SALT

Salt Sustainable Global Fixed Income Opportunities Fund Fact Sheet – July 2023

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 July 2023

Benchmark for ESG purposes	Bloomberg Global Aggregate Index (NZD hedged)
Fund Assets	$62.09 million
Inception Date	10 February 2023
Underlying Manager	Morgan Stanley Investment Management
Average credit rating	Standard & Poor's A- / Moody's A3
Effective Duration	3.2 years

Unit Price at 31 July 2023

Application	1.0131
Redemption	1.0120

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 July 2023

Global fixed income securities	95.4%
Cash	4.6%

Fund Performance to 31 July 2023

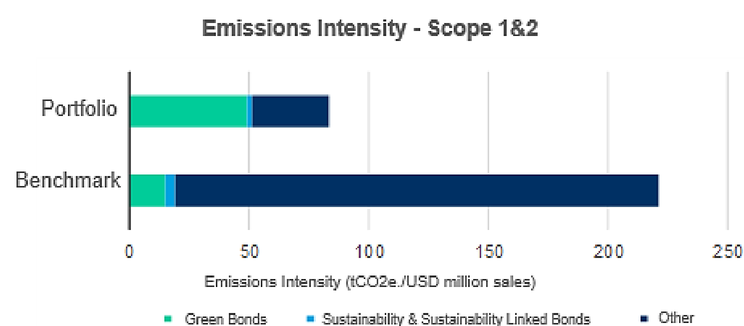
Period	Fund Return (Gross incl. ICs)
1 month	0.89%
3 month	0.92%
Since inception cumulative	1.56%

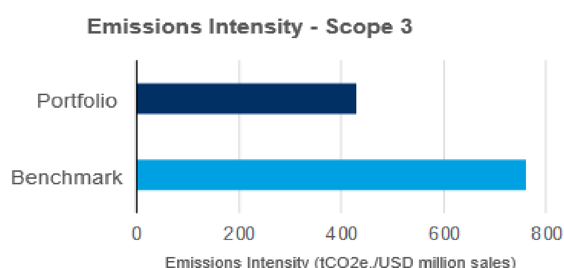
Performance is gross of fees and tax. Data as of 31 July 2023.

Fund ESG Dashboard	Portfolio	Index	YTD change
MSCI ESG Score (MV%.)	98.5%	91.5%	-
Exposure to Corporates with CO2 footprint reduction targets	94%	88%	-
Green, plus Social, Sustainability and Sustainability-linked bonds	22.8%	2.6%	-
Sustainable SBTi approved / committed targets	63.0%	38.9%	-
CO2 Footprint Scope 1&2 (tCO2e/$mn emission intensity)	76	216	-
CO2 Footprint Scope 3 (tCO2e/$mn emission intensity	428	759	-
MSCI ESG Score (Adjusted)	7.56	6.32	7.56
- Environment score	7.53	6.13	7.53
- Social score	5.62	5.53	5.62
- Governance score	6.19	5.74	6.19
MSIM ESG Sovereign score	2.12	2.10	-

Source: MISM Monthly Investment Report / MSCI ESG Research as at 31 July 23.

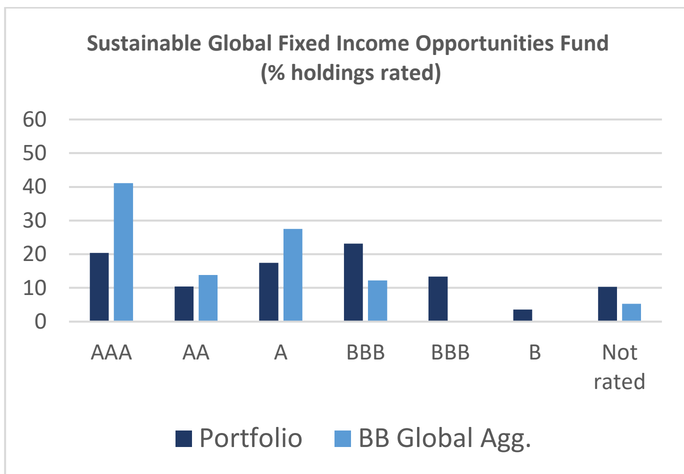
Fund CO2 Emissions Intensity characteristics at 30 June 2023





Source: MISM

Fund credit ratings vs. Bloomberg Barclays Global Agg.



Source: MISM

Portfolio Review

- In the one-month period ending July 31, 2023, the portfolio returned 0.89%. The performance can be attributed to the following factors:
- The portfolio's positioning in duration had a positive impact on performance as yields rose.
- Within investment grade credit, spreads tightened with financials outperforming industrials and utilities.
- The portfolio's exposure to high yield credit had a positive impact on performance, predominately driven by industrials.
- Exposure to government related debt also had a positive impact on performance.
- The portfolio's exposure to securitized debt had a positive performance.

Strategy Changes

There were no material changes in strategy during the July month.

Portfolio Commentary & Outlook

Risk assets sustained their rally in July as economic data continued to show its resiliency and the soft-landing rhetoric gained credibility. Corporate credit spreads were largely tighter over the month as the US led the way in producing strong economic data with inflation data surprising to the downside. The Chinese government also announced they would continue to support their economy with further stimulus. This all bodes well for risk assets.
Within the credit space, high yield outperformed investment grade with lower rated securities outperforming. Euro-area credits broadly outperformed their US counterparts. Securitized credits also tightened, albeit less so than corporate credits.
Within the macro space, markets saw multiple rate hikes within the developed markets throughout July. These hikes were mostly supplemented by dovish overtones from central bankers signalling that the end may be near for the rate hiking cycle. Only time (and data) will tell if it is necessary to keep hiking. On the other hand, the emerging markets continued to rally as EM central banks either cut rates or broadcasted that rate cuts are imminent. EM central banks led the way in terms of hiking rates and so far, are leading the way in terms of cutting. The dollar was broadly lower over the month, depreciating against a basket of DM and EM currencies.

US recession risk continues to decline with many analysts including the Fed research staff now saying the highest probability scenario is no recession at all. Despite increased optimism on the economy, inflation has been behaving well. Falling inflation, reasonable growth (falling probability of recession) is generally good for financial assets, except maybe for longer-maturity DM government bonds which have been hurt by valuations (steep inversion of yield curves), rising US deficits and issuance plans, QT, especially in Japan which is slowly moving to a tighter monetary policy. Moreover, EM central banks have begun to cut rates with Latin America leading the way as both Chile and Brazil cut rates more than expected. The backdrop for bonds is quite benign barring longer dated bonds.
Financial conditions continue to tighten. The full effects of cumulative rate hikes have likely not been fully felt and credit conditions continue to tighten per the US senior loan officer's survey. The pandemic surge in service's spending will likely wane in the second half of the year. Savings rates and pools of excess savings are dwindling, boding ill for continued robust spending. The US labour market is slowing, albeit very slowly.
Employment is growing, unemployment rates are low and household incomes in real terms are expanding finely with the big drop in inflation. The goods sector which has been in pseudo-recession all year looks like it is beginning to wake up. Capital expenditures and high levels of US fiscal support for expansion of manufacturing capacity in the US is very supportive. Newfound demand for tech, including AI related expenditures should also be a positive. Goods inventories are low as is household demand, which should both begin to improve in the months ahead. It could be that the goods sector business confidence surveys are at their bottoms and are likely to improve going forward, offsetting slowdown in service sector spending.

With inflation falling almost everywhere the pressure to raise rates slightly further or not at all is growing. We would not be surprised if the Fed is finished hiking rates while the ECB hikes one or maybe two more times (as does the Bank of England). EM central banks have already started cutting and this should continue over the second half of the year. Reduced central bank pressure on rates improves the outlook for shorter-maturity bonds significantly and we have already seen the beginnings of steeper yield curves. While we believe the best opportunities lie in shorter maturity bonds of all sectors given their yield advantage, there are limits. Without confidence that monetary policy will be eased, curves can only steepen so far, or real long-maturity yields can only rise so far. But in the interim, the higher carry from shorter maturity bonds should be enjoyed.

Despite a lot of positives for bonds, including higher longer-maturity yields improving expected returns, there are caveats. The first is valuation. There are limits to the rally in risk-free government yields unless central banks cut rates. We generally favour those countries closest to finishing the hiking cycle or that are cutting rates. While US 10-year Treasury yields are at multi-year highs we would not get too bullish. Yields below 4% may be difficult to sustain until the Fed calls "all clear."

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In credit sectors, markets have embraced the soft-landing scenario as spreads have tightened this year and hover near lows outright or within historical ranges. In the investment grade space, we view non-financials being expensive or rich to their fundamentals and prefer large cap financials given their extra yield and proof they can weather financial volatility. That said, we do not see a reason to be bearish. Fundamentals remain solid both at a macro and sector level. The other challenge for IG corporates is wide spreads on US agency mortgages. These spreads are quite competitive to higher quality IG, and we would substitute these for many alternatives in the IG universe.

The high yield market is more convoluted. Spreads are in the bottom quartile, but yields are in the top quartile historically. Yield buyers find them attractive. Spread buyers seem them as risky. Our view: be selective. Avoiding defaults and blow-ups will eventually be key as higher rates and refinancing risks feed into corporate performance and outlooks. We are modestly positive on both sectors.

We continue to favour shorter maturity securitized credit (RMBS, ABS, selected CMBS) as offering the best opportunities in fixed income. The outlook has modestly deteriorated as US household balance sheets come under more pressure and excess savings are run down. We are trying to take advantage of higher yields on higher quality issuers to achieve our target returns, rather than venture down the risk/rating spectrum. Our favourite category of securitized credit remains non-agency residential mortgages, despite challenging home affordability. Somewhat surprisingly, US housing looks like it may have bottomed out.

Overall, fixed income had not been this attractive in a very long time. While risks remain, we do not envision a hard landing for the global economy. This will be supportive of credit and EM and not too painful for government bonds. Most yields compensate for remaining risks, with the caveat -- that with policy rates so high, cash and short maturity bonds offer compelling yields compared to longer-maturity bonds.

Recent good news on the US economic front has caused the US dollar to stabilize if not appreciate. While the dollar looks vulnerable medium term, other DM currencies do not offer compelling advantages at the moment. The most undervalued currency continues to be the Japanese yen but given the slow-moving nature of Japanese monetary policy and still exceptionally high hedging costs, it will be difficult for the yen to rally until Japanese rates move higher or begin to fall in a meaningful way in the US. We continue to like being underweight the U.S. dollar over the longer term versus a basket of mostly emerging market currencies.

However, given EM's strong year to date performance, we are not in a rush to increase exposure. We also continue to like emerging market local government bonds versus hard currency debt and developed market government bonds given the differences in recent inflation performance, level of real yields, and central bank policy trajectories.

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