SALT

Funds Management

Salt NZ Dividend Appreciation Fund Fact Sheet – March 2019

Manager Profile

Salt Funds Management is a boutique investment management firm wholly owned by its employees which specialises in managing NZ/Australian equity and listed property mandates for wholesale and retail clients.

Investment Strategy

The Salt NZ Dividend Appreciation Fund targets a portfolio of shares of New Zealand companies that may, in our opinion, pay high and sustainable dividends. A considerable body of robust research suggests that stocks with strong and sustained dividend policies tend to generate higher free cash flow than average and outperform their index benchmarks over time. The strategy is not intended to naively generate the highest possible yield but rather to generate a high and sustainable dividend yield.

Fund Facts at 31 March 2019

Benchmark	S&P/NZX 50 Gross Index
Fund Assets	$83.0 million
Inception Date	30 June 2015
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 31 March 2019

Application	1.4724
Redemption	1.4664

Investment Guidelines

The guidelines for the NZ Dividend Appreciation Fund are shown below:

NZ shares	95% – 100%
Cash	0% – 5%
Unlisted securities	0% – 5%
Maximum active position	8%

Target investment Mix

The target investment mix for the Salt Dividend Appreciation Fund is:

Australasian Equities	100%

Fund Allocation at 31 March 2019

NZ shares	97.86%
Cash	2.14%

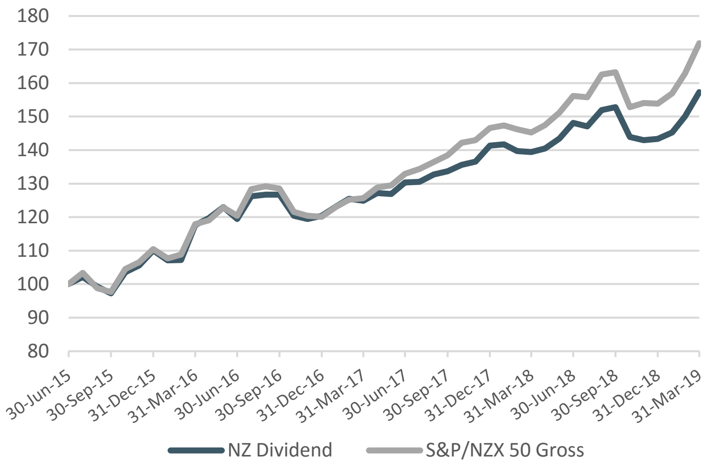
Fund Performance to 31 March 2019

Period	Fund Return*	Benchmark Return
1 month	4.86%	5.58%
3 months	9.72%	11.73%
6 months	2.94%	5.28%
1 year	12.85%	18.34%
2 year p.a.	12.21%	16.96%
3 years p.a.	10.17%	13.39%
5 years p.a.	15.05%	13.88%
7 years p.a.	16.19%	15.88%
10 years p.a.	15.59%	14.29%
Inception p.a.	13.45%	11.67%

Performance is after all fees and does not include imputation credits or PIE tax.

*From 1 October 2008 to 30 June 2015, performance is from a fund with the same strategy and the same portfolio manager.

Cumulative Fund Performance to 31 March 2019*



Fund performance has been rebased to 100 from inception.
Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

Top Overweights	Top Underweights
Spark NZ	Auckland Intl Airport
Investore Property	Mainfreight
Tower	Ryman Healthcare
Scales Corporation	Infratil
Turners Automotive	EBOS

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Quarterly Equity Market Commentary

Summary

- The Fund returned +9.72% after all fees and expenses for the quarter compared to +11.73% for the S&P/NZX 50 Gross Index.
- NZ's S&P/NZX 50 Gross Index rallied strongly over March to lift the quarterly return to a +11.7%.
- The largest positive came from the Fund's long-standing overweight in Scales (SCL, +12.7%) who delivered a strong result.

Bulls globally rejoiced as the MSCI World Accumulation Index rebounded from its late 2018 travails to post a remarkable rise of +12.5% in local currency terms for the first quarter of 2019.

The equities surge was primarily driven by a remarkably fast change in view from the Federal Reserve, slashing its rates forecasts to expect no rate hikes in 2019, sending a much more dovish tone to markets. The S&P 500 surged +13% over the quarter despite consensus actually reducing calendar year 2019 earnings expectations by over 3% according to FactSet. The NASDAQ was similarly strong at +16.5%. These two indices are now a mere 3.8% and 5.2% below the all-time highs achieved in 2018. The 10-year Treasury yield ended the quarter at 2.41% down from 3.09% at the start of the year.

China lowered its growth rate target from "around 6.5%" to a range 6-6.5% and announced a raft of measures including modest monetary stimulus and tax cuts to boost lending and consumer spending in light of weaker than expected macro data. The Shanghai Composite surged nearly +24% over the quarter, and the Hang Seng rose +10.5%.

European markets were up to a lesser extent with the UK's FTSE 100 +9.5%, Germany's DAX +5.3% and France's CAC 40 +9.5%, despite the shambles that is Brexit, slowing Chinese demand for exports, and ongoing yellow-vest disruption. In light of slowing Eurozone growth, the ECB took modest steps to bolster confidence through a series of stimulatory measures which will provide targeted funding and more liquidity into the financial system.

The Australian market had its best quarter in nearly a decade with the S&P/ASX 200 up +9.5%, led by Technology (+20.7%), Resources and Materials (+19.0% and 17.8%), whilst Banks (+3.0%), Consumer Staples (+5.2%) and Health Care (+6.3%) lagged. The RBA sent dovish tones citing mixed global macro data and falling house prices as a concern given high levels of household indebtedness.

NZ's S&P/NZX 50 Gross Index rallied strongly over March (+5.6%) to lift the quarterly return to a +11.7%. The RBNZ shifted to a dovish tone and the NZ 10-year yield fell from 2.38% to 1.75% over the quarter, propelling equities higher despite slowing trading partner growth, a weakening housing market and talk of new capital gains taxes. The strongest performers over the quarter were Vista (VGL, +31%) and a2 Milk (ATM, +28%) on strong results whilst there was an influx of investment chasing higher yielding large cap companies. The worst performers were Sky Television (SKT, -25%) on continued subscriber losses, Kathmandu (KMD, -18%) on a light result and Air NZ (AIR, -13%) on a weaker growth outlook.

Quarterly Fund Commentary

The Fund failed to keep pace with a rampant bull market over the March quarter, with a series of modest headwinds adding up to performance of +9.72% compared to the extremely strong +11.73% turned in by the S&P/NZX 50 Gross Index.

The Fund's relatively low multiple, high yield nature makes it not entirely surprising that it struggled to keep up with a surge in share prices which was particularly concentrated in large cap and high multiple companies. The market is now on an all-time record one year forward PE of 28.6x (ex-property companies) using FNZC data. Earnings forecasts have now retreated 7% since their high back in April 2018, with extremely low 10-year bond yields being the main support, falling from 2.38% to 1.75% over the quarter. Remarkably, they are now below the 1.9% CPI inflation rate and even at these unprecedented levels, NZ market is more than 20% overpriced on our analysis.

While the overall market is very expensive, there is a record divergence between the average PE of 28.6x and the median PE of just 16.8x. We view this as attractive in the current environment, with the trick being to find companies that can still pay sustainable dividends and meet earnings expectations against a mixed economic backdrop. Many of the Fund's key positions trade well below market multiples, have solid projected growth outlooks and trade on yields well above market – we are just waiting for the market to move beyond its current flow-driven large cap, high multiple infatuation and agree with us on the bottom-up fundamentals.

Contributors

Major positives were fewer in number and led by Scales (SCL, +12.7%) who delivered a strong result, this year's apple crop is shaping up well and they have significant accretive reinvestment capacity when their cool store sale settles. This was closely followed by our overweight in Contact Energy (CEN, +12.8%) whose operating performance has been solid and wholesale electricity prices have been strong. The Fund benefitted overall from being moderately overweight the high yielding gentailer sector.

Detractors

Key headwinds over the quarter came from underweights in a series of high multiple, low yield names which rose sharply despite evidence of potential earnings risks. These were led by Mainfreight (MFT, +16.4%) where evidence of slowing trade flows in all key markets was ignored and MFT is now on a remarkable forward PE for a transport business of 27.2x. We calculate MFT only earns a circa 10% return on capital employed.

Other problematic underweights included Auckland Airport (AIA, +15.5%) where traffic growth is clearly slowing as shown by an earlier Air NZ warning; Infratil (IFT, +14.3%) for whom Trustpower was strong but peer company performance in the Australian data centre and retirement village spaces was weak; Ryman (RYM, +14.1%) despite clear evidence of slowing house prices and transactions; and Goodman Property (GMT, +14.3%) where we have underestimated the surge in industrial property and invested in cheaper peers.

Portfolio changes were relatively limited. We lifted our Precinct Property position in its discounted equity raising at $1.48 and significantly lifted our Spark holding on weakness that followed a result that was in-line from the core business but didn't have a Southern Cross Cable dividend. Spark is now a standout on relative value grounds versus other large cap high yielders which have been very aggressively chased. We lightened our ANZ Bank and Westpac holdings, exited AMP into a fleeting bounce and used strength to lower Fletcher Building, Sky City and Vector. For the latter, lower bond yields could create difficulties for allowable returns in their next regulatory rate reset.