

SALT

Salt Sustainable Income Fund Fact Sheet – December 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 31 December 2023

Benchmark	Bank deposit rates (BNZBIL Index)
Reference portfolio	SAA-weighted component benchmark indices' performance
Fund Assets	\$44.63 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Prospective distribution yield (cents per unit) / based on Unit Price of 1.12.23	1.125 cents per unit per Quarter / 5.34% per annum

Unit Price at 31 December 2023

Application	0.8721
Redemption	0.8685

Sustainability Metrics

Fund ESG Scores	Portfolio	Category ave
Morningstar ESG score	21.05	22.00

Scores indicate risk level – a lower score reflects a lower ESG multi-factor risk level. ESG score as at 31.12.23. Sustainability 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 31 December 2023

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 31 December 2023

Period	Fund Return (before fees and tax)	Gross Reference Portfolio Return
1 month	3.91%	4.07%
3 months	6.35%	6.61%
6 months	2.67%	2.50%
1 year	6.33%	5.03%
2 years p.a.	-2.44%	-3.58%
Since inception p.a.	0.25%	-0.71%

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

Top Individual Holdings at 31 December 2023

Goodman Property Trust	DEGV 0% 15/5/24 (Germany)
US 5Yr Note (CBT)	Kiwi Property Group
Fisher & Paykel Healthcare	Infratil
Cash	Spark NZ
Precinct Properties NZ	Auckland International Airport

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Market Commentary

- After something of a reality check in the third quarter of the year, the December quarter saw strong returns across nearly all asset classes. Further progress on inflation saw markets anticipating earlier interest rate cuts leading to an 11.5% (in USD) rally in developed market equities and an 8.1% (in USD) return from the global aggregate bond index.
- Asset classes that have struggled most under the interest rate mantra of “higher for longer” such as real estate investment trusts showed some of the highest returns. Global REITS rallied 15.6% over the quarter.
- As the quarter began markets were becoming increasingly convinced that interest rates in the key developed markets had peaked. Softer than expected inflation prints in the US and Europe had markets bringing forward rate cut expectations.
- This expectation was reinforced by a dovish December statement from the US Federal Open Market Committee where the latest projections removed the final hike from prior projections and added an extra cut into 2024. By the end of the quarter US interest rate markets were anticipating six 25-basis point cuts in the Fed funds rate in 2024, an expectation we think will ultimately be disappointed.
- Activity data in Japan remained somewhat sluggish over the quarter. September quarter GDP data showed weaker-than-expected domestic demand, consumption, and capital expenditure. The focus remains on wage growth where the strength of corporate earnings supports the expectation of further wage growth next year. The Bank of Japan left monetary policy unchanged at its December meeting, though we expect they may end their Yield Curve Control and Negative Interest Rate policies as early as their January meeting. This is based on our view that such moves are as much about policy normalisation as concerns about inflation.
- The sluggish December PMI readings out of China suggest that fourth GDP will likely slip further. Some rebound in the manufacturing PMI in January 2024 is likely with pass-through of the Rmb1trn additional fiscal support to infrastructure projects flows through. However, its sustainability still bears watching. China's reflation journey will remain bumpy and gradual.
- In New Zealand, there was a meaningful softening in labour market pressures with a decline in employment and a rise in the unemployment rate from 3.6% to 3.9% over the September quarter. Wage growth also moderated. The biggest surprise of the quarter came with weaker than expected third quarter GDP growth which was accompanied by significant downward revisions to prior data. This seems to put the nail in the coffin of the one further hike included in the RBNZ's November interest rate projections. However, it does not necessarily bring forward rate cuts. That will depend on whether the weaker growth data will be followed by soft inflation readings, particularly non-tradeable inflation. The next CPI data is due for release on January 24th.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund continued to rebound, with a return of 3.91% (before fees/tax) in December month, which lifted its quarterly return to 6.35% and its one-year return to 6.33% (before fees/tax.) The gain in December again reflected sharp rallies in the listed Real Asset and equity returns of the portfolio, which were enabled by a shift lower in global interest rates, also lifting bond returns.

For the full year to 31 December, the portfolio's reference index rose by 5.03% which was behind the fund's 1-year gross return.

Despite a range of headwinds for markets, 2023 proved a much better investing environment than 2022. As inflation progressively shows signs of a definitive down-shift, we expect component asset classes to improve further, as global central banks ultimately embark on interest rate easings. Volatility across markets is ever-present but sentiment is less fragile. Central banks around the world remain vigilant, but have scope assess the impact of high rates on inflation pressures positively, and incrementally lower rates. We expect value recoveries in interest-rate sensitive assets.

December month saw positive returns from all of the Income Fund's component assets. The strongest components were the Salt Enhanced Property fund, with a monthly contribution of 1.40%, and the Salt NZ Dividend Appreciation fund, which contributed 0.94% in December. The Sustainable Global Infrastructure fund rallied as interest rates fell, contributing 0.56% to the Income fund for the month. The Sustainable Global Property fund similarly responded to lower rates and contributed 0.23% in December, reflecting the small exposure held in the Income fund.

The Sustainable Global Fixed Income Opportunities fund contributed 0.61% for the December month, and is now the largest Sustainable Income fund component, at 29.5%.

For the full 2023 year, the key contributors to the Salt Sustainable Income Fund's performance were the NZ Dividend Appreciation Fund, which accounted for 1.5% of the overall return; the Global Fixed Income Opportunities Fund, which contributed 1.4% and the Enhanced Property Fund, which contributed 1.2%. Having been an effective portfolio stabiliser in the volatile 2022 year, Sustainable Global Infrastructure only made a flat overall contribution in 2023 but lower interest rates ahead aid the sector.

Salt Sustainable Income Fund outlook

We believe bond yields have now adjusted sufficiently (via a volatile and uncertain route in the last 18 months) to be moving 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 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 suppressed returns from NZ equities through until late in 2023, and the relative weakness of NZ shares compared to global equities was a notable feature last year. Diversified Income Funds containing an allocation to domestic equities have generally experienced improved capital value moves in the latter months of 2023, although their income yields remain attractive by historical standards, as the NZ equity market moved downwards over the 2 years since 2021.

We anticipate the longer-term capital growth strategies within the Sustainable Income Fund to boost performance, as inflation conditions are stabilizing. However, there could still be a mild recessionary period to traverse en route to that outcome (as was the case recently in New Zealand, if not globally.) The phase of actual interest rate reductions from central banks is still some months into the future and we expect a major beneficial capital growth impact of such - will mainly be a 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 paid out in November. This will be updated again in February 2024, dependent on the outlook for overall Fund's 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 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 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.

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 indeed 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 income 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 downward to reflect weaker economies in the year ahead, yet the Real Asset components of Infrastructure and Property are well-suited to the probable subdued period ahead, as central bank policy rates will begin to fall and there has been a downward shift at the short end of the yield curve. 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.