SALT

Salt Sustainable Global Fixed Income Opportunities Fund Fact Sheet – September 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 30 September 2024

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$166.33 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management
Average credit rating	Standard & Poor's A / Moody's A2
Effective Duration	3.22 years

Unit Price at 30 September 2024

Application	1.0626
Redemption	1.0615

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 30 September 2024

Global fixed income securities	95.5%
Cash, FX, short term & sundry	4.5%

Fund Performance to 30 September 2024

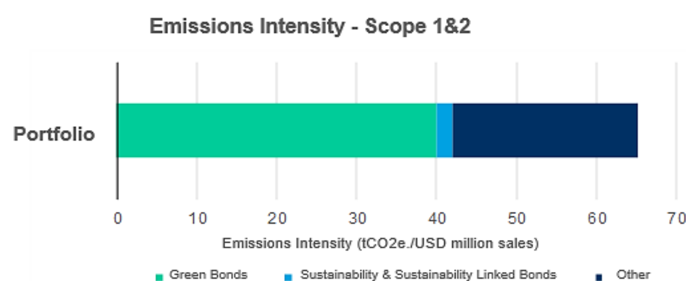
Period	Fund Return (Gross incl. ICs)
1 month	0.94%
3 month	3.49%
6 month	4.30%
1 year	10.10%
Since inception p.a.	6.66%
Since inception cumulative	11.02%

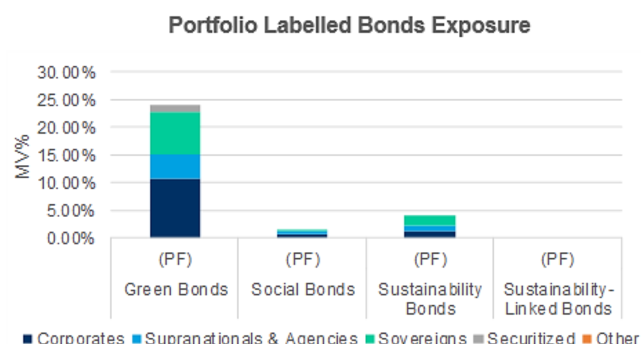
Performance is gross of fees and tax. Data as of 30 September 2024.

Fund ESG Dashboard	Portfolio	2024 YTD change
Exposure to Corporates with CO_2 footprint reduction targets	96%	-
Green, plus Social, Sustainability and Sustainability-linked bonds	29.6%	+11%
Sustainable SBTi approved / committed targets	52%	+5.3%
CO_2 Footprint Scope 1&2 (tCO2e/$mn emission intensity)	65	+33.7%
CO_2 Footprint Scope 3 (tCO2e/$mn emission intensity	582	+18.4%
MSCI ESG Score (Adjusted)	7.09	-0.15
- Environment score	7.22	34.4%
- Social score	6.15	8.2%
- Governance score	6.47	-9.3%

Source: MISM Monthly Investment Report/ MSCI ESG Research at 30 Sep. 2024

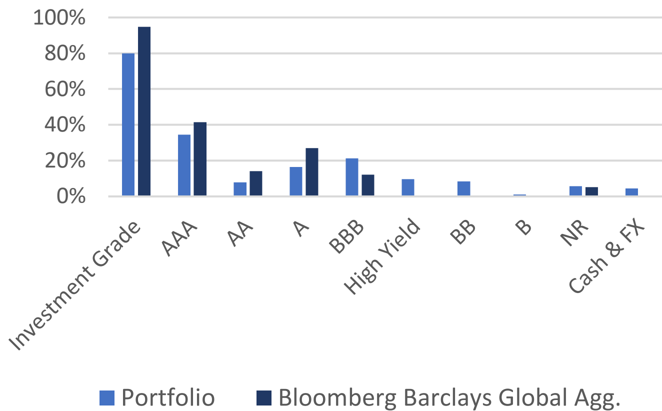
Fund CO_2 Emissions Intensity characteristics as at 30 Sep. 2024





Source: MISM Monthly Investment Report as at 30 September 2024

Fund credit ratings vs. Bloomberg Barclays Global Agg.



Source: MISM as at 30 September 2024

Portfolio Review

- In the one-month period ending September 30, 2024, the portfolio returned 0.98%. 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 long exposure to the US and the Euro-area were the largest contributors as global government bond yields fell over the month. The curve steepening positions in the US and the Euro-area also added to performance as yields fell the most at the front-end.
- Within FX, the long AUD and CAD positions contributed to performance.
- Regarding the portfolio's positioning within spread sectors, the exposure to investment grade corporates added to performance as spreads tightened over the month, whilst high yield corporates detracted slightly.
- The long exposure to securitized credit added to performance, mainly within ABS, RMBS and CMBS.

Strategy changes

- Overall, duration exposure remained broadly unchanged.
- Increased the long duration exposure in Canda, New Zealand and Euro-area, whilst reducing the exposure to UK, Peru and US.
- Increased the long exposure to Greek spreads.
- Trimmed the investment grade corporates exposure (mainly within financials) and ABS.
- Within FX, transitioned NZD from short to long, increased the AUD long and closed the long PEN.

Market Review and Outlook

Bonds continued their stellar run in September. Yields fell across most government bond markets while credit spreads modestly tightened. Unlike, in August, non-US Treasury markets led the way as yields fell double digits except in the UK and Japan. Economic data continued to be worrisome particularly the growth outlook in Europe with the US labour market in the spotlight after a very weak July number. The good news is that the US labour market did not worsen in August, but it also did not improve much, keeping markets worried about the deteriorating trend. There is historical evidence that once the unemployment rate risks, like it has, it continues to worsen until the Fed or other fiscal policy measures are implemented. While we do think there are extenuating circumstances this time around suggesting it is not as big a deal that the unemployment rate is where it is, the Fed, as it should as the world's most important risk manager, should take notice.

And they did. The big news which really propelled markets higher was the Fed's decision to cut rates 50 bp and up its forecast to another 50 bp of rate cuts this year, a large turnaround from June when they anticipated only cutting rates once, 25 bp in 2024. The market had been expecting less with the decision emphasizing the Fed's worries that with inflation falling and the unemployment rate rising policy rates were too restrictive. The ECB also cut rates emphasizing improving inflation and a weak growth outlook.

The Fed's move is significant. It represents a commitment to be pre-emptive in reducing restrictiveness before the economy weakens or unemployment moves much above normal. With the US economy increasingly looking like it is near its long-term trends in terms of growth and inflation (target) it is no longer necessary to keep policy so tight. In other words, if the economy is performing "normally" shouldn't interest rates be "normal" too. Thus, the Fed has begun to recalibrate monetary policy. The big question being, how much recalibration is necessary? The market is looking for substantial rate cuts both this year and next, taking the Fed funds rate down to 3% by early 2026. This is an aggressive forecast. With US inflation above target and GDP growth strong, it is not clear how much policy rates need to be cut. Certainly, taking rates down by 100 bp is fairly easy as even at a 4.5% policy rate, monetary policy is still tight. For the Fed to go below 4% will need more evidence that labour markets will deteriorate further, or inflation falls to target quickly. While possible, this is not our base scenario.

With US Treasury yields hovering around 3.8% (interestingly enough about the same level we started the year with) it will be difficult for yields to fall further even with 100 bp of rate cuts this year unless the data weakens unexpectedly further (e the unemployment rate going over 4.4%, the peak in the Fed's forecast. With a lot of rate cuts discounted by the market it is difficult to forecast further drops in yields. On the other hand, the trend in US employment has been weaker without a let up yet, so it is also difficult to oppose the Q3 bull market. As always markets and policy will be data dependent which unfortunately should be volatile in the months ahead. A neutral-ish to slightly underweight duration position in the US looks appropriate, with better value outside the US, whether in Europe where economic growth is anaemic and central banks are responding or in Asia where countries like New Zealand are behind in the rate cutting cycle but are experiencing weaker growth. Longer term, where US and Global 10-year yields go depends on the extent of the easing cycle.

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Credit markets (let alone equities) also continue to perform. A combination of strong nominal and real US growth combined with falling inflation, easier monetary policy and evidence of strong productivity growth provides an exceptionally good backdrop. That said, credit spreads, both investment grade (IG) and high yield (HY) are struggling to move lower. Both are at the tight end of their historical ranges (euro IG looks better) and will be challenged to tighten meaningfully further. US spreads could tighten a bit further but that will probably be it. In both cases, markets are punishing underperformers making company/sector selection increasingly important. Indeed, as credit spreads most likely move sideways over Q4, security selection will increasingly be important as any underperformance from owning underperforming companies will be difficult to offset with winners.

The appropriate credit market strategy should be focused on avoiding problematic companies and building in as much yield as possible without taking undue risks. There is little reason to believe spreads will materially widen when economic growth is decent (and coming in around expectations) and central banks are cutting rates, potentially aggressively. Yield-oriented buying should contain spread widening, but any slacking in demand could be problematic, although there is no evidence of this from September when there was record issuance and spreads tightened, albeit modestly. This risk is offset, however, by central banks' rate cutting bias which should serve to truncate spread widening risk. As it reduces tail risks of recession. We remain modestly overweight credit in portfolios with a modest bias to upgrade credit quality.

Emerging market (EM) local market returns were also solid with several countries performing quite well. If a country has a solid economic outlook, decent growth, falling inflation, a central bank able and willing to cut rates, bonds car likely to perform well. But as with corporate credit, when bad news hits or markets are disappointed, bonds and currencies can be hit badly. Choosing exposures wisely remains very important. We continue to avoid Mexican and Brazilian bonds as their respective markets deal with political uncertainty (Mexico) and fiscal risks (Brazil). We remain focused on idiosyncratic opportunities that feature favourable risk/reward characteristics as in the Dominical Republic, Colombia and Peru.

The best opportunities remain in US mortgage-backed securities and other securitized credit given ongoing uncertainty about the state of the US economy and the Fed's likely reaction function. 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 they should outperform U.S. Treasuries, although their Q3 outperformance has diminished our enthusiasm. Like in credit, we have also been looking to move up in credit quality and out of non-US structured given tighter spreads and increased macroeconomic risks in Europe.

In currency markets, the outlook for the U.S. dollar remains unclear. It has weakened as US rates have fallen relative to the rest of the world, but we are not as optimistic about the likely extent of rate cuts. However, it is possible the Fed's employment mandate will incentivize the Fed to be as dovish or even more dovish than other central banks who have weaker economies. The US economy, even with a slowdown, is still growing faster than most other countries implying that rate cuts in the US could eventually bolster the US economy and currency. As of now, however, it remains unclear who can surpass the US as global growth leader. Europe and China are seeing lacklustre cyclical data in addition to grappling with structural woes, although the Chinese stimulus programs announced in September have significantly boosted Chinese stocks, possibly bolstering their currency at least in the near term.

Despite faster growth in general, emerging markets continue to be confronted with idiosyncratic challenges (as well as opportunities). Emerging market currencies continued to be affected positively by easier US monetary policy but remain subject to a variety of local risks which may or may not overcome the pro-risk on bias of G7 central bank easing (along with Chinese stimulus. We look to capitalize on idiosyncratic mispricings where there are clear fundamental and value differences. For now, the dollar is likely to remain under pressure.

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