Salt Sustainable Income 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 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 strong Environmental, Social and Governance credentials & reliable income generation. The Fund's strategy is to invest in a quality asset mix with an aim to provide regular, sustainable income and a positive return on capital. At times 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 or volatility 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 31 July 2022

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$46.33 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Current yield to 31/10/22	4.00% per annum

Unit Price at 31 July 2022

Application	0.9350
Redemption	0.9311

Investment Guidelines

Sector	Target	Range
New Zealand Fixed Interest	20%	0% – 40%
International Fixed Interest	15%	0% – 40%
Australasian Shares	30%	15% – 45%
Global Listed Property	15%	0% – 30%
Global Listed Infrastructure	15%	0% – 30%
Cash or cash equivalents	5%	0% – 20%

Fund Allocation at 31 July 2022

New Zealand Fixed Interest	0%
International Fixed Interest	18%
Australasian Shares	33%
Global Listed Property	29%
Global Listed Infrastructure	18%
Cash or cash equivalents	2%

Fund Performance to 31 July 2022

Period	Fund Return	Reference Portfolio Return
1 month	4.59%	4.16%
3 months	-1.68%	-0.76%
1 year	-5.17%	-5.16%
Since inception	-3.03%	-3.77%

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

Goodman Property Trust	Property for Industry
Kiwi Property Group	Argosy Property Trust
Precinct Property	Stride Ppty & Stride Invest Mgmt
Fisher & Paykel Healthcare	Vital Healthcare Property Trust
Spark NZ	Mainfreight

Holdings stated as at 31.07.22, excludes cash and consolidated International Fixed Interest Fund component of the Sustainable Income 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.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund rebounded moderately in July, with a positive monthly return of 4.59% (after fees). This helped recover much of the prior Quarter's negative returns, and the fund's 3-month return move up to -1.68% as at 31 July. On the rolling six-month basis, the fund recorded a decline of -3.16% while since inception, the return was -3.0% as at 31 July.

In contrast to June, every global 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.

As has been the recent pattern, the most robust returns were contributed by Equity Asset classes. Both Global and NZ shares returned above 6% in the July month, while Global Infrastructure and Property were also able to rebound strongly. At the end of June, we introduced the Salt Sustainable Global Property Fund into the Income Fund's holding set at a weight of 3.5% due to much better valuations in Global Real Estate given the sharp international asset re-pricing this year. The dividend yield on the sector has now risen to a sufficient level to warrant inclusion in the Sustainable Income Fund, and further internationalises the underlying holdings, adding diversification. The timing of this decision proved fortunate, as Salt's Sustainable Global Listed Property Fund logged a 7.7% monthly gain in July. However, the primary purpose of the inclusion is to provide an additional yield source for distribution to investors, with capital growth a medium-term objective.

Although the capital growth element built up in this fund in late 2021 has been reversed by 2022's market developments, the income level has been enhanced. We anticipate the capital growth aspect of the Fund to resume gradually once international conditions stabilize. 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.

The Global Fixed Interest Fund was, unusually for 2022, a positive contributor to returns in July, with a monthly bond fund return of +2.9%, which recovered the comparable loss in the fund booked in June. The Income Fund remained underweight in the Fixed Interest asset category throughout the period. Fixed Interest assets are currently at just above half their Strategic Asset Allocation weighting, at 18% versus 35% in the SAA.

Stronger than expected inflation prints until August in the US kept the pressure on Central Banks with the US Fed hiking rates 0.75% in July and signalling more to come. However, the market took cheer from the FOMC acknowledging slowing economic growth that should eventually slow the pace of tightening. Markets began pricing a terminal Fed Funds rate of 3.3% in 2023 immediately after the Fed's latest move. US Federal Reserve "QT" expectations see PIMCO remaining underweight the agency and semi-government sectors, but now having a small overweight exposure to the mortgage sector, slightly preferring non-agency mortgages.

Securitised assets remain PIMCO's preferred way to take spread exposure offering greater default protection in the current environment. In geographical tilts, the Fixed Interest fund is underweight the US and core Eurozone, predominantly versus non-EMU Europe and Australia/NZ.

The bond components of the portfolio have dragged on bond valuation returns as interest rates rose; however, the yield received from those bond investments is also now higher and will support the Sustainable Income

Fund's forward distribution path. This is characteristic of a transition period from a low- to a mid-level interest rate regime.

Most recently, a lower global growth path has also allowed bond yields to move down modestly. This has in turn been positive for the Listed Real Asset components of the Salt Sustainable Income Fund, as both listed property and infrastructure are "bond yield competitors" and sovereign yields are an important influence in the valuation of real assets.

It is crucial to note that the Income level from equity dividends and bond coupons received into the fund has been commensurately rising through the recent period of market turbulence and remains in excess of the Income Fund's distribution rate of 4.0% p.a. This trend exemplifies the incremental return of some "risk premia" into asset classes, though this has far to go.

The equity capital value components of the Income Fund have adjusted to weaker economies ahead, but the Real Asset components of Infrastructure and Property are suited to an economically uncertain and inflation-prone period ahead. Defensive merit should be re-asserted in coming quarters through continuing positive demand for these specific equity types, along with the sustainable dividend-payers in the broader Australasian market.

Although the NZ dividend-focussed equity components of the portfolio are yet to make a sustained positive portfolio impact, we expect them to now exert a neutral impact at best on overall Income Fund performance until a catalyst emerges for equity market recovery. Nevertheless, the income yield provided by these assets is important to the Fund's distribution level.

July saw a gain in the NZ and Australian dividend-focussed components of the Sustainable Income Fund, with moderate rebounds of 5.0% in the month. The pricing in of rising interest rates has supressed equity returns in the last year, but the income yield characteristics of the equity, property and infrastructure sectors continue to strongly support their inclusion at substantial weightings in the fund. By contrast, bond yields, while now higher, are not quite at the level required to make a positive contribution and the risk of mark-to-market valuation declines on many bonds remains.

Nevertheless, given the rapid run-up in global bond yields, the point at which additional Fixed Income exposure may be added to the Salt Sustainable Income Fund is coming closer. Internationally, major central banks are now communicating the desirable course of carrying through several more meaningful interest rate increases, sufficient to anchor inflation expectations, and this does unnerve markets at times. While the resultant volatility requires fortitude from investors, the objective of securing an inflation-resilient income level now 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.

Greg Fleming, MA