86% |

Performance is before fees and tax, adjusted for imputation credits.
Reference Portfolio return is gross.

## Top Individual Holdings at 29 February 2024

| | |
|---|---|
| Goodman Property Trust | Kiwi Property Group |
| US 5Yr Note (CBT) Jun24 | Infratil |
| Fisher & Paykel Healthcare | Auckland International Airport |
| Precinct Properties NZ | Spark New Zealand |
| US 2YR Note (CBT) Jun24 | Contact Energy |

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## Market Commentary

- February was a good month for equity market returns, reflecting generally resilient economic data and solid earnings reports, especially in the United States. Developed market equities rose 4.3% over the month (in USD). It was not such a good month for fixed income markets as the stronger data saw an ongoing pullback in interest rate reduction expectations, both in terms of quantum and timing. The global aggregate index was down -1.3% (in USD) over the month.
- Economic data was strong in the US. The US composite Purchasing Managers Index (PMI) remained in expansion territory in February, and the economy added 353,000 jobs in January. The unemployment rate has now remained unchanged for 3-months at 3.7%. Stronger than expected outcomes for both the CPI and PPI led to expectations of a strong core PCE result after 3-months of more muted increases.
- In Europe, the composite PMI rose more than expected to 48.9 in February. That is still in contraction but suggests the worst of the downturn may be over. January inflation came in at 2.8%, still above the ECB's 2% target. Expectations for a first interest rate cut from the ECB next quarter have grown stronger recently, however, interest rate markets scaled back their bets on the magnitude of cuts this year after the PMI result.
- In Japan, the Topix saw another healthy rise of 4.9% over the month. That was despite a weaker-than-expected GDP print for the December quarter of -0.1%, placing the economy in a technical recession. It should be noted that the economy's reopening drove strong GDP growth in the first half of the year, so Japan's average annual growth for 2023 was strong both on a real basis (+1.9%) and on a nominal basis (+5.7%).
- The Chinese share market had a better month in February. Activity data over the Lunar New Year resulted in stronger economic activity while the authorities announced several stimulus measures, including a larger than expected cut to the 5-year loan prime rate. Speculation was also building through the month about the likelihood of some form of fiscal measures to be announced at the National People's Congress in early March.
- The Reserve Bank of Australia kept rates on hold in February and softened its tightening bias, but by less than expected. While risks are viewed as balanced, there is still concern about resilient inflation, especially services, which is contributing to cautious guidance. We think the RBA will be one of the last central banks to start cutting interest rates.
- In New Zealand, December quarter labour market was not as soft as expected. The unemployment rate rose from 3.9% to 4.0% over the quarter, but this was less than the 4.2% forecast by the RBNZ. This saw a significant change in market expectations of the next move in interest rates from a cut to further hikes. In the end, sense prevailed and the RBNZ left interest rates unchanged at the February Monetary Policy Statement. They also flagged less probability of future hikes.

## Salt Sustainable Income Fund Commentary

**The Sustainable Income Fund's rebound paused in February, with a return of -0.4% (before fees) in the month, which led its quarterly return to 3.16% and its one-year return to 2.27% (before fees.) The small declines in January and February reflect reconsiderations in bond markets as to the likely speed of lower central bank interest rates, which led to consolidation in the listed Real Asset returns within the portfolio after their strong late-2023 gains.**

For the three-month period to 29 February, the Sustainable Income Fund was slightly ahead of its reference index, outperforming by 0.06%. For the year to 29 February, the portfolio's reference index rose by 2.8% which was 0.5% ahead of the fund's 2.3% one-year gross return. On a two-year annualised basis, the fund's gross return is in line with that of the reference index: -1.37% p.a. compared to -1.30% p.a. for the index.

As inflation progressively shows signs of a definitive down-shift, we expect component asset classes to improve further, as global central banks will ultimately embark on interest rate easings. Volatility across markets is ever-present but sentiment is much less fragile. Central banks around the world remain vigilant, but have scope to assess the impact of high rates on inflation pressures positively, and incrementally lower rates. We expect value recoveries in interest-rate sensitive assets to continue in 2024.

However, markets expressed excessive optimism in late-2023 as to how swiftly those central bank rate cuts are likely to eventuate. A more realistic turn as 2024 got underway explains the softer returns from the most interest rate-sensitive asset components of the Income fund.

February month saw the only positive returns contributions to the Income Fund coming from the Sustainable Global Infrastructure Fund, which provided 0.35% and the Global Fixed Interest Opportunities Fund and Sustainable Global Property Fund, which contributed 0.03% and 0.02%, respectively.

On the negative side of the ledger, the Salt Enhanced Property Fund made a negative impact of -0.67% in February and the NZ Dividend Appreciation Fund detracted0.13% for the month. The Sustainable Global Property fund made a neutral contribution in February, at 0.02%.

## Salt Sustainable Income Fund outlook

Markets got ahead of themselves in late-2023 in anticipating central bank rate cuts, though these are still expected for later this year. We believe bond yields have now adjusted sufficiently (via a volatile and uncertain route in the last 18 months) for us to move progressively toward a higher bond positioning within the Sustainable Income Fund. We consider inflation risk now poses reduced danger to the capital valuations of bond portfolios. The allocation to bonds is now 29.5% vs a 35% SAA. Our next step will be to increase this even closer toward a Neutral allocation.

The Reserve Bank of New Zealand has remained "on hold" with the Official Cash Rate, as core inflation is persisting, so domestic yields and discount rates are likely to stay fairly elevated. This suppressed returns from NZ equities through 2023, and the relative weakness of NZ shares compared to global equities was a notable feature last year. There is some scope for improved NZ returns later this year, and the latest RBNZ Monetary Policy Statement indicated a less aggressively-restrictive tone than feared.

Diversified Income Funds containing an allocation to domestic equities have generally experienced flat overall capital value moves early 2024, although their income yields remain attractive by historical standards, as the NZ equity market has moved sideways-to-down in the last two years.

Until a catalyst for a resumption in NZ equity market performance emerges, much of the medium-term capital growth objective of the Fund will be driven by international assets, which comprise half of the Portfolio at current allocation weightings.

We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to boost performance, as inflation conditions are stabilizing. However, there is still a mildly recessionary period to traverse en route to that outcome (in New Zealand, if not globally.) The phase of actual interest rate reductions from central banks is still some months into the future but when that is underway, we expect more beneficial capital growth impacts. This positive portfolio role will likely be a key feature of total returns in 2024-5.

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.

## Distribution of 1.125 cents per unit / quarter retained

Higher component asset yields enabled us to retain the quarterly cents-per-unit distribution from the fund, at 1.125 cpu, for the latest quarterly distribution which was paid out / reinvested in February. This will be updated again in May 2024, dependent on the outlook for overall Fund's income.

As noted earlier, the silver lining in the bond market's repricing is that the yield received from bond investments have shifted to a higher range and that supports the Sustainable Income Fund's forward distribution path. This is characteristic of a transition into a mid-level interest rate regime which may endure for years, rather than months, ahead.

Internationally, major central banks are now communicating the phase of interest rate adjustments, sufficient to anchor inflation expectations, has been successful. Recently, the balance of evidence has been on the better side globally, particularly suggesting that the US Federal Reserve is well on track to engineer an economic "soft landing." Rate reductions will follow incrementally later this year. In New Zealand, the timing is uncertain, as the Reserve Bank will need to assess the trajectory of inflation in early 2024 and may not actually move the OCR down until the last quarter of the year.

While the data-driven market volatility at times requires fortitude from investors, the objective of securing an inflation-resilient income level means that equity market fluctuations and corrections over short periods are inevitable. Over the medium-term, moderate capital gains in addition to income advantages are expected, and the Sustainable Income Fund is positioned to harvest them.

It is crucial to note that the Income level from equity dividends and bond coupons received into the fund has been commensurately rising through periods of market turbulence. This trend exemplifies the incremental return of some "risk premia" into asset classes, though this has further to go. The fund's modelled income received from coupons and dividends is still modestly above its prospective distribution yield. We regard this as prudent, in a still-uncertain environment.

The equity capital value components of the Income Fund have adjusted to reflect weaker economies overall, yet the Real Asset components of Infrastructure and Property are well-suited to the subdued immediate period ahead, as central bank policy rates will begin to fall. Defensive merit should continue to be asserted in coming months through renewed demand for these specific "Real Asset" equity types, along with the sustainable dividend-payers in the broader Australasian market.