SALT

Salt Sustainable Global Fixed Income Opportunities Fund Fact Sheet – October 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 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 31 October 2024

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$165.92 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management
Average credit rating	Standard & Poor's A / Moody's A2
Effective Duration	3.10 years

Unit Price at 31 October 2024

Application	1.0530
Redemption	1.0519

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 31 October 2024

Global fixed income securities	98.95%
Cash, FX, short term & sundry	1.05%

Fund Performance to 31 October 2024

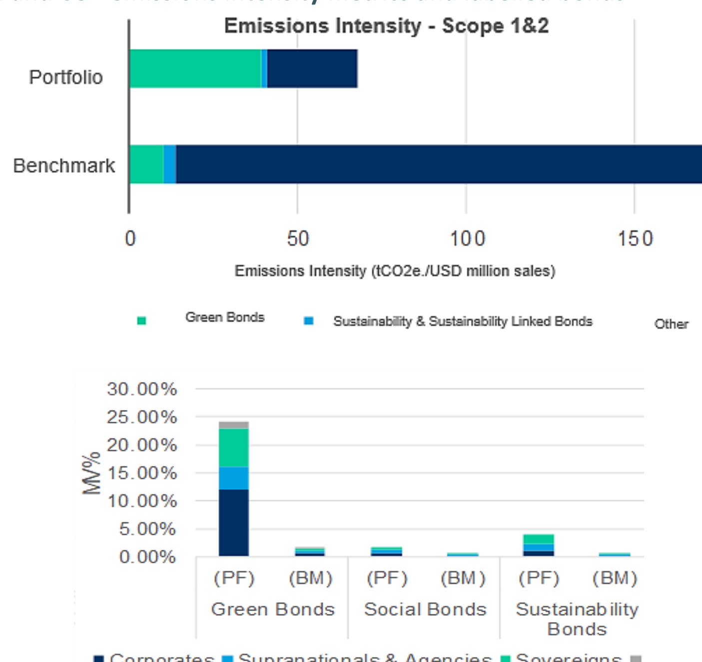
Period	Fund Return (Gross incl. ICs)
1 month	-0.86%
3 month	1.09%
6 month	3.98%
1 year	9.14%
Since inception p.a.	5.78%
Since inception cumulative	10.07%

Performance is gross of fees and tax. Data as of 31 October 2024.

Fund ESG Dashboard	Portfolio	2024 YTD change
Exposure to Corporates with CO2 footprint reduction targets	96%	-
Green, plus Social, Sustainability and Sustainability-linked bonds	29.8%	+11.2%
Sustainable SBTi approved / committed targets	55.1%	+8.4%
CO2 Footprint Scope 1&2 (tCO2e/$mn emission intensity)	68	+39.2%
CO2 Footprint Scope 3 (tCO2e/$mn emission intensity	561	+14.2%
MSCI ESG Score (Adjusted)	7.30	+0.06
- Environment score	7.44	+0.56
- Social score	6.03	-0.05
- Governance score	6.41	-0.16

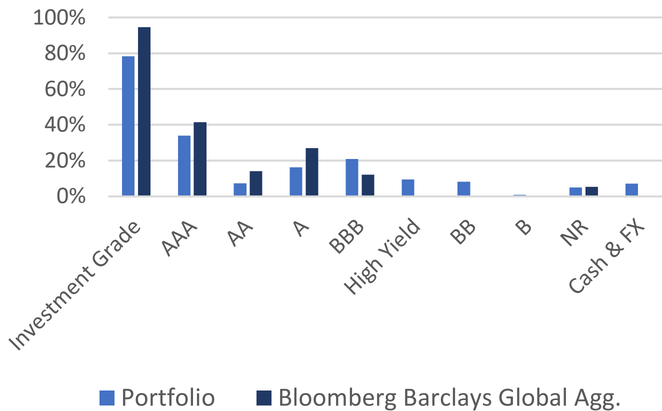
Source: MISM Monthly Investment Report/ MSCI ESG Research at 31 Oct. 2024

Fund CO2 emissions intensity metrics and labelled bonds



Source: MISM Monthly Investment Report as at 31 October 2024

Fund credit ratings vs. Bloomberg Barclays Global Agg.



Source: MISM as at 31 October 2024

Portfolio Review

- In the one-month period ending October 31, 2024, the portfolio returned -0.86% (gross of fees and tax.) The performance can be attributed to the following factors:
- Macro decisions detracted while the portfolio's positioning within spread sectors contributed to performance.
- Regarding the portfolio's positioning within spread sectors, the exposure to investment grade and high yield corporates added to performance as spreads tightened over the month.
- The long exposure to securitized credit added to performance, mainly within CMBS and ABS. The contribution was slightly offset by the exposure to agency RMBS.
- Regarding macro decisions, the long exposures to the US and the Euro-area were the largest detractors as global government bond yields rose over the month.
- Elsewhere the exposure to external and quasi spread contributed as spreads tightened.
- Within FX, the long AUD vs short CAD position and short USD position detracted.

Strategy changes

- Macro: overall, duration exposure was reduced to 3.10 years, specifically we added to the long US duration exposure, whilst increasing the short duration exposure to Japan.
- Within FX, increased long NZD and reduced the long AUD vs short CAD.
- Sector Spreads: increased the exposures to both high yield and investment grade corporates. We also increased securitized exposure, mainly within Agency RMBS and ABS.

Market Review and Outlook

After showing consistent strength through the summer, bond market performance turned distinctly negative in October. The 10-year U.S. Treasury yield rose approximately 50 bps, generating the worst monthly bond market performance since the third quarter of 2022. This pushed year-to-date returns below that of cash and most other sectors outside of high yield and loans. This was especially unusual considering it occurred on the back of the Fed's 50-bp rate cut. This rollercoaster-like performance is likely to continue as the doors open to even more macroeconomic, policy and rate volatility due to the surprisingly strong victory of Donald Trump and the Republican party in the recent U.S. election.

After the summer's run of weaker-than-expected U.S. labour market reports pushed the Fed toward cutting rates by 50 bps, labour market data for August and September rebounded with the unemployment rate falling from 4.3% to 4.1%. Moreover, data on the real economy continued to power ahead. Gross domestic product (GDP) grew at an annualised rate of nearly 3% in the third quarter, and fourth quarter growth is forecast to be in the neighbourhood of 2.5%. Although there is no doubt that hiring has slowed, it has not collapsed, and the weakness can be explained by the usual ebbs and flows in hiring patterns along with concerns over the results of the presidential election. Rather than demand weakness alone, increased labour supply has driven unemployment higher over the past year. Going forward, we expect to see more stability and less deterioration in employment, suggesting the Fed would not need to aggressively cut interest rates over the next 12 months. We believe two more rate cuts are reasonable for 2024, taking the ceiling on the fed funds rate to 4.5%.

U.S. Election impacts

That said, there is now a heavy focus on the implications of the November U.S. elections. The market's immediate reaction on Wednesday, 6 November was clear. The results were: great for stocks; especially great for financial stocks; good for credit; terrible for U.S. Treasury bonds; not so good for the rest of the world's bonds; good for the U.S. dollar. This movement in asset prices seems logical given Trump and the Republicans' platform and policy preferences. Questions surrounding how markets will shift under policy and economic changes linger. One question is: how much dismantling of the Inflation Reduction Act and CHIPS and Science Act will occur? These policies have been strongly positive for the U.S. economy, and if the Republicans end these programs without replacement, fiscal policy may be less expansionary than expected, putting less pressure on inflation and the Fed.

There is no doubt that the Republicans' sweeping victory in the November election has further changed the calculus of where bond markets are headed. Even before the election it was becoming less clear how much easing the Fed would do given the surprising strength in the U.S. economy. This is particularly true as recent Fed rate cuts were more in line with a recalibration of the rate structure than a move to counter concerns about imminent economic weakness. The need for this proactive stance, already being questioned prior to the election, is even more open to debate post-election.

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The election has given the forthcoming Trump administration, along with a Republican-controlled Congress, considerable leeway to adopt large swathes of the Trump agenda as stated in policy proposals and campaign rhetoric. How much of this is actually implementable is an open question. It will be months before some clarity emerges, depending on staffing, prioritization of policies, etc. In the interim, the market will rely on the agenda as we currently understand it: tax cuts (both new and continuation of the 2017 cuts), tariffs (and potential trade wars), deregulation, and immigration (reduction thereof as well as possible heightened deportations). Markets will be awaiting more details on the new administration's legislative and executive order priorities and the timing and implementation of these policies to gain more confidence about the trajectory of inflation and growth.

The market's initial reaction to price out another rate cut in 2025 was reasonable, in our view, but how much more needs to be priced out remains to be seen. The implications for the rest of the world's central banks are more ambiguous. The initial reaction on 6 November was bullish: the Trump agenda was expected to be good for U.S. growth/inflation but bad for growth elsewhere, meaning central banks outside the U.S. would step up their easing in response, which led to a distinct steepening of yield curves. Although we are sympathetic to this reaction, we are not sure it is entirely correct. A stronger U.S. dollar, higher tariffs and less efficient allocation of resources are inherently inflationary. The growth impact is probably negative. The questions are: which comes first, and which is viewed as worse from a monetary policy perspective? This will likely complicate the rate-cutting paths of central banks around the world. We have already seen the Norwegian and Indonesian central banks postpone cutting interest rates due to currency weakness (albeit not directly related to Republican electoral success).

In terms of impacts on bond yields, we can expect the following: further upward pressure on yields, steeper yield curves due to inflationary pressures and rising risk premiums. We believe the new floor on the 10-year U.S. Treasury yield is likely to be 4%, with a ceiling of 5%, the 2023 high.

Credit view

Credit markets were performing well before the election, and they have performed even better in the days following. This initial response makes sense as a stronger U.S. economy leads to improved cash flows and deregulation and protectionism help U.S. profits (at least in aggregate). However, the longer-term impact is less obvious. Greater opportunities and more regulatory leeway usually lead to riskier behaviour and greater leverage — not usually positive for creditors. With credit spreads on the tight side (expensive by historical standards but not overvalued), opportunities remain attractive, but we do not expect especially high returns.

Our credit market strategy is focused on avoiding problematic companies and building as much yield into the portfolio without taking undue risks. There is little reason to believe spreads will materially widen when economic growth is decent and central banks are predisposed to cutting interest rates. Yield-oriented buying should contain spread widening. We remain modestly overweight credit in our portfolios with a modest bias to higher quality.

Emerging market (EM) bonds are unlikely to thrive under a Trump-led Republican government. Stronger growth but higher rates and weaker global trade linkages are not usually conducive to strong EM performance. That said, we believe countries with solid economic outlooks, decent growth, falling inflation and a central bank able and willing to cut interest rates despite policy changes in the U.S. are likely to perform well. Country and security selection remain imperative. We continue to avoid Mexican and Brazilian bonds as their respective markets deal with political uncertainty (Mexico), fiscal risks (Brazil) and Trump policies.

With all the noise and uncertainty now coming out of Washington, we believe the most attractive opportunities remain in securitized credit, particularly in U.S. mortgage-backed securities. U.S. households with prime credit ratings have strong balance sheets, which should continue to be supportive of consumer credit and ancillary structures, especially as housing prices remain firm. Changes in U.S. tax policy should also be supportive. Higher coupon U.S. agency mortgage securities remain relatively attractive versus investment grade corporates, and we believe they are likely to outperform U.S. Treasury bonds. As in our corporate credit positioning, we are looking to move our securitized credit exposures up in credit quality and out of non-U.S. structures given tighter spreads and increased macroeconomic risks in Europe. One area in securitized credit that is vulnerable to a potentially changing Fed policy is commercial mortgage-backed securities (CMBS). If interest rates do not fall as much as expected, the refinancing of many U.S. office-backed deals will become problematic. We continue to generally steer clear of this sector.

In currency markets, the outlook for the U.S. dollar has improved since Trump's election. Easier fiscal policy, tighter monetary policy (relative to previous expectations), trade wars and stronger U.S. growth all bode well. However, one caveat to this upbeat narrative is surprisingly weak U.S. employment. Further deterioration will give the Fed room to continue to cut interest rates as long as the Trump agenda does not upset the inflation story. The U.S. economy remains exceptional with regard to its growth trajectory, productivity performance, profit performance and level of yields. It is a high hurdle for other currencies to beat these fundamentals.

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