Salt Sustainable Global Shares Fund Fact Sheet – December 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

To achieve the Fund's investment objectives, 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 31 December 2024

Fund Assets	$86.88 million
Inception Date	12 July 2021
Underlying Manager	Morgan Stanley Investment Management

Unit Price at 31 December 2024

Application	1.4459
Redemption	1.4400

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 Allocations at 31 December 2024

Global equities	98.0%
Cash & sundry items	2.0%

Fund Performance to 31 December 2024

Period	Fund Return	Benchmark Return
1 month	2.67%	2.84%
3 months	10.53%	13.40%
6 months	15.98%	15.51%
1 year	28.63%	34.12%
2 year p.a.	25.47%	28.77%
3 year p.a.	10.84%	13.69%
Since inception p.a.	12.55%	14.37%

Performance is before fees and tax and adjusted for imputation credits.
Benchmark (MSCI World Index in NZD) performance is gross.

Fund holdings

Top 10 holdings	
Microsoft (US)	Aon (US)
SAP (DE)	L'Oreal (FR)
VISA (US)	Accenture (US)
Alphabet (US)	CME Group (US)
Procter & Gamble (US)	Intercontinental Exchange (US)

Source: MSIM, data as at 31 December 2024.
The Top 10 Holdings represented 41.8% of the total portfolio.

The Portfolio's weighted average carbon intensity (WACI) was 82% lower than the MSCI AC World Index.[A]

Market Review

- In the December quarter markets were dominated by events in the US with Donald Trumps's victory in the US Presidential election, a hawkish pivot from the US Federal Reserve and ongoing strength in the US dollar.
- Trump's victory had markets contemplating more expansionary US fiscal policy, including further tax cuts, and a more nationalist trade policy. At the same time, the US Federal Reserve signalled there was less scope for interest rate cuts in the period ahead. These two events cancelled each other out in equity markets, while both were bad for bonds.
- In the US, data releases continue to point to resilient growth and recent inflation results have been generally higher than expected, stalling the disinflation process. While the Fed cut interest rates by 25 basis points in December, they signalled only two cuts in 2025, down from the previously signalled four.
- In Europe, the central bank delivered a 25bp rate cut in December, taking the deposit rate to 3.0%. As the downside risks to growth build, the Bank removed the reference to the need for restrictive policy from its statement. That seems to open the door to a steadier pace of rate cuts to neutral, wherever that may be.

- The Bank of Japan left interest rates unchanged in December though expectations of another interest rate hike continue to build. The Bank will likely want further clarity on next year's Shunto wage negotiation before moving, making a hike in January or March likely.

- In China the authorities to continue to signal further stimulus is in the pipeline, though details remain scant. Stimulus delivered to date appears to be having some impact with the December non-manufacturing PMI rising from 50.0 to 52.2, and while the manufacturing index came in weaker than expected at 50.1, there were glimmers of recovery under the hood. More fiscal stimulus is still required, preferably aimed at boosting demand (consumption) rather than supply.

- In Australia the RBA delivered a more dovish that expected statement in December, potentially opening the door to an interest rate cut as early as February. However, that optimism was quickly dashed as the unemployment rate surprised to the downside in November, falling from 4.1% (where it has been for 3 months on the trot) to 3.9%.

- In New Zealand, labour market data for the September quarter was weak with employment contracting over the 3-month period. The unemployment rate rose from 4.6% to 4.8%, with a decline in the participation rate preventing a sharper rise. September quarter GDP data incorporated revisions to the prior data showing activity levels had been higher than previously estimated up until March 2024, but that there had been a sharper fall in activity through the middle quarters of the year.

Portfolio Review

- The Portfolio delivered +2.67% (Gross/NZD) in December and +10.53% in the fourth quarter. The MSCI World Index returned +2.84% in the month and +13.40% in Q4.

- For the full year 2024, the Portfolio provided a respectable absolute return of +28.63%, in keeping with the investment team's long-term compounding expectation of c.9-10% p.a. (in U.S. dollars), however it was unable to match another impressive year from the MSCI World which returned +34.12%.

- Given the Portfolio is designed for long-term capital appreciation through steady and predictable compounding, lagging the index in years of such extraordinary returns is not unusual, as witnessed in 2023.

- For the quarter, the largest contributors to absolute performance were: **Visa** (+71 basis points [bps]), **SAP** (+40 bps), **Alphabet** (+41 bps), **Booking Holdings** (+45 bps), and **TSMC** (+29 bps).

- The largest absolute detractors were: **L'Oréal** (-64 bps), and other key detractors in Q4 include **Keyence** (-46 bps), which reported mixed Q2 results in the quarter and awaits a recovery in the machine tool cycle, **AIA** (-46 bps), where good operational momentum was hampered by negative sentiment over China, **IQVIA** (-42 bps), as the company revised its 2024 guidance downward due to uncharacteristic trial delays, and **Thermo Fisher** (-39 bps), which we added to after the company reported unremarkable Q3 results, given the industry's post- pandemic challenges are now beginning to show signs of easing.

- In terms of Q4 relative performance, the Portfolio benefitted from avoiding the lower quality, capital intensive sectors, notably Materials, which lessened the impact from the overweight to Consumer Staples and Health Care, and the underweight to Consumer Discretionary and Communication Services.
  Stock selection was hampered by relatively weaker returns in Information Technology (IT), Consumer Staples and Financials.

- For 2024 overall, the largest contributors to absolute performance were: **SAP** (+279 basis points [bps]), **TSMC** (+184 bps), and **Visa** (+104 bps), **Microsoft** (+84 bps) and **Alphabet** (+105 bps).

- As in Q4, the largest absolute detractor for the year was **L'Oréal** (-66 bps), which was down -28% in 2024 due to weakening U.S. and China demand and the threat of tariffs. We see the current trading weakness as cyclical: L'Oréal is a global business pivoting to where growth is robust and is backed by well-invested brands, as such, we expect improving sales growth trends in 2025 and a return to mid-single-digit compounding over the medium term. **AIA** (-41 bps) fell -15%, on account of sector-specific pressures in the Asia insurance market and a less favourable investor attitude towards China, although we maintain that the investment thesis is intact, supported by structural growth factors. **IQVIA** (-39 bps) also returned -15%, due to what appears to be an industry level slowdown in clinical research.

- Elsewhere, **CDW** (-30 bps) has been affected by the continued weakness in hardware demand in the post-COVID era, some of which is cyclical – although we remain vigilant to any structural issues which may hamper future compounding potential. Lastly, **Reckitt Benckiser's** (-21 bps) share price fell sharply on the negative verdict of a U.S. state court relating to its infant formula. Following a partial recovery in the share price helped by its restructuring strategy and a later infant formula lawsuit where it was found not liable, we exited the position.[1]

  For 2024, sector allocation was positive, as the benefit from the IT and Financials overweights, along with the boost from not owning the cyclical sectors, notably Materials, Energy, and Real Estate, outweighed the hit from the defensive sector overweights and Communication Services underweight. In terms of stock selection, the relative underperformance was largely on account of weakness in IT and Financials.

- Within IT, the Portfolio's respectable +22% return, helped by strong absolute performers such as SAP and TSMC, failed to match the substantial +33% IT index return, given the Portfolio's skew toward Software and IT Services (up 19% and 11% respectively) which make up over 70% of the Portfolio's IT exposure; in 2024, this significantly lagged the more cyclical AI-fuelled Semis (+62%) and Hardware (+27%) subsectors.

- Another way of looking at allocation is considering the impact of the 'Magnificent Seven[2]': the Portfolio owned Microsoft and Alphabet; however, the investment team's high-quality bar and strict valuation discipline precluded it from owning the other five.

- This cost the Portfolio over 500 bps of relative performance, with more than half of this (-315 bps) attributable to Nvidia alone. Within Financials, relative weakness was primarily down to the handful of stock-specific issues noted above.

2025 Outlook (Morgan Stanley Investment Management)

2024 was a very strong year for markets overall, with the MSCI World Index up 19% in USD, making it five out of the last six years with returns above 15%.3 However, this success was far from equally shared, with the "Magnificent Seven" delivering close to half the global index's returns, and the "Magnificent One", Nvidia, generating 20% of them all on its own. There was also a serious variation by geography, with the U.S. returns of 24% a full 20 percentage points ahead of EAFE's 4%.2

Earnings explain much of this hierarchy in 2024 returns. The S&P 500's forward earnings rose 12% in the year, but this was made up of the "Magnificent One's" 38% earnings' surge alongside a mere 6% for the "S&P 493". However, even this long tail of the U.S. market was well ahead of EAFE's 2% earnings fall. The strength of the dollar helped the U.S., as did the country's stronger economic growth. U.S. gross domestic product (GDP) growth reached a very healthy 2.7% in 2024, in contrast with the shrinking German and Japan economies.

Looking forward, the U.S. economy continues to look healthier than other developed markets. Its 2%+ expected GDP growth for 2025 is twice that of EAFE, despite the continued softness in some areas such as low mortgage issuance and weak manufacturing PMIs (purchasing managers' indexes). However, positive surprises for the U.S. economy may be tougher to find than in the last two years, given the higher starting base for economic growth.

The economic factor not receiving as much attention as it should is the U.S. budget deficit, which is running at an unprecedented 6%-7% of GDP at a time when the economy is at close to full employment. Either the U.S. budget deficit will be cut significantly by the new DOGE's (Department of Government Efficiency) efforts outpacing tax cuts, which could suck demand out of the economy, acting as a major dampener on economic growth and thus corporate profits, or the deficit will remain very high, growing debt further from the current $36 trillion, which could put pressure on long Treasury yields and even the mighty dollar. The 10-year Treasury rate rising 100 basis points as the U.S. Federal Reserve has cut policy interest rates by 100 basis points is perhaps an ominous sign.

Our real concern is how the expected 2025 earnings growth of 15% for the U.S. gets delivered. The expectation is not that we are dependent on the "Magnificent Seven" to deliver this but that the earnings growth will be broad-based, with the "493", excluding the "Magnificent Seven", growing earnings at 13%. Given revenues are only expected to grow 5%, in line with nominal GDP growth expectations, this double-digit earnings per share growth implies a sharp further improvement in margins from what are already at near-record levels, even excluding the "Magnificent Seven".

The claim that "prediction is very difficult, particularly about the future" is attributed to both the Nobel Prize winning physicist Niels Bohr and the baseball Hall of Fame member Yogi Berra. Despite their differing backgrounds, they would probably both agree that prediction is particularly difficult in 2025 given the heightened geopolitical and U.S. policy uncertainty combined with wildly varying prognostications for GenAI. However, the markets do not seem to be afflicted by any such doubt, given the elevated equity multiples, modest VIX and, most starkly, BBB-rated bond spreads at their lowest this century. Given this market obliviousness to the world's volatility, we believe a strategy that seeks to deliver steady compounding through decent top-line growth and resilient earnings, which is trading at a reasonable multiple, offers an important role to play in clients' portfolios.

Portfolio activity

During the fourth quarter (Q4) we added one new name to the portfolio and made two complete sales. In Q4, we purchased **ASML**, the dominant provider (with over 90% market share) of lithography machines, essential tools for semi-conductor manufacturing. Due to the complexity of these devices, barriers to entry are high, particularly in the advanced extreme ultraviolet machines (EUVs) where ASML is the sole supplier. Following a downgrade to guidance at the Q3 results due to sluggish end markets, some challenges downstream with ASML's customers – Intel and Samsung – and concerns around Chinese growth, we were provided with the chance to purchase this quality stock at a ten-year low relative to the market.

During the quarter, we sold our position in **Reckitt Benckiser** on quality grounds. Reckitt is a company we have held in our global portfolios for many years, with the company being a leading quality compounder within the Staples sector for much of that time. More recently however, it has appeared amongst the top detractors as investors grappled with the difficulties of getting a clear read of the business in the post-COVID period. Management attributed 'unusual' factors to justify performance issues, which may have masked more structural challenges. Given the strong valuation support, we were more patient with Reckitt than we otherwise might have been, but valuation grounds were not sufficient to justify holding the company once we had lost conviction in the quality thesis. Once the stock had made a partial recovery, we made the decision to exit in Q4.

We also sold out of the small position in **Universal Music Group** during the quarter, due to risks to the quality thesis following the sharp slowdown in subscription growth by the streaming platforms announced at the Q2 results, as digital music adoption appears to be further along the S-curve than previously thought. In response, the company has pivoted more towards pricing uplifts to generate the ambitious new financial targets for 2024-2028, announced at the company's capital markets day in September 2024. Given pricing-based growth has lower visibility than UMG's original subscription-based growth strategy, we decided to exit the modest position.

Sources

A. Source: Trucost. WACI is calculated using Scope 1 & 2 emissions per $m of company revenue. The term carbon refers to greenhouse gas (GHG) emissions, measured in metrics tonnes of carbon dioxide equivalent (CO_2e) emissions. Our data provider's methodology follows the GHG protocol and includes carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), sulphur hexafluoride (SF_6) and Nitrogen Trifluoride

1. As Reckitt noted in their press release, “The verdict is consistent with the scientific consensus that there is no established causal link between the use of specialised pre-term hospital nutrition products and NEC, and that where human milk is unavailable or when supplementation is necessary, specialised pre-term hospital nutrition products can provide essential, lifesaving nutrition” Mead Johnson Welcomes Defence Verdict in Whitfield Case | Reckitt.com

2. Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla.

3. Source: FactSet, as of December 31, 2024.

4 Source: Bloomberg, as of December 31, 2024.