SALT

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

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$86.46 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management
Average credit rating	Standard & Poor's A- / Moody's Baa1
Effective Duration	3.14 years

Unit Price at 31 March 2024

Application	1.0396
Redemption	1.0384

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 March 2024

Global fixed income securities	95.9%
Cash, Short term & Sundry	4.1%

Fund Performance to 31 March 2024

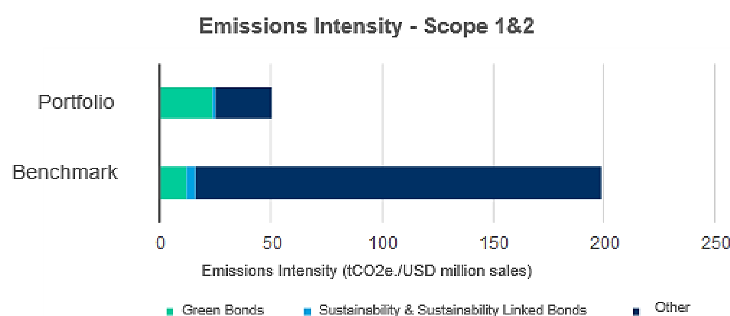
Period	Fund Return (Gross incl. ICs)
1 month	0.74%
3 month	1.17%
6 month	5.56%
1 year	6.24%
Since inception cumulative	6.45%

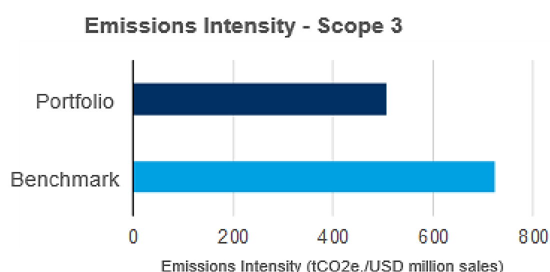
Performance is gross of fees and tax. Data as of 31 March 2024.

Fund ESG Dashboard	Portfolio	Index	2024 YTD change
MSCI ESG Score (MV%.)	98.3%	92.0%	0.0%
Exposure to Corporates with CO2 footprint reduction targets	95%	89%	
Green, plus Social, Sustainability and Sustainability-linked bonds	23.6%	3.1%	+5.2%
Sustainable SBTi approved / committed targets	47.8%	38.5%	+1.1%
CO2 Footprint Scope 1&2 (tCO2e/$mn emission intensity)	50	199	+3.5%
CO2 Footprint Scope 3 (tCO2e/$mn emission intensity	506	723	+2.9%
MSCI ESG Score (Adjusted)	7.54	6.36	-0.07
- Environment score	7.93	6.19	+0.13
- Social score	5.49	5.51	-0.07
- Governance score	6.23	5.92	-0.04

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

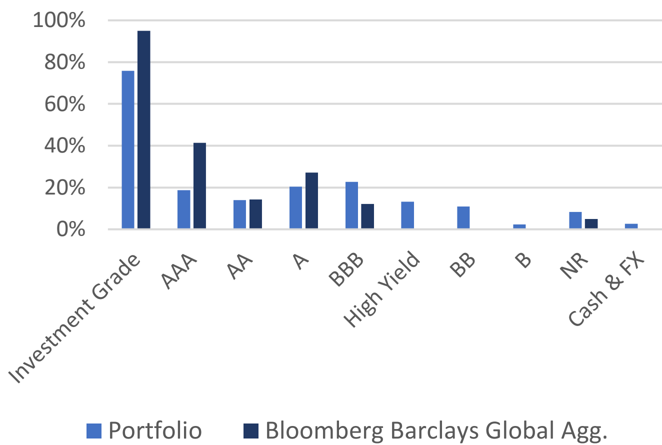
Fund CO2 Emissions Intensity characteristics at 31 March 2024





Source: MISM Monthly Investment Report as at 31 March 2024

Fund credit ratings vs. Bloomberg Barclays Global Agg.



Source: MISM as at 31 March 2024

Portfolio Review

- March month's positive performance can be attributed to the following factors:
- 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 (EUR, USD) was positive as yields declined.
- The contribution to Emerging Markets (EM) Local rates (Mexico) was negative overall.
- 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 ABS and non-agency RMBS was positive.
- Positioning in currencies was broadly negative, with the long position in EM FX contributing positively (long MXN), outweighed by the negative contribution from DM FX.

Market Review

- Bond yields seem to be settling into a broad holding pattern. After soaring in January/February, March brought a respite, at least in developed countries.
- Yields are up significantly from year end, and expectations of rate cuts have been significantly scaled back, in some cases like in the US. Certainly, bonds are much more attractive now than they were in early January, but March, in many ways, did not deliver a lot of "new" news.
- Economic growth looks a bit better in Europe and China, although it is premature to believe in a robust rebound. Inflation looks like it is continuing to fall in Europe while the US economy continues to defy sceptics who believed high interest rates would slow things down.
- In fact, most historical data suggests that the economy is enjoying a bit of a resurgence with both manufacturing and service sectors expanding, and GDP growth likely to expand more than 2% in the first quarter after a 4% surge in the second half of 2023.
- The second quarter starts off suggesting a continuation of strong growth. More worryingly, some inflation indicators are no longer strongly disinflationary, in particular, the ISM prices paid index surprised significantly to the upside in March while oil prices climbed. While not overly worrisome, the combination of increasingly strong growth alongside a stalling or significant slowdown in disinflation suggests that the Fed might be challenged cutting rates three times this year. Indeed, Fed communications have reiterated the need to be cautious in cutting rates before inflation is defeated.

Portfolio Commentary & Outlook

- Overall, the duration of the portfolio was increased by 0.18 years, closing March at 3.14 years.
- Within Developed Markets rates (DM), we added duration in the US (on dovish FOMC comments) and EUR rates.
- Within Emerging Markets (EM) Local rates, we maintain exposure to Mexico and Brazil.
- Within credit, we maintain a long position in Investment Grade (IG) predominantly through financials and a preference for EUR relative to USD.
- Within securitized, we reduced exposure to agency RMBS and increased exposure to non-agency RMBS. Overall, we maintain a positive view to securitized credit given attractive carry and technicals.

It is increasingly reasonable to question the need for the Fed to cut rates. Yes, inflation is falling (but how much and how fast); yes, the labour market is normalizing (but not there yet); yes, wage growth looks to be slowing (although difficult to be definitive). But, the real economy seems to be doing just fine with regard to robust corporate profits, strong nominal GDP growth, the ISM manufacturing index rising over 50, a meaningful increase over the LTM, and a still robust service sector. In fact, one could ask oneself the question exactly why is the Fed contemplating rate cuts? The situation looks better outside of the US, but where the Fed goes others are sure to. So, markets will need to be vigilant over the next few months to gauge how much freedom central banks around the world will have to engage in with respect to the rate-cutting cycle.

Despite newfound concerns about the direction of the US economy, it is likely the Fed will cut rates this year, probably at least two times, as will the ECB. Shorter maturity bonds look attractive even if the US and/or global economy outperforms. However, longer maturity bonds do not look as attractive as yield curves generally remain inverted; significant rate cuts through 2026 are discounted; and even if policy rates are cut, the likely magnitude of those cuts are unlikely to be large enough to push longer-maturity bond yields materially lower. That said, policy rates are high and restrictive and will fall over time, and longer-maturity real yields are high by historical standards. It is also difficult to be overly bearish, and range trading on lower maturity bonds across the developed world looks like the most likely outcome for now.

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Within credit markets, the beat goes on. Spreads continue to tighten broadly, except for euro HY where idiosyncratic events have driven spreads wider, and fundamentals remain strong. Stronger growth and continued pricing power have supported corporate results while central banks' pivot to eventually easier policy provides an important backstop to downside economic risk. That said, US investment grade spreads are at historically high valuations. While this is not a signal for imminent underperformance, there is limited upside (in spread terms) particularly in higher quality names. Value remains better in subordinated financials although recent outperformance has led us to selective profit taking. But, after the back up in government bond yields, the all-in yield on investment grade remains attractive as a medium-term total return investment and will likely outperform cash. Euro investment grade spreads have lagged USD bonds and have room to catch up, particularly in financial names, which we prefer.

High yield bonds also remain well bid, and while spreads are also historically tight, all-in yields are high. It is this "high" yield, much higher than cash, that attracts buyers. Even with spreads tight, high yield should still perform given a solid macro environment. Per usual, recession risk remains the biggest threat but is unlikely to occur in the next 12 months given data momentum and likely policy easing. Preliminary default data also supports the idea of continued low default rates, and with those that do occur being the result of idiosyncratic risks. In summary, credit looks attractive, but it is primarily a carry game rather than a capital gains story.

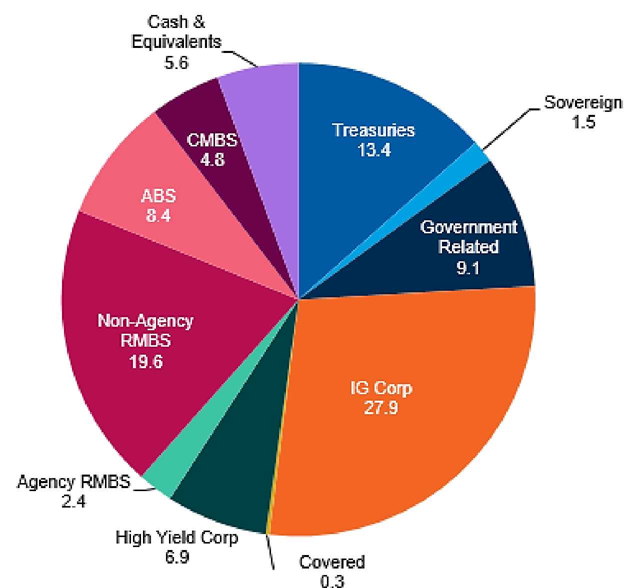
EM local markets had a challenging March but still look like they will outperform developed bond markets over the remainder of the year. EM central banks are cutting rates, and this should continue but at a reduced pace. It was notable that the Central Bank of Mexico made their first rate cut in March on the back of diminishing inflation and sky-high real rates, and more should come in the months ahead. While inflation remains well behaved, worries about a slower paced inflation progress and a shallower than expected developed market rate cutting cycle will make EM central banks cautious about getting too far ahead of the Fed. While worries about a lagging Fed has caused an upward correction in EM local yields, we still consider EM local debt attractive. We prefer Latin American bond markets, as central banks in this region have begun cutting rates and are likely to continue doing so.

Given the uncertainty surrounding the robustness of the global economy and likely central bank reactions to such data, we continue to find the best fixed income opportunities in shorter maturity 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. A strong US labour market and rising real incomes should keep household finances on a solid trajectory, even if not as robust as 18 months ago.

Despite challenging home affordability, our favourite category of securitized credit remains non-agency residential mortgages. Surprisingly, US housing looks like it may have bottomed out, with prices rising once again, and commercial office CMBS remains challenging. Despite good recent performance, US agency mortgages still have value compared to investment grade credit, at least in higher coupons and should outperform US Treasuries.

In currency markets, the outlook for the US dollar is unresolved. It is at a high valuation, but US economic outperformance has been notable. Until the rest of the world catches up, the dollar is unlikely to fall except in isolated circumstances for idiosyncratic reasons. As such, we are not convinced that materially underweighting the dollar makes sense, but contrariwise, we are also not convinced one should be overweight the dollar. We continue to believe selective EM currencies look like better opportunities against a basket of both the dollar, European, and Asian currencies.

Portfolio sectoral positioning at 31 March 2024



Source: Morgan Stanley Investment Management 31 March 2024 report

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