Salt Sustainable Global Fixed Income Opportunities Fund Fact Sheet – July 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 July 2024

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$161.26 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management
Average credit rating	Standard & Poor's A / Moody's A3
Effective Duration	2.90 years

Unit Price at 31 July 2024

Application	1.0430
Redemption	1.0419

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 July 2024

Global fixed income securities	85.08%
Cash, FX	14.92%[1]

Fund Performance to 31 July 2024

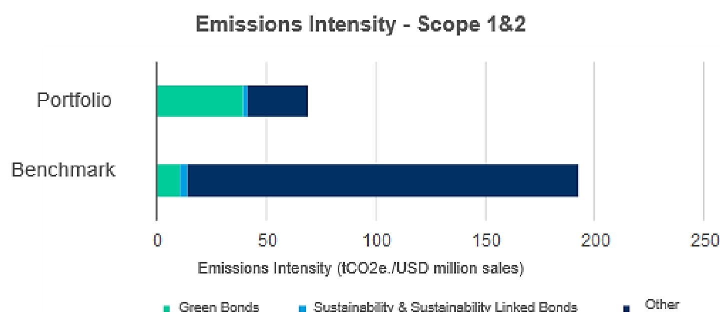
Period	Fund Return (Gross incl. ICs)
1 month	1.49%
3 month	2.86%
6 month	3.18%
1 year	7.21%
Since inception p.a.	6.02%
Since inception cumulative	8.88%

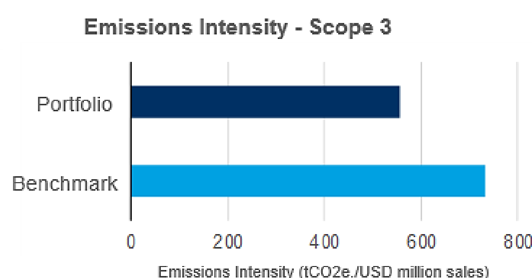
Performance is gross of fees and tax. Data as of 31 July 2024.

Fund ESG Dashboard	Portfolio	Index	2024 YTD change
Exposure to Corporates with CO2 footprint reduction targets	96%	90%	-
Green, plus Social, Sustainability and Sustainability-linked bonds	30.5%	3.0%	+11.9%
Sustainable SBTi approved / committed targets	51.4%	39.5%	+4.7%
CO2 Footprint Scope 1&2 (tCO2e/$mn emission intensity)	69	193	+40.5%
CO2 Footprint Scope 3 (tCO2e/$mn emission intensity	556	731	+13.1%
MSCI ESG Score (Adjusted)	7.35	6.09	+0.11
- Environment score	7.46	5.95	+0.58
- Social score	6.01	6.65	-0.07
- Governance score	6.40	6.48	-0.16

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

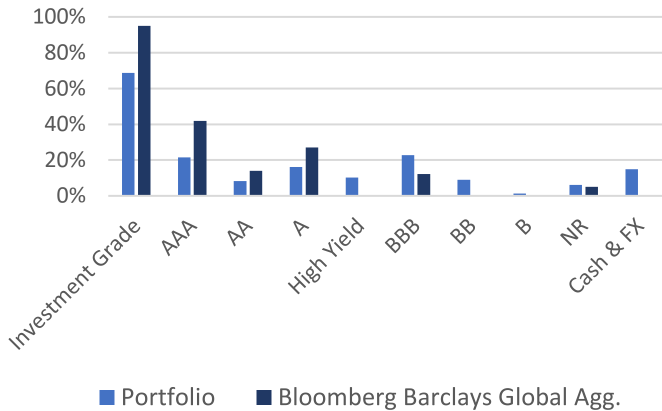
Fund CO2 Emissions Intensity characteristics as at 31 July 2024





Source: MISM Monthly Investment Report as at 31 July 2024

Fund credit ratings vs. Bloomberg Barclays Global Agg.



Source: MISM as at 31 July 2024

Portfolio Review

- In the one-month period ending 31 July 2024, the portfolio returned 1.49% (gross.) The performance can be attributed to the following factors:
- Both macro decisions and the portfolio's positioning within spread sectors contributed to performance.
- Regarding macro decisions, the exposure to the USD and the Euro denominated duration were the largest contributors as interest rates rallied over the period.
- Within FX, the long AUD vs CAD detracted as the CAD strengthened over the period as well as our EM FX positioning which detracted marginally from performance.
- Regarding the portfolio's positioning within spread sectors, the exposure to investment grade and securitized credit continued to add to performance as spreads tightened. Particularly, the exposures to investment grade corporates and to non-agency RMBS and CMBS.
- Strategy changes:
- Overall, the duration of the portfolio was raised by 0.37 years, closing July at 2.90 years.
- Regarding macro positioning, the portfolio added 0.37 years of duration, mainly in the US, New Zealand and Canada.
- Reduced duration in Japan and Euro-area.
- Within spread sectors, the portfolio trimmed some of the non-agency RMBS and ABS exposure and increased the agency-RMBS and CMBS positioning.
- Reduced exposure to investment grade industrials.
- Note 1. The elevated Cash level in the Fund as at 31 July results from substantial inflows late in the month, and is not indicative of any change in investment strategy.

Market Review and Outlook

July was another month of consecutively strong returns for fixed income investors. Government bond yields fell as the inflation picture improved across most of the world, economic data continued to come in at or around expectations, and the rhetoric about central banks beginning their easing cycles picked up. The U.S. 10-year Treasury yield fell 37 basis points (bps) over the month and the yield curve between 2- and 10-year maturities steepened by 13 bps. Similar themes were seen among much of the developed and emerging markets. Investment grade credit spreads continued to grind tighter with the euro area outperforming the U.S., while high yield markets experienced marginal spread widening over the month. Emerging markets (EM) external and EM corporate spreads also widened. Within currency markets, the dollar fell 1.7% versus a basket of other currencies, most notably versus the yen, which appreciated 7.3% versus the dollar over the month as the Bank of Japan raised its policy rate to 0.25%.

July saw a continuation of the recent positive performance in fixed income. Government bonds continued to rally as both inflation and activity data affirmed the view that central banks would soon cut rates and do so more quickly than previously expected. Economic activity continued to slow gradually from a high base, thus giving central bankers room to dial back the level of policy restriction. Yield curves also steepened towards the end of the month; as investors not only expected more and quicker cuts by central banks, but also began to reconsider the outlook for fiscal policy and public deficits – particularly in the U.S.

On the back of recent data, U.S. Treasury yields have continued to move meaningfully lower. July's economic releases continued to paint a picture of cooling inflation, thus giving the Federal Reserve (Fed) room to focus on the second of its two mandates – employment. To that end, markets have become sensitized to signs of weakness in the labour market, seeing softening there as a possible catalyst for more easing. Faster-moving indicators like the unemployment rate are modestly increasing, even though labour market data and business surveys are continuing to point to trend-like growth of about 2% in 2024. The U.S. economy is still creating well over 100,000 jobs per month, although one important caveat is that large-scale immigration into the U.S. over the past two years has complicated the task of interpreting data.

The Fed, which has stayed the course on data dependence this cycle, is finally starting to see data that should justify its change in stance. Outside the U.S., however, many central banks have already started to lower rates, including the Swiss National Bank, Riksbank, Bank of Canada and European Central Bank (ECB). Just as for the Fed, the most important question pertains to how quick and deep their cutting cycles will be. The information we have at hand suggests they will proceed cautiously, with services inflation and wage growth remaining elevated in regions like the U.K. and eurozone. Recent upside surprises in realized inflation in Canada and the eurozone also suggest inflationary risks remain.

Despite central banks' reluctance to pre-commit to policy paths, bond investors' optimism about future policy has increased. Cuts are now almost fully priced for each of the September, November and December Federal Open Market Committee (FOMC) meetings, as well as one cut per quarter in 2025. The ECB, meanwhile, is priced for more than two additional cuts this year and almost six cuts to the end of 2025. While the aforementioned scenarios are certainly not impossible, an aggressive easing cycle would be contingent on activity data slowing and pointing to a deep recession.

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Going forward, much is still unclear about the depth and pace of the global easing cycle. While we believe bonds can continue to perform well in the near term, we remain cognizant that a sustained rally would require a material slowing of activity data to suggest a recession and central banks globally to move away from the conservative approach they have embraced so far. Longer term, the level that U.S. and global 10-year yields will go to depends on the extent of the easing cycle.

Like was the case in June, markets were confronted with political surprises in July in the form of the assassination attempt on Republican presidential nominee Donald Trump and President Biden's subsequent withdrawal from the race. While the former event led markets to price in a much higher probability of a Republican-dominated Congress, Vice President Harris' candidacy has made the race closer. Although, there is some uncertainty as to her likely policy platform. As before, we believe the situation warrants monitoring, and we remain alert for new information that could change our outlook.

Regarding credit, we continue to view credit spreads as fairly priced, and although they may appear rich by historical standards, we do not believe they are expensive relative to fundamentals. There is no reason to believe spreads will materially widen when economic growth is decent (and coming in around expectations) and central banks are beginning to engage in a modest rate-cutting cycle. Yield-oriented buying should contain spread widening, but one factor we are paying close attention to is the level of all-in yields and their impact on demand for corporate bonds.

It is possible that if yields fall further, buyer demand could begin to wane and spreads could widen, especially under a rising recession probability scenario. This risk is offset, however, by central banks' rate-cutting bias, which should serve to truncate spread widening risk. We remain modestly overweight credit in portfolios.

EM local market returns were varied, with positive returns from duration but mixed currency returns. In Asia, Fed-sensitive central banks look more likely to be able to ease policy soon, given increased certainty about a Fed cut that has also lifted pressure on local exchange rates. In Latin America, government bond yields also fell, but a few currencies – such as the Brazilian real and Mexican peso – were materially affected by the unwinding of carry trades in the second half of July. We remain focused on idiosyncratic opportunities that feature favourable risk/reward characteristics.

Given global economic and policy uncertainty, we continue to find the most attractive fixed income opportunities in shorter maturity (0-5 years) securitized credit, such as residential mortgage-backed securities (RMBS), asset backed securities (ABS) and selective non-office commercial mortgage-backed securities (CMBS), given their higher yields and strong collateral. U.S. households with prime credit ratings have strong balance sheets, and this should continue to be supportive of consumer credit and ancillary structures, especially as house prices remain firm. U.S. agency mortgages still have value compared to investment grade credit, at least in higher coupons, and we believe they are likely to outperform U.S. Treasurys.

In currency markets, the outlook for the U.S. dollar remains uncertain. July saw the dollar weaken against peers as yield differentials narrowed. Convergence of the U.S. economy towards global averages, as well as imminent Fed cuts, should exert some downward pressure on the dollar, notwithstanding a resurgence in recessionary fears that would prompt a flight to relative safe-haven assets. As of now, however, it remains unclear who will inherit the position of global growth leader. Europe and China are seeing lacklustre cyclical data while also grappling with structural woes.

Emerging markets continue to be confronted with idiosyncratic challenges (as well as opportunities). In the middle of the month, carry trades began to be unwound, owing to a variety of catalysts including equity market volatility, intervention by Japanese authorities in the yen, a hawkish shift by the Bank of Japan and political uncertainty in the U.S. We look to mainly capitalise on idiosyncratic mispricings where there are clear fundamental and value differences.

We believe EMD assets are cheap, and valuations are attractive, continuing to make the asset class valuable for investors. Spreads marginally widened but remain in line with long-term averages, so when just looking at the benchmark, upside is limited. However, opportunities outside the benchmark remain, as several countries continue with reforms and restructurings.

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