SALT

Salt Sustainable Global Fixed Income Opportunities 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 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 December 2023

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$84.52 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management
Average credit rating	Standard & Poor's A- / Moody's A3
Effective Duration	3.36 years

Unit Price at 31 December 2023

Application	1.0287
Redemption	1.0275

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 December 2023

Global fixed income securities	96.4%
Cash & FX hedging	3.6%

Fund Performance to 31 December 2023

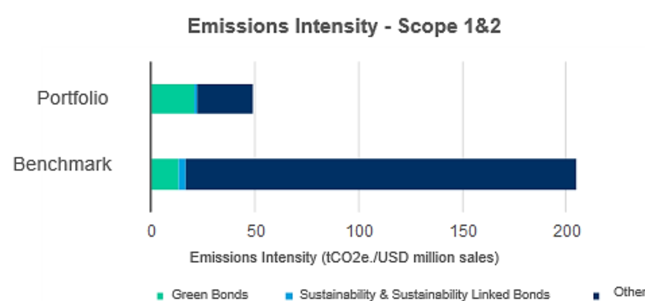
Period	Fund Return (Gross incl. ICs)
1 month	2.12%
3 month	4.34%
6 month	4.52%
Since inception cumulative	5.21%

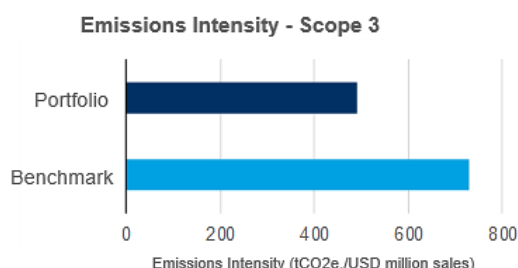
Performance is gross of fees and tax. Data as of 31 December 2023.

Fund ESG Dashboard	Portfolio	Index	Since-inception change
MSCI ESG Score (MV%.)	98.3%	91.8%	+2.1%
Exposure to Corporates with CO2 footprint reduction targets	95%	88%	
Green, plus Social, Sustainability and Sustainability-linked bonds	17.5%	2.7%	-9.3%
Sustainable SBTi approved / committed targets	46.7%	37.8%	-13.1%
CO2 Footprint Scope 1&2 (tCO2e/$mn emission intensity)	49	205	-30.4%
CO2 Footprint Scope 3 (tCO2e/$mn emission intensity	492	728	3.4%
MSCI ESG Score (Adjusted)	7.63	6.32	+0.18
- Environment score	7.80	6.13	+0.46
- Social score	5.56	5.52	-0.03
- Governance score	6.27	5.77	+0.07

Source: MISM Monthly Investment Report/ MSCI ESG Research as at 29 Dec. 23.

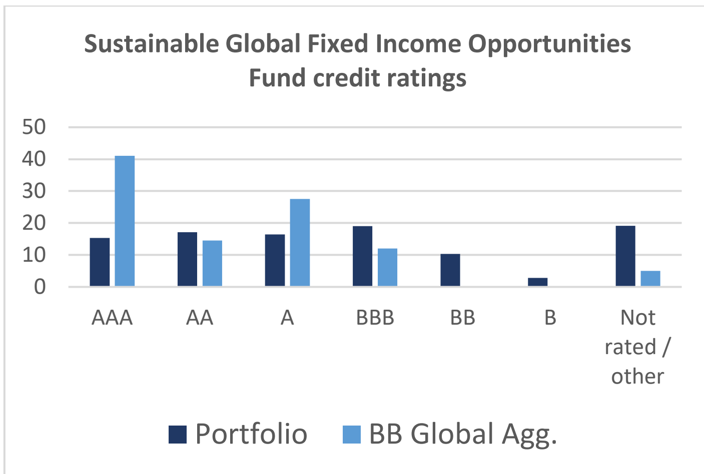
Fund CO2 Emissions Intensity characteristics at December '23





Source: MISM Monthly Investment Report as at 29 Dec. 23.

Fund credit ratings vs. Bloomberg Barclays Global Agg.



Source: MISM as at 31 December 2023

Portfolio Review

- In the one-month period ending December 31, 2023, the portfolio return had a strong 2.1% gain, as was also the case in November month. The December result can be viewed in the context of a 3.1% gain in the Bloomberg Barclays Global Aggregate Bond Index (NZD-hedged.) The performance can be attributed to the following factors.
- Given falling yields and tighter spreads in response to lower inflation data, both macro decisions (long duration) and sector spreads (long credit risk) contribution were positive this month.
- The portfolio's duration positioning in Developed Markets (DM) rates (USD, EUR, GBP) was positive as yields fell and curve steepened.
- The contribution of Emerging Markets (EM) Local rates (mostly Brazil) was also a positive impact.
- The allocation to European government bonds also contributed positively on tighter swap spreads.
- The allocation to Investment Grade (preference for EUR over USD, bias to financials, focused on significantly important institutions), and high yield corporates (predominantly industrials) both contributed given tighter spreads in the US and Europe.
- Within securitized assets, the allocation to non-agency RMBS was positive.
- Positioning in currencies was broadly flat, with the long position in EM FX negative overall (long Brazilian real).

Market Review

- December picked up where November left off with yields of government bonds falling and spreads tightening, for the most part, across the globe. In the UK, year-on-year CPI came in nearly half a percentage point below consensus expectations, while core PCE in the US likewise showed a marked deceleration. As a result, Fed communication turned more dovish 10-year yields in the US fell by 45bps over the month, 42bps in Germany, 64bps in Canada, 46bps in Australia, and 56bps in New Zealand as inflation continued to fall and central bank policy paths were revised to include more rate cuts happening sooner than previously anticipated.
- Elsewhere, the central banks of Australia, Canada, Japan, and Switzerland held policy constant, while Norges Bank surprised with a hike.
- December's stunning bond market performance was a fitting end to a roller-coaster, trying year which ended with what one might call a fairy tale ending: strong positive returns after a dismal first nine months. Will the trajectory of growth, inflation and financial stability concerns justify the rather large rate cuts priced into much of the world? Going forward, central banks will have their work cut out for them to deliver the cuts the market currently expects. If the rate cuts currently expected to occur do not happen, bond markets, including government, credit and securitized markets are likely to underperform. The good news is that rate cuts are likely to happen, both in the US and elsewhere. The pace and magnitude, however, remains uncertain.
- Central banks are not yet convinced that the market's more bullish views are justified, meaning that growth must continue to be modest (if not weaker), labour markets cannot strengthen (they can remain unchanged) and inflation, most importantly, must continue to fall. Whether or not the economy needs further rate cuts will depend on the economy. The market is making a relatively large bet that the Fed will cut rates upwards of six times in 2024 which is aggressive but not impossible. Interest rates still look attractive medium term, but look fairish near term, post 2023 rally. It is difficult to know if the economy will evolve according to the market's forecast. We are hopeful, but wary.
- Euro IG outperformed US IG, as December saw a continuation of the Q4 themes. Credit market spreads tightened, and risk-free yields rallied, as markets interpreted the inflation data and Central Banker's comments as confirmation that policy had pivoted from inflation to growth concerns, rates had peaked, and base rate cuts could lead to a "Goldilocks" economic outcome of low growth and lower inflation. Market sentiment in the month was driven by several factors; firstly, no further escalation in geo-political concerns although towards month end increased activity in the Red Sea highlights tensions remain in the region. Secondly M&A rumours, legal cases lost, and earnings revisions created single name credit volatility. Finally, a supportive technical due to strong inflows into IG credit and low market liquidity due to the year-end holidays.

Portfolio Commentary & Outlook

- There were no material changes in strategy during the month. Overall, the duration of the portfolio was again extended slightly (+0.31 years) from November to 3.36 years as at end-December.
- Looking forward, our base case sees January 2024 supply as an opportunity to buy credit at a small discount against an improving macro backdrop for credit following the central bank pivot from concerns over inflation to concerns over overgrowth. We see carry as an attractive return opportunity but given the uncertain medium term fundamental backdrop we have less confidence in expected spread tightening.

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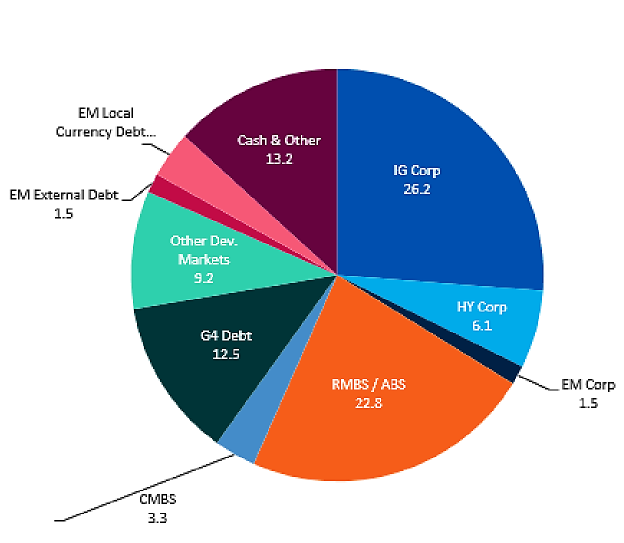
- Securitized credit spreads also tightened in December as securitized new issuance was light and demand remained strong. European securitized market activity slowed in December, and overall securitized issuance volumes in Europe were much lighter in 2023.
- After wild fluctuations in both rates and spreads in 2023, we enter 2024 with rates and spreads for securitized products at similar levels as we started 2023. We also have a similar outlook as we had at the start of 2023 – positive on residential mortgage sectors and business-related ABS, cautious on commercial real estate and consumer-related ABS, neutral on agency MBS, and neutral on duration positioning in general.
- We believe the recent sharp rally in rates is slightly overdone, however lower rates should help securitized credit: improving affordability, lowering debt service coverage, and improving refinancing potential.
- Emerging Markets Debt (EMD) continued to rally across all segments of the asset class. The US dollar continued to weaken during the month creating a favourable backdrop for EM currencies. Rate cutting cycles continued across Latin America with Colombia and Chile cutting rates while Mexico is shifting its narrative to likely cut next year. Suriname completed its debt restructuring with its creditors with an oil linked value recovery instrument (VRI). Argentina devalued its currency by over 50% as an emergency measure to help with its struggling economy.
- EM assets have rallied during the last few months of the year with the help of dovish rhetoric from developed markets and a weaker US dollar. EMD is well positioned for a continued rally as valuations remain attractive and developed market rate cuts appear imminent. Local rates in particular are attractive as the macro environment starts to shift to a favourable backdrop for local assets.

Portfolio Sectoral Positioning at December '23



Source: MISM Monthly Investment Report as at 29 Dec. 23

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