SALT

Salt Sustainable Global Shares 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 Fund's investment objective is to outperform (after fees and expenses but before tax) the MSCI World (Net) Index in New Zealand dollars on a rolling three-year basis. To achieve this, the Fund targets a portfolio of global companies with high total return potential and high Environmental, Social and Governance (ESG) factor scores.

The strategy seeks to provide attractive long-term returns with less long-term volatility than the broader market by reducing the risks associated with poor ESG outcomes. The Fund will seek to achieve its investment objective by investing primarily in global equity.

Fund Facts at 30 June 2024

Fund Assets	$65.37 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 30 June 2024

Application	1.2550
Redemption	1.2499

Investment Guidelines

The guidelines for the Sustainable Global Shares Fund are:

Global Equities	95% – 100%
Cash	0% – 5%

Target investment Mix

The target investment mix for the Salt Sustainable Global Shares Fund is:

Global equities	100%

Fund Allocation at 30 June 2024

Global equities	97.7%
Cash & sundry items	2.3%

Fund Performance to 30 June 2024

Period	Fund Return*	Benchmark Return**
1 month	2.94%	3.15%
3 months	-1.49%	0.74%
6 months	10.90%	16.11%
1 year	14.42%	20.84%
2 year p.a.	15.88%	20.55%
Since inception p.a.	9.27%	11.50%
5 year p.a.*	12.21%	13.97%

Performance is before fees and tax and adjusted for imputation credits. Benchmark performance is gross. *Fund performance shown to 27th June only due to a NZ holiday on final trading day of month. ** full month's benchmark return for June was 2.88%.

Fund ESG Scores	Portfolio	Index
Sustainable Global Shares	26T CO_2 /$m	162T CO_2 /$m
Portfolio Carbon Footprint:	16% of Index*	

Source: MISM Quarterly Investment Report & Trucost based on the Scope 1 & 2 carbon emissions per $1million of Portfolio companies' sales, and as weighted average carbon intensity (WACI). *As at 30 June 2024, the Portfolio's carbon footprint was 84% lower than that of the Index.

Top 10 holdings	
Microsoft (US)	Intercontinental Exchange (US)
SAP (DE)	RELX (UK)
VISA (US)	United Health Group (US)
Accenture (US)	Thermo Fisher Scientific (US)
Alphabet (US)	Aon (US)

Source: MSIM, data as at 30 June 2024.
The Top 10 Holdings represented 41.34% of the total portfolio.

Market Review

- The June quarter of 2024 proved to be another positive quarter for global equities. The quarter started poorly as overheating concerns from the first quarter weighed on markets, though those fears abated during the quarter as hopes of a soft landing were revived. Developed market equities rose 2.8% (in USD) over the quarter.
- The flipside of resilient economic data has been felt in stubborn services inflation which remains inconsistent with central bank 2% inflation targets. At the end of the quarter, markets continued to price in fewer rate cuts by developed central banks than they did at the start of the year. In this environment the global aggregate bond index returned -1.1% (in USD) over the quarter.
- After the initial strength at the start of the quarter, US economic data softened during May and June. Despite this and reflecting prior upside inflation surprises, the US Federal Reserve delivered a hawkish message in June, reducing the number of expected rate cuts in 2024

from three to one. Given the subsequent softer data, markets were by the end of the quarter expecting two cuts this year.

- The European Central Bank became the first of the major central banks to cut interest rates. This move had been signalled well in advance of the June meeting. But reflecting the uncertainty of the inflation outlook, the ECB was careful not to commit to any particular future path for monetary policy, reinforcing their ongoing data dependence.

- Following the outcome of the European parliamentary election, President Macron of France called a snap election. This election is in two rounds, the first on June 30th and the second on July 7th. Between those two polls, the UK had a general election on July 4th, and markets welcomed the change in government after 14 years with a Labour landslide.

- The weakness in the Yen continues to be a key focus in Japan over the quarter. While this is usually positive for Japan exports and the export heavy Topix, the very low level of the Yen is starting to impact negatively on consumer and service sector business confidence.

- Activity data in China is generally surprising to the upside over the quarter, though a look under the hood reveals a strong performance from exports alongside ongoing weakness in domestic demand. Problems in the real estate sector remain largely unresolved and pose a key risk to the outlook.

- Partial inflation data in Australia has been surprising to the upside recently, keeping the RBA's August meeting live for a possible rate hike. At the end of the quarter market pricing was evenly split between a hike and a hold at that meeting. Full June quarter inflation data to be released in July will be critical to the outcome.

- In New Zealand, activity data has been weak and labour market data has been softening. Forward indicators of inflation are continuing to trend in the right direction. The latest ANZ Business outlook saw cost expectations falling a bit further, though they remain uncomfortably high. However, with the economy struggling, it's harder to pass those costs on. Pricing intentions fell to a net +35.3%, its lowest level since 2020. This better of data has markets expecting the RBNZ to start easing monetary policy earlier than signalled.

Portfolio Review

- For Q2 overall, the benefit from the zero weight in Consumer Discretionary and Materials, as well as the slight Information Technology overweight, meant sector allocation was positive. Stock selection was negative for the quarter. IT was the largest detractor, given the Portfolio's tilt toward Software (up only 4%) and IT Services (down 11%); in the quarter both sub-sectors significantly lagged the AI-fuelled Semis (+19%) and Hardware (+17%). Health Care and Financials detracted to a lesser extent, while Industrials and Communication Services were stronger.

- At the strategy level, the largest contributors to absolute performance during the quarter were Alphabet thanks to robust growth across Search, YouTube and Cloud and increased optimism about AI impacts, TSMC, who, as the leading foundry, is set to win from growth in AI logic, Microsoft, helped by its strong position in generative AI (GenAI) adoption, Texas Instruments, as the cycle nears the end of its cyclical bottom, and SAP, which continues to benefit from its transition to the cloud.

- The strategy's largest absolute detractors for the quarter were Accenture, which struggled in the quarter due to the soft industry environment and the slow appearance of GenAI revenues, despite a relief rebound in June after the Q3 results, IQVIA, which faced headwinds including a last minute trial cancellation, Aon, due to concerns that organic growth is lagging peers, Visa, affected (along with peer MasterCard) by the class-action antitrust suit over transaction fees, and Abbott Laboratories, ahead of a U.S. court case over the supposed health risk to premature infants from its baby formula.

- The largest contributors to absolute performance during the June month were SAP (+69 basis points [bps]), Microsoft (+54 bps), TSMC (+40 bps), Accenture (+32bps) and Alphabet (+23 bps).

- The largest June month detractors were AIA (-25 bps), VISA (-15 bps), L'Oreal (-14 bps), IQVIA (-8bps) and Revvity (-6bps.)

Commentary & Outlook for June 2024
(Morgan Stanley Investment Management)

The MSCI World Net Index returned +2.0% in U.S. dollars (USD) in June month and a similar +2.3% in local currency (+2.9% in NZD). Information Technology (IT) (+9%) and Communication Services (+4%) were the month's top performers, while Consumer Discretionary and Health Care (both +2%) were closer to the overall index.
Other than Real Estate (+1%), all other sectors were in the red, with Utilities (-5%) at the bottom of the pile. In terms of geographies, the U.S. (+4%) was the strongest performing market in the month which meant other major markets struggled.
Other than Singapore (+1% USD, +1% local) and Switzerland (0% USD and local), all major markets were negative, with France (-8%, -6%) the weakest performing country due to political fears.

Global equity markets were milder in Q2, with the MSCI World returning +2.6% in USD and +3.0% in local currency (+0.8% in NZD), although for the year to date (YTD) the index has returned a very healthy +12% in USD. IT (+11%) and Communication Services (+8%) continued their mighty YTD performance (+25% and +22% respectively), however it is perhaps more meaningful to look at returns at the subsector/stock level.

IT strength was underpinned by Semis (+19%) and Hardware (+17%) in Q2, largely thanks to NVIDIA (+37%) and Apple (+23%) respectively, while for Communication Services Alphabet (+21%) has been the key return driver.
The Portfolio's key defensive sectors – Consumer Staples and Health Care (both 0%) – just avoided finishing in the red, while Materials (-3%) came in last.

Geography wise, the U.S. (+4%) outperformed the index in the quarter. Singapore (+9% USD and local) was the strongest performing major market, followed by the U.K. (+4% USD and local) and Switzerland (+3% USD and local). Bar Hong Kong (+1% USD and local), all other major markets were in the red. As in the June month, France (-8%, -7%) was the weakest constituent over the full second quarter.

Disclaimer: The information in this publication has been prepared from sources believed to be reliable and accurate at the time of preparation but Salt Funds Management Limited, its officers, directors, agents, and employees make no representation or warranty as to the accuracy, completeness, or currency of any of the information contained within, and disclaim any liability for loss which may be incurred by any person relying on this publication. All analysis, opinions and views reflect a judgment at the date of publication and are subject to change without notice. This publication is provided for general information purposes only. The information in this publication should not be regarded as personalised advice and does not take into account an individual investor's financial situation or goals. An individual investor should, before making any investment decisions, seek professional advice. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

Portfolio activity

During Q2, we initiated a position in **CME**, the U.S. futures exchange, which has a 90%+ share of futures in a range of asset classes, notably rates and equity indices. Futures exchanges are natural monopolies due to the network effect with clearing positions, as positions can be netted within an exchange, but not between them. The equity business is also backed by exclusive access to the S&P and Russell indices.

The opportunity to buy came as the multiple hit a 10-year low, partly due to fears of a challenge from dealer-backed new entrant FMX, fears that we think are overdone given the network advantages for the incumbent.

The only final sale was the small position in **Veralto**, which was spun out of **Danaher** in last 2023. We exited once the valuation had improved.

Looking at the additions in the quarter, we continued to build on the positions initiated in the first quarter in the Consumer Staples firm **Haleon** along with **Hologic** within Health Care. In addition, we added to **AJ Gallagher**, as the insurance broker's acquisition engine continues to drive compounding and Zoetis which derated on excessive fears about the side-effects of Librela, a pain-relief medication for dogs.

On the other side, we reduced the position in **Danaher** on valuation concerns, particularly given the lack of clarity about the timing for the bioprocessing recovery after the post-COVID sag. We also trimmed the **Reckitt Benckiser** position size, despite the very attractive valuation, given the uncertainty around the infant nutrition litigation.

Outlook – Nvidious Position (Morgan Stanley Investment Management)

Global equity markets are back to high multiples on high earnings, with the MSCI World Index at 18.5 times forward earnings, and those earnings meant to rise 12% in 2025 despite already record margins. The market seems to be dominated by the twin beliefs in the invulnerability of the U.S. economy and the massive impact of generative artificial intelligence (GenAI).

The confidence in the U.S. economy is understandable given that there has been no economic recession for 15 years, barring the special case of COVID in 2020, and the GenAI excitement fits with the history of potentially transformative technologies, from railways to the internet.

This is not the easiest environment for an investment philosophy that looks to back proven and established winners, with earnings that are resilient in tough economic times. When risk is "on" and the market is fixated on exponential growth curves, rating stocks on their "AI-ness", a portfolio of businesses designed for long-term compounding at reasonable valuations is not in fashion.

But what if the prevailing orthodoxy is wrong or starts to unravel? While the companies we own generally continue to compound and include good potential second wave beneficiaries of AI, where they control proprietary data and strong market positions, they are not experiencing the rocketing valuations seen by those first wave AI winners.

This narrative is not a surprise to those who invested through the internet bubble of the late 1990s. In recent years quality has become more conflated with growth and many quality managers are unabashed in claiming current market winners as quality trophies. The disconnect persists long enough to test the steeliest resolve, to force conversations about whether semi-conductors still display cyclical characteristics, and for the conversation to turn to a three trillion dollar plus topic: **Nvidia**'s position.

Even with its recent pullback, Forbes' "hottest stock of the decade" (June 2024) valued at >20x sales and >40x P/E2 has growth rates more akin to a startup, with earnings expectations having increased a staggering 5x versus where they were just two years ago. Nvidia holds a 90-95% market share in data centre GPUs (Graphics Processing Units), EBIT margins of 60%+ and has single handedly produced the equivalent of 80% of the market capitalisation rise of the dot com bubble.

The current valuation assumes two things: that there will be massive commercial applications of GenAI and that **Nvidia**'s dominance will continue. GenAI does indeed have enormous potential in multiple areas, from coding to customer relations to image generation and beyond, and we do expect some data rich constituents of our portfolios to benefit.

However, so far at least, most businesses, the potential end users, have been experimenting with GenAI rather than betting heavily as they are struggling to find clear cut use cases. There is a stark contrast between the forecasts of close to a trillion dollars of annual GenAI capex in a few years, and the mere $500m of GenAI-related revenue that Accenture, the world's leading IT Services company, has reported over the past year.

The other threat will come if any of Nvidia's four largest customers (**Microsoft**, **Amazon**, **Alphabet** and **Meta**, which currently comprise around 40% of its revenues) succeed in their efforts to design a better priced alternative to the H100 or its next generation follow-up chips Blackwell (2025) and Rubin (2026).

Economics undergraduate principles spring to mind - abnormal profits first attract abnormal speculation and then abnormal competition. Moreover, there's an inherent cyclicality of demand for capex beneficiaries, whatever today's trend might be, as shown by the history of massive 50%-90% drawdowns in Nvidia's otherwise very successful history, in 2002, 2008, 2018 and 2022.

For the avoidance of doubt, we are not making a bear case for Nvidia here, there is plenty of potential upside... it is just that there is plenty of potential downside as well, and the market seems more focussed on the former at present. It is this very wide range of outcomes that excludes us from owning **Nvidia**.

Disclaimer: The information in this publication has been prepared from sources believed to be reliable and accurate at the time of preparation but Salt Funds Management Limited, its officers, directors, agents, and employees make no representation or warranty as to the accuracy, completeness, or currency of any of the information contained within, and disclaim any liability for loss which may be incurred by any person relying on this publication. All analysis, opinions and views reflect a judgment at the date of publication and are subject to change without notice. This publication is provided for general information purposes only. The information in this publication should not be regarded as personalised advice and does not take into account an individual investor's financial situation or goals. An individual investor should, before making any investment decisions, seek professional advice. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

Our strategies do embrace change and evolve significantly over time – our flagship global strategy's Consumer Staples weight has gone from over 60% to under 20% over the last decade, and Information Technology is now over a quarter of the portfolio, even excluding the stocks that GICS moved into other sectors last year.

However, we continue to look for the same characteristics – strong intangible assets delivering high returns and pricing power, recurring revenues and decent, resilient growth, all at a reasonable valuation. We have also reflected on some important lessons, most notably in Consumer Staples and Health Care.

We shall aim to be less patient where larger holdings underdeliver on earnings while overdelivering on negative surprises, even if their valuations appear to be supportive. Also, we recognize we need to be more wary of transformational acquisitions, especially if they may be covering up existing problems in the core business.

While recent relative performance has been challenging, our experienced team sees good prospects for our portfolio holdings. Our portfolio composition has continued to evolve, from companies with powerful strongholds in dental care and painkillers to medtech for burgeoning women's health services, innovative life sciences that support medical discovery, digital music, leading data companies set to benefit from AI and the enterprise staples of our era – cloud-based software as a service, data, payments and insurance broking.

We believe these should deliver a portfolio offering resilient mid-to-high single digit revenue growth and faster earnings growth at a reasonable valuation, with a free cash flow yield close to that of the market, offering a continuation of the double-digit compounding achieved over the last quarter of a century.

The current index composition and economic sailing conditions have made it challenging to deliver strong relative performance. We remain steadfast in following our quality process and our focus on valuation and fundamentals. We believe focus on absolute compounding has worked in the past and will continue to work in the future. The backdrop of high expectations generally in the market and high specific expectations for direct GenAI plays (and increasingly one exceptional company) make us nervous about the prospects for the market. There are only two ways of losing money in equities – the earnings go away, or the multiple goes away. Our 'double fussy' philosophy, owning resilient earnings at reasonable valuations, should help mitigate both risks, while providing decent compounding.

Disclaimer: The information in this publication has been prepared from sources believed to be reliable and accurate at the time of preparation but Salt Funds Management Limited, its officers, directors, agents, and employees make no representation or warranty as to the accuracy, completeness, or currency of any of the information contained within, and disclaim any liability for loss which may be incurred by any person relying on this publication. All analysis, opinions and views reflect a judgment at the date of publication and are subject to change without notice. This publication is provided for general information purposes only. The information in this publication should not be regarded as personalised advice and does not take into account an individual investor's financial situation or goals. An individual investor should, before making any investment decisions, seek professional advice. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.