SALT

Salt Sustainable Global Fixed Income Opportunities Fund Fact Sheet – February 2025

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 primary objective of the Fund is to target and generate an attractive rate of return over a full three-to-five-year market cycle. To achieve this, the Fund targets a portfolio of global fixed income securities with enhanced total return potential and superior Sustainability characteristics.

The objectives of this top-down selection process are to:
1. Reduce exposure to material ESG risk and negative sustainability impacts, through restriction screening of controversial sectors such as weapons, tobacco and some fossil fuels, as well as international norms violations;
2. Tilt the portfolio in favour of the 80% strongest sustainability performers across corporates, by sub- sector, and sovereigns; and
3. Contribute to positive outcomes based on key sustainability themes, with a particular focus on low carbon intensity.

The Fund will invest at least 50% in investment grade bonds, and a minimum of 15% in sustainable bonds. The fund targets its returns to be 100% hedged to the New Zealand dollar.

Fund Facts at 28 February 2025

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$169.87 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management
Average credit rating	Standard & Poor's A / Moody's A2
Effective Duration	3.36 years

Unit Price at 28 February 2025

Application	1.0617
Redemption	1.0606

Investment Guidelines

The guidelines for the Sustainable Global Fixed Income Opportunity Fund are:

Global Fixed Income securities	95% – 100%
Cash	0% – 5%

Fund Allocation at 28 February 2025

Global fixed income securities	95.0%
Cash, FX, short term & sundry	5.0%

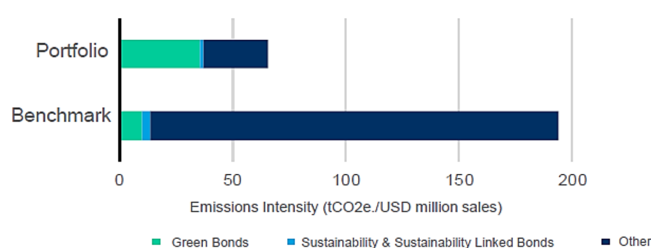
Period	Fund Return (Gross incl. ICs)
1 month	1.23%
3 month	1.72%
6 month	2.60%
1 year	6.80%
Since inception p.a.	6.12%
Since inception cumulative	12.85%

Performance is gross of fees and tax. Data as of 28 February 2025.

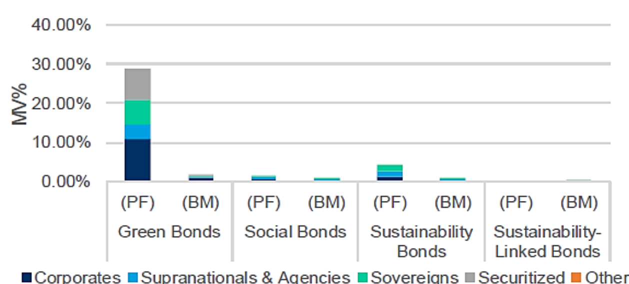
Sustainability scoring and Emissions intensity

Fund ESG Dashboard	Port.	Agg	YTD change
Exposure to Corporates with CO2 footprint reduction targets	95%	90%	-
Green, plus Social, Sustainability and Sustainability-linked bonds	34.5%	2.9%	-1.9%
Sustainable SBTi approved / committed targets	49.1%	39.0%	-5.4%
CO2 Footprint Scope 1&2 (tCO2e/$mn emission intensity)	66	194	-3.6%
CO2 Footprint Scope 3 (tCO2e/$mn emission intensity	497	702	-0.5%
MSCI ESG Score (Adjusted)	7.02	6.06	-0.16
Negative Indicators			
- Red Flags	0.0%	0.1%	0.0%
- CCC MSCI Rated	0.0%	0.3%	0.0%

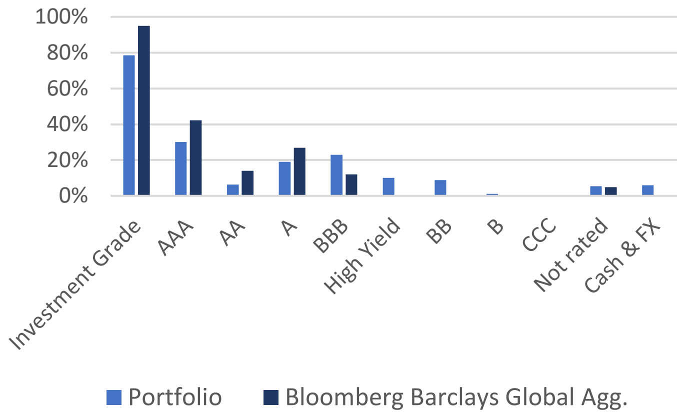
Source: MISM Monthly Investment Report/ MSCI ESG Research at 28 Feb. 2025



Portfolio versus Bloomberg Global Agg. Index labelled bonds



Fund credit ratings vs. Bloomberg Barclays Global Agg.



Source: MISM as at 28 February 2025

Portfolio Review

- In the one-month period ending 28 February 2025, the portfolio returned 1.23%. The performance can be attributed to the following factors.
- Both macro decisions and sector spreads had a positive impact on performance in February.
- Regarding macro decisions, the long exposures to the US and Euro-area had a positive impact on performance.
- Higher "risk-free" rates continued to contribute to performance.
- Quasi spread positioning added to performance in February.
- Within FX, the long JPY and USD positions added to performance.
- Regarding the portfolio's positioning within sector spreads, the exposure to investment grade added to performance as spreads widened in February.
- The long exposure to securitized credit added to performance, mainly within Agency/Non-Agency RMBS and ABS..

Strategy changes

- Overall, duration exposure was increased to 3.36 years, this was achieved by increasing the long exposure to US and Euro-area duration and closing the short exposure to Japan.
- The portfolio also increased the long exposure to New Zealand duration.
- Within FX, increased long JPY and USD positions and initiated a long AUD position.
- In sector spreads, we trimmed exposure to investment grade and high yield corporates.

Market Review and Outlook

Things are changing fast and remain fluid. Given the breadth and depth of changes, we could be witnessing an epochal event. Whether it is for better or worse we do not know, but the global landscape is shifting rapidly.

The scope of policy changes so far has been unprecedented. In little over a month since his inauguration, President Trump has unleashed a stream of directives on trade, foreign policy, immigration, government employment, taxes, social and environmental policy. Both the pace and direction of this torrent have been unparalleled in modern, post-World War II history. Notably, over the span of two days, President Trump announced the suspension of military aid to Ukraine, sided with Russia in a United Nations vote on resolutions on Ukraine and announced 25% tariffs on Canada and Mexico. This is provoking unprecedented responses from the rest of the world. The decision to suspend aid to Ukraine has triggered the biggest shift in German fiscal policy since reunification and an €800 billion defence spending package proposed by the European Commission. In a reference to former European Central Bank (ECB) President Draghi's comment during the 2012 sovereign debt crisis, prospective German Chancellor Merz vowed to do "whatever it takes" to defend Europe as he stiches together a coalition seeking to upend 50 years of German fiscal rectitude.

This is creating financial market volatility unseen outside of exogenous crises like COVID-19 or the 2008 Global Financial Crisis. For example, on 3 March, German equities had their best day since late 2022. The next day, 4 March, was their worst day since 2022. There are many more examples, but the bottom line is that when the most powerful country in the world decides to change/disrupt global trade, geopolitical alignments and fiscal policy all in one go, there will be fallout, which is what we are seeing in the markets today. Investors are faced with unprecedented uncertainty about the short- and long-run impacts to the U.S. and global economies, the global political structure, and asset prices.

This means that the initial consensus post-inauguration that Trump's policies would reinforce "exceptional" U.S. economic performance has been upended. The assumption that an "S&P put" on his more aggressive policies would keep him in check does not seem to be playing out. His willingness to implement high tariffs seems based on two reasons: first, to raise revenue relatively costlessly (which is very debatable), and second, to remake global trade, reducing the large U.S. trade deficit as surplus economies (namely, China and the European Union) remain adamantly against boosting their economies. While markets were aware from Trump's first term and his 2024 campaign rhetoric that he liked tariffs as a policy tool — or at least as a threat to achieve other objectives — markets generally disbelieved that he would impose them to the extent announced so far, given the possible downside risks to U.S. growth and asset prices. Indeed, the risk of a major trade war along with relatively high tariffs and the administration's seemingly relentless drive to reduce the federal government's footprint has caused the U.S. economy to sputter and equities to fall in the first few months of the year. The U.S. economy's downshift in the first quarter — even before trade issues escalated — has led to legitimate questions about the economy's underlying health. Is the slowdown temporary, due to one-off events like wildfires, cold weather and rising imports seeking to front-run tariffs? Or, is it deeper and long-lasting, as weaker U.S. equities unnerve consumers, corporates postpone capital expenditure and U.S. fiscal policy tightens, at least in 2025? For now, we view the slowdown as temporary, barring a serious trade war.

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Indeed, markets are now predicting three Federal Reserve (Fed) interest rate cuts this year and another cut in 2026, versus only one expected in 2025 as recently as January. U.S. bond yields have dutifully followed Fed rate expectations lower despite inflation showing no meaningful signs of slowing to the Fed's target and household inflation expectations ratcheting higher pre- and post-tariff announcements.

With newfound worries about the robustness of the economy, the Fed is back in play — something we would not have said at the beginning of the year. That said, given the still negative inflation outlook and tariffs likely to worsen near-term economic performance, the Fed will likely only move if it sees a threat to growth and employment. If the unemployment rate rises again, breaching the Fed's previously stated undesirable 4.4% level, the Fed will likely cut rates.

We are sceptical that the Fed will need to cut rates three times in 2025, but given the unusual position of the economy and outlook for policy, we cannot dismiss the possibility of a sooner-than-expected rate cut. The strong outperformance of U.S. dollar bonds in 2025 reflects market anxieties that Trump policies will be growth-destroying not growth-enhancing, at least for now, and that the "bad" policies will happen before the "good" stuff happens, e.g., more deregulation and tax cuts. Is it possible that Trump is frontloading the "bad" growth policies, to get the pain out of the way up front and set the stage for a strong rebound in the economy in 2026/2027?

Along these lines, we have conversely seen a reversal in the fortunes of bonds outside the U.S., which have underperformed U.S. Treasurys. Growth and fiscal policy expectations, particularly in Europe, have flipped relative to the U.S. The pressure exerted on Europe from subpar growth and, probably most importantly, the threat that Trump will withdraw security guarantees, has forced unprecedented change.

The policy agenda from Europe and relative to the baseline just a month or two ago is now expected to be much easier fiscal policy and probably tighter (or at least less easy) monetary policy. The possibility of peace or the cessation of hostilities between Ukraine and Russia has also emboldened economic optimism, as rebuilding Ukraine and rapprochement with Russia would be perceived as a positive, at least to some degree. What this means is that the premium on exceptional U.S. economic performance is shrinking on both sides of the Atlantic.

The outlook for European bonds is therefore murkier as bond markets will be asked to absorb hundreds of billions, if not trillions, of additional debt. Details about European fiscal policy — and importantly U.S. tariff policies and the extent of retaliation — won't be known for several months, and it remains possible that Trump could backtrack and ease the pressure if the pain is perceived to be too high. But this historic tilt toward European self-defence and its implications look like a train that cannot be stopped.

Given the uncertainties about these unprecedented policies and policy goals, it is difficult to predict the near-term impacts. The push/pull of Trump policies combined with Fed policy objectives appears to generate a somewhat stagflationary outcome with ambiguous implications for yields. The 10-year U.S. Treasury yield seems a bit too low, close to 4%, as definitive evidence of a slowdown big enough to elicit multiple Fed rate cuts is not yet evident.

The key indicator will be the labour market — jobless claims, in particular. Any signs that consumers are pulling back as they grapple with uncertainty will undermine the "Goldilocks" (not too hot, not too cold) economy. Similarly, the massive underperformance of European bonds this year seems a bit premature given the information at hand and the likely volatility of Trump administration policies over time. But if recent trends continue, the direction of travel seems clear, meaning: the U.S. desire for a multipolar world with Europe responsible for its own defence; easier global fiscal policy; a revamped global trading system, with the U.S. less willing to be the consumer of last resort and using tariffs as the tool to achieve it; global supply chains revamped; and higher inflation than in the pre-pandemic years as populist policies are implemented worldwide. And, as expected, execution risks and the potential for unintended consequences during these transitions are likely to be high, generating more business cycle volatility than usual.

Credit market impact

Credit markets do not like uncertainty and do not like weak/volatile equity markets. U.S. credit spreads have been widening under the tariff onslaught. We do not envision material widening absent greater economic underperformance, but spreads are not likely to regain their equilibrium until there is greater clarity on the macro outlook. Paradoxically, Trump's policies seem to have triggered a positive impact on European/non-U.S. equity markets while hurting U.S. stocks, through their impact on relative fiscal and trade policies. This change has helped euro investment grade bonds weather the storm better than U.S. investment grade. We have preferred euro investment grade credit over U.S. credit, and recent events do not change this preference. That said, the recent outperformance of euro credit has been large, and we are wary of chasing it given the recent volatility in markets and the tendency for mean reversion, i.e., markets overshooting then correcting. This backdrop requires being highly selective and actively managing rating, country and industry holdings to avoid the inevitable problems likely to arise in the next 12 months. We remain focused on avoiding companies and industries at risk (either from idiosyncratic underperformance, secular challenges or increased management aggressiveness) while building as much yield as is reasonable into the portfolio without jeopardizing returns from credit losses or spread widening. We still identify better opportunities in euro-denominated bonds of U.S. names and European banks, although we have been selectively reducing exposure to investment grade overall.

Securitized credit and U.S. agency mortgage-backed securities (MBS) have been less ruffled by recent volatility than other sectors and remain our favourite overweight. But even here, the recent streak of strong performance is diminishing its relative and absolute attractiveness. The recent rally in yields has reduced the outright attractiveness of fixed income, and the relative outperformance of this sector compared to corporate credit has marginally reduced its relative value.

That said, securitized credit does not face the same issues as the U.S. corporate sector during this period of heightened economic uncertainty. New issues are frequently multiple times oversubscribed, making it difficult to accumulate large positions. Amid the current noise and uncertainty in the world, we believe this sector can continue to perform well. In the agency sector, higher coupon securities continue to be attractive compared to investment grade corporate bonds and other agency coupon structures, and we believe they are likely to outperform U.S. Treasury securities. More recently, given the rally in U.S. interest rates, European mortgage securities now offer better relative value. Selectivity remains key.

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In currency markets, also somewhat paradoxically, the U.S. dollar has been weakening. The U.S. implementation of tariffs was supposed to be dollar-positive as it would encourage other countries to let their currencies depreciate to offset their effects. The opposite has tended to happen. Countries like China are digging in their heels and have resisted currency depreciation, looking for fiscal policy to offset tariff effects, while Europe, contrary to the naysayers, has now announced plans for historically unprecedented fiscal expansion. These policy mixes have, at least for now, undermined the dollar, as U.S. policy seems to be going in the other direction, i.e., tighter fiscal policy and easier monetary policy. How long this is likely to last is unknown and depends on policy implementation around the world.

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