Salt Sustainable Income Fund Fact Sheet – September 2023

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 30 September 2023

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	$42.65 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Prospective distribution yield (cents per unit) / based on Unit Price of 1.10.23	1.125 cents per unit per Quarter / 5.44% per annum

Unit Price at 30 September 2023

Application	0.8338
Redemption	0.8303

Sustainability Metrics

Fund ESG Scores	Portfolio	Category avge
Morningstar ESG score	21.14	22.00

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 30.09.23. 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 30 September 2023

Global Fixed Interest	28.0%
Australasian Shares	28.5%
Global Listed Property	23.5%
Global Listed Infrastructure	17.0%
Cash or cash equivalents	3.0%
Asset allocation to Fixed Interest + Cash	**31.5%**

Fund Performance to 30 September 2023

Period	Fund Return (before fees)	Gross Reference Portfolio Return
1 month	-2.37%	-2.55%
3 months	-3.84%	-3.85%
6 months	-3.14%	-3.67%
Year to date	-1.08%	-1.48%
1 year	1.02%	1.51%
Since inception p.a.	-3.66%	-3.43%

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

Top Individual Holdings at 30 September 2023

Goodman Property Trust	Precinct Properties
US 5Yr Note (CBT) Dec 23	Spark NZ
Fisher & Paykel Healthcare	US 2Yr Note (CBT) Dec 23
Federal Rep. Germany note	NZD Cash
Kiwi Property Group	Auckland International Airport

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Market Commentary

September month and the last two months of the third quarter saw global equities retreat after strong July returns. Growth and inflation signals remained of concern to investors, undermining expectations for reduced monetary tightening from central banks. Higher bond yields caused interest-rate sensitive assets to decline in general last quarter.

- The September quarter of 2023 was somewhat reminiscent of the 2022 year as global equities suffered a reality check in the face higher bond yields. Developed market equities fell -3.4% (in USD) over the quarter, though were still up a healthy 11.6% year-to-date. The global aggregate bond benchmark had a similarly tough quarter, falling -3.6% (in USD).
- While the outcome was much like 2022, the reasons behind the moves were different. 2022 was all about the sharp trend higher in interest rates, while the quarter just gone was about the realisation that interest rates would remain higher for longer as central banks sought to tame stubbornly high inflation.
- Fiscal sustainability has been another focus for bond markets, particularly in the United States, where concerns are rising about the amount of issuance that will be required to sustain the large fiscal deficit.
- Oil prices surged higher over the quarter, rising 28%. Higher oil prices present another headwind to consumer demand and will be problematic for central banks as headline inflation reaccelerates.
- In the United States, key activity data including retail sales and industrial production all expanded. Third quarter GDP growth is tracking at a healthy 1.2% (q/q annualised). Headline inflation rose again on the back of higher oil prices, but core declined to an annual 4.3%. The Fed left interest rates unchanged in September, though projections showed one more hike and a tighter stance through next year. A government shutdown was avoided, but only provided funding through to November.
- Business surveys remained subdued across Europe in September. Composite PMIs were still in contraction territory with the euro area index at 47.1 and the UK index at 46.8. On a more positive note, inflation fell more sharply than expected in both the euro area and the UK. The ECB raised its deposit rate by 25bps to 4% but the Bank of England, in a surprise move, left rates unchanged at 5.25%.
- China economic data improved in August with a reacceleration in both retail sales and industrial production and, after a brief flirtation with deflation, the annual rate of CPI inflation rose to 0.1%. Real estate distress remained a key focus, but the authorities have been eager to signal support by easing banks' Reserve Requirement Ratio.
- In Australia, data over the month has broadly tracked in line with the RBA's forecasts, with unemployment higher and inflation lower, providing little reason for the RBA to shift from its current "wait and see" approach. Still, we expect somewhat more challenging inflation dynamics over the next few months which will challenge the RBA's position.
- In New Zealand GDP growth came in much stronger than expected for the June quarter, though the annual rate of expansion continues to fall. We see annual growth at close to zero when the September quarter data is released- in December. As expected, the RBNZ left interest rates unchanged at the August Monetary Policy Statement but emphasised the higher for longer message.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund experienced a negative return of -2.37% (before fees) in September month, which lowered its return over the 2023 Year to Date to -1.08% (before fees.) The fall in September reflects weak returns in both the equity and fixed interest components of the portfolio. For the full year to 30 September, the fund gained 1.02% (before fees.)

Despite a range of headwinds for markets, 2023 has so far proved a somewhat better investing environment than 2022. As inflation progressively shows signs of a definitive peak, we expect component asset classes to improve, as indeed occurred in the first part of 2023, with periodic interruptions. Volatility across markets is ever-present and sentiment is fragile. Central banks around the world remain resolute.

September quarter saw negative returns from most of the Income Fund's component assets. The sole resilient component was the Sustainable Global Fixed Income Opportunities fund, which contributed 0.01%. The Salt Sustainable Global Property Fund subtracted -0.18% over the three-month period, while Enhanced Property had a negative impact of -1.09%, the NZ Dividend Appreciation Fund subtracted -1.13% and the Salt Sustainable Global Listed Infrastructure Fund subtracted -1.52%.

Salt Sustainable Income Fund outlook

We believe bond yields have now adjusted upwards enough, to have lowered our previous underweight bond positions within the Sustainable Income Fund. The allocation to bonds is now 28% 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 paused in lifting the Official Cash Rate though core inflation is persisting, so domestic yields and discount rates are likely to stay quite elevated. This is supressing returns from NZ equities this year, and the relative weakness of NZ shares compared to global equities is now notable. Diversified Income Funds containing an allocation to domestic equities have generally experienced a downward capital value move, although their income yields may well have been enhanced recently.

We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to boost performance, as inflation conditions stabilize. However, there could be a mild recessionary period to traverse en route to that outcome. The phase of actual interest rate reductions from central banks is still some time into the future and we expect a major beneficial capital growth impact of such will only become apparent only from late in 2023, or even early in 2024.

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

Higher component asset yields enabled us to lift the quarterly cents-per-unit distribution from the fund, to 1.125 cpu, from the quarterly distribution date paid out in August. This will be updated again in November, dependent on the outlook for overall Fund income at that time.

As noted earlier, the silver lining in the bond market's repricing is that the yield received from bond investments is also now higher and 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 last phase of interest rate adjustments, sufficient to anchor inflation expectations, and this does unnerve markets at times. Recently, the balance of evidence has been on the better side internationally, particularly suggesting that the US Federal Reserve is on track to engineer an economic "soft landing."

While the data-driven market volatility 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 indeed been commensurately rising through the recent 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 income is still modestly above its prospective distribution yield. We regard this as prudent in an uncertain environment.

The equity capital value components of the Income Fund have adjusted downward to reflect weaker economies in the year ahead, yet the Real Asset components of Infrastructure and Property are well-suited to an inflation-affected period, once central bank policy rates begin to fall or there is a downward shift at the short end of the yield curve. As global central banks increasingly pause their interest rate tightening cycles, defensive merit should be re-asserted in coming months through continuing positive demand for these specific "Real Asset" equity types, along with the sustainable dividend-payers in the broader Australasian market.

Greg Fleming

Greg Fleming, MA