SALT

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

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$94.60 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management
Average credit rating	Standard & Poor's A / Moody's A3
Effective Duration	2.53 years

Unit Price at 30 June 2024

Application	1.0282
Redemption	1.0271

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 June 2024

Global fixed income securities	98.7%
Cash, Short term & Sundry	1.3%

Fund Performance to 27 June 2024

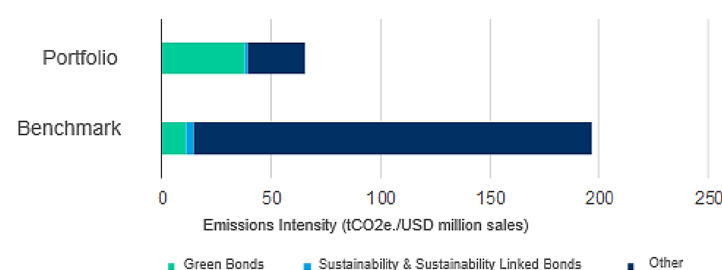
Period	Fund Return (Gross incl. ICs)
1 month	0.60%*
3 month	0.78%
6 month	1.96%
1 year	6.58%
Since inception p.a.	5.30%
Since inception cumulative	7.28%

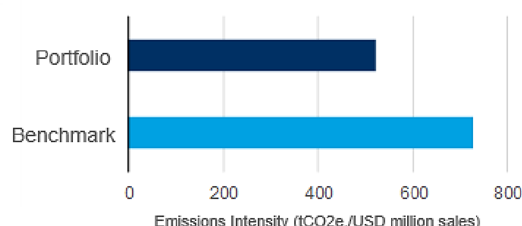
Performance is gross of fees and tax. Data as of 27 June 2024.
* performance to 27th June only due to a NZ holiday on final trading day of month.

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	29.4%	3.0%	+10.8%
Sustainable SBTi approved / committed targets	51.1%	38.8%	+4.4%
CO2 Footprint Scope 1&2 (tCO2e/$mn emission intensity)	66	197	+34.5%
CO2 Footprint Scope 3 (tCO2e/$mn emission intensity	521	726	+6.0%
MSCI ESG Score (Adjusted)	7.21	6.08	-0.03
- Environment score	7.34	5.94	+0.46
- Social score	6.16	6.64	+0.09
- Governance score	6.50	6.47	-0.07

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

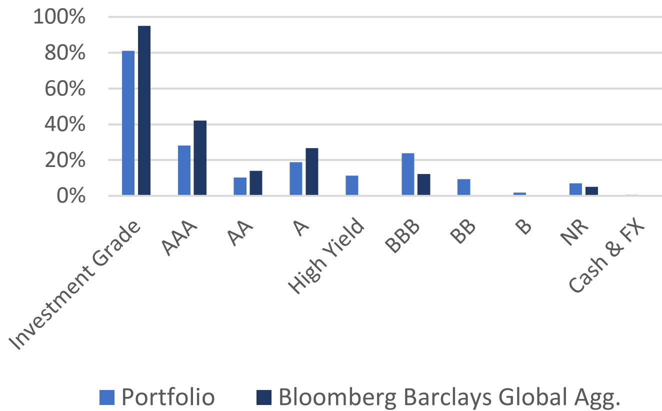
Fund CO2 Emissions Intensity characteristics as at 30 June 2024





Source: MISM Monthly Investment Report as at 30 June 2024

Fund credit ratings vs. Bloomberg Barclays Global Agg.



Source: MISM as at 30 June 2024

Portfolio Review

- In the one-month period ending June 30, 2024, the portfolio returned 0.68%. The performance can be attributed to the following factors.
- Macro Decisions (long duration) contributed to performance while sector spreads (long credit risk) detracted this month.
- The portfolio's duration positioning in Developed Markets (DM) rates (EUR, USD) was positive as yields fell.
- Within EA spreads, our allocation to France and peripheral spreads (Italy and Greece) detracted to performance, primarily due to widening spreads after the French election announcement.
- The allocation to Investment Grade (preference for EUR over USD, bias to financials, focused on significantly important institutions) negatively contributed to performance given wider spreads in Europe.
- Within securitized assets, the allocation to ABS and Non-Agency RMBS was positive, while Non-Agency CMBS was negative. Overall, our securitized allocation contributed to performance.
- There were no material changes in strategy during the month.
- Overall, the duration of the portfolio was reduced by 0.04 years, closing June at 2.53 years.

Market Review

- June continued the recent roller-coaster performance in fixed income. Government bonds continued to rally as economic data, particularly inflation in the U.S., renewed its downward trajectory and re-invigorated the "soft landing" thesis that the Federal Reserve (Fed) would cut rates more than once this year and multiple times next year.
- A "soft landing" is an economy experiencing falling inflation, lower policy rates and trend-like growth with only modest upward pressure on unemployment rates. This scenario is quite positive for fixed income, in general, but particularly for spread sectors like corporate and securitized credit. In the U.S., both the consumer and producer price inflation prints were softer than expected. In the euro area, although inflation readings were largely in line with market projections, it led to markets pricing in more monetary support from the European Central Bank (ECB).
- Later in the month, however, policymakers turned less dovish and data came in stronger. Various Fed speakers also began to explicitly reference further policy tightening, though they were quick to stress rate hikes were not in their base case, while minutes from the May meeting revealed that a few policymakers doubted just how restrictive current policy is. Inflation in other markets – most notably, Australia, the U.K. and the eurozone – was also higher than expected and showed signs of price pressures reaccelerating.
- While several DM central banks are widely expected to cut rates in the coming months, the depth of the cutting cycle is more important for fixed income markets than the timing of the first cut. Recent data and policy communications suggest central banks will likely adopt a cautious approach. We have stayed short duration as momentum is bearish, carry is negative and valuations in longer maturities are unattractive, in our view.
- Cross-market, we prefer to be short Australian vs. U.S. rates due to evidence of still-sticky inflation and the Reserve Bank of Australia turning more hawkish. We also remain underweight duration in Japan, where communication has turned less dovish amid concern about the weak yen, and confidence has grown that positive wage-price dynamics will likely lead to sustainably higher inflation.
- Within Developed Markets rates (DM), we initiated a short duration in Japan. Japan seems the most at risk of higher yields as rates normalize and recent commentary from the BoJ is consistently leaning hawkish despite not delivering on tapering. We also went neutral duration in Canada given stronger CPI print.
- During the month we increased our exposure to Euro SSAs, as swap spreads widened given the volatility coming from France, so we invested cash into SSAs, and then sold the duration via futures. Overall duration in Europe was up modestly MoM.
- Within credit, we maintain a long position in Investment Grade (IG) predominantly through financials and utilities.
- We also looked to modestly increase the yield in the portfolio by the addition of selective high yield bonds after the volatility around the French election gave a better entry point.
- We also added to EM local exposure, notably to Peru and Colombia, where higher yields offer attractive value.
- Regarding currency positioning, we increased our short JPY and CAD.
- Within securitized, we reduced exposure to agency and non-agency RMBS. Overall, we maintain a positive view to securitized credit given attractive carry and technicals.

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Portfolio Commentary & Outlook

Looking at the second half of the year, there is no doubt that markets are now on rate-cut watch. Outside of Australia and Japan, no central banks are considering raising rates. After rate cuts from Switzerland (more than one), Sweden, Canada and the ECB, it is only a matter of time before we see more. The questions are how long we have to wait and how deep those cuts will be. Despite central bank reticence to jump on the rate-cutting train, bond investors have become optimistic about future Fed policy and are now forecasting up to two Fed rate cuts in 2024, when, as of earlier this year, there was less than one expected. The current outlook is that rate cuts will happen, just not yet. In addition to monetary policy uncertainty, the outlook for bonds has become clouded by politics. It is possible that political change could usher in meaningfully different economic policies, which could have a material impact on yields and/or spreads. The situation warrants monitoring, so we have become more cautious and are adopting a wait-and-see posture.

In June, European investment grade credit spreads widened driven by wider swap spreads, while government bond yields rallied. Market sentiment was dominated by several factors. Firstly, European and French assets re-priced wider (the France-Germany government bond spread widened to multi-year highs) following Macron’s call for snap elections and reflecting the market’s concerns about the fiscal and geopolitical implications. Secondly, European composite purchasing manager’s index (PMI) data came in softer than expected but remains in expansionary territory. In the US data came in softer than expected as ISM manufacturing moved further into contractionary territory. Thirdly, the ECB joined the Swiss National Bank and Sweden’s Riksbank in cutting policy rates by 25 basis points (bps), with communication avoiding pre-committing to a particular rate path. Finally, primary issuance in June was in line with expectation. New issue order books remained robust, but investors demanded bigger new issue premiums against a backdrop of higher volatility. In June, performance in the high yield market was generally firm and led by the higher quality, longer-duration segments, which benefited from a further decrease in Treasury yields. June also marked the quietest month for default and distressed exchange activity since July of last year.

Looking forward our base case remains constructive for credit supported by expectations of a “soft landing”, fiscal policy that remains supportive of growth/employment/consumption, and strong corporate fundamentals. Lighter gross issuance in the second half of 2024 coupled with strong demand for the “all-in” yield offered by investment grade credit are expected to create a supportive technical dynamic. Finally, the uncertainty and outcome of the French parliamentary elections are expected to drive near-term sentiment for credit markets. When looking at credit spreads, we view the market as close to fairly priced and therefore see carry as the main driver of return, with the potential for a reversal in some of the spread widening seen in June if we see a positive election outcome in France.

Given the uncertain medium-term fundamental backdrop, we have less confidence in material spread tightening. Our outlook for the high yield market remains somewhat cautious as we begin the third quarter. The high yield market is contending with increasing uncertainty and several likely sources of volatility over the intermediate term, with the ultimate question centreing on the magnitude of the anticipated volatility.

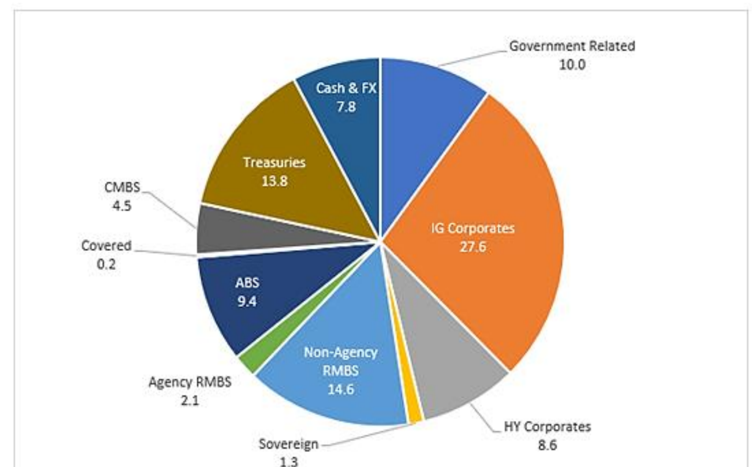
Securitised credit spreads were slightly wider to unchanged in June as new issuance remained strong, but demand managed to keep up. U.S. agency mortgage-backed securities (MBS) spreads widened 6 bps in June to 149 basis points above comparable duration U.S. Treasurys.

After several months of spread tightening across securitised products through May, we saw spreads widen slightly and stabilise in June, and we expect spreads to stabilise at current levels in. Overall demand levels remain strong, but we believe it will be challenging to push spreads much tighter from current levels. We have moved from a neutral to a positive view on agency MBS valuations, which are one of the very few sectors that have cheapened year-to-date.

Performance was mixed for the major segments of emerging markets debt (EMD). The Brazilian real and Colombian peso suffered due to fiscal concerns, while in Mexico the market had negative reactions to Claudia Sheinbaum’s strong presidential and political party wins and the Mexican peso sold off. The South African rand strengthened to recent highs during the month. The African National Congress (ANC) lost its majority for the first time in nearly 30 years, but the coalitions that are expected to form with the opposition are seen as positive.

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.

Portfolio positioning as at 30 June 2024



Source: Morgan Stanley Investment Management 30 June 2024

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