Funds Management

Salt NZ Dividend Appreciation Fund Fact Sheet – December 2018

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 December 2018

Benchmark	S&P/NZX 50 Gross Index
Fund Assets	$67.8 million
Inception Date	30 June 2015
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 31 December 2018

Application	1.3420
Redemption	1.3365

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 December 2018

NZ shares	99.24%
Cash	0.76%

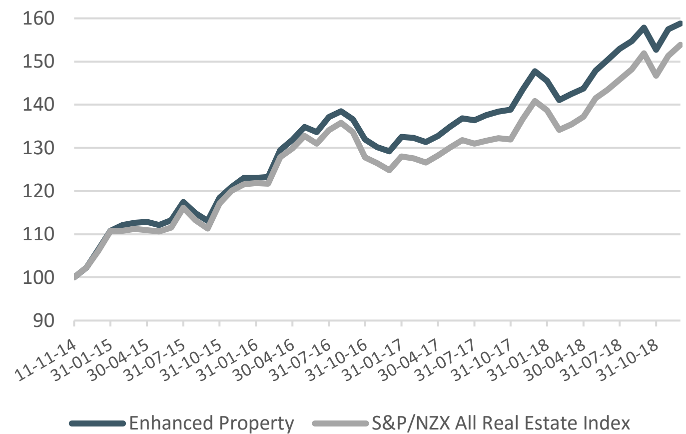
Fund Performance to 31 December 2018

Period	Fund Return*	Benchmark Return
1 month	0.29%	-0.14%
3 months	-6.18%	-5.77%
6 months	-3.24%	-1.47%
1 year	1.43%	4.92%
2 year p.a.	9.11%	13.16%
3 years p.a.	9.21%	11.69%
5 years p.a.	14.32%	13.22%
7 years p.a.	15.63%	15.19%
10 years p.a.	14.33%	12.49%
Inception p.a.	12.75%	10.77%

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 fund with equivalent strategy and same portfolio manager.

Cumulative Fund Performance to 31 December 2018*



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
Investore Property	Ryman Healthcare
Scales Corporation	Infratil
Tower	Auckland Intl Airport
Turners Automotive Group	EBOS
Metlifecare	Mainfreight

SALT FUNDS MANAGEMENT
Level 3, The Imperial Buildings, 44 Queen Street | PO Box 106-587, Auckland 1143
P: +64 9 967 7276 | E: info@saltfunds.co.nz | www.saltfunds.co.nz

Quarterly Equity Market Commentary

Summary

- The Fund fractionally lagged its benchmark declining by -6.18% after all fees and expenses compared to the -5.77% turned in by the Index during the quarter.
- Many markets around the world saw the last quarter of 2018 reverse all the gains of the year and then some to make it something of an 'annus horribilis'.
- A very strong tailwind came from our large underweight in Ryman Healthcare (RYM, -23%), whose result was typically opaque.

Many markets around the world saw the last quarter of 2018 reverse all the gains of the year and then some to make it something of an 'annus horribilis'. The MSCI World Accumulation Index shed an astonishing -13.4% in the December quarter, ending the year -8.7% below where it started in USD terms.

The figures for the US markets were even worse, with the S&P 500 total return for the December quarter being -14.0%, the worst quarter since September 2011, to finish the year down -6.2%. The tech-heavy NASDAQ had a worse quarter, falling a staggering -17.5% to end the year down -3.9%. Markets became increasingly concerned that the trade war with China and the related slowing of the second biggest economy would weigh on the growth outlook. This was coupled with a Federal Reserve that was considered overly keen to remove stimulus, thus slowing the economy too fast. The 10-year Treasury yield fell from highs of 3.08% to 2.68% and the yield curve increasingly looked like it was due to invert - the market expressing its view the US will likely fall into recession within the next 1-2 years. The cost of a barrel of oil fell by more than 1/3rd on oversupply fears despite OPEC production cuts. As money looked for a safe haven, gold enjoyed a rally above $1280 an ounce versus the $1200 level observed early in the quarter.

Asian markets fared similarly poorly, with the Shanghai Composite capitulating -11.6% in the quarter to end the year down -24.6% on trade concerns and numerous signs of weakening domestic demand. Japan's Nikkei fell -17% and the Hang Seng fell -7%.

The UK continued being buffeted by Brexit related noise with the FTSE 100 down -10.4% in the quarter and -12.5% for the year. European bourses were hit by Brexit fears, an end to QE by the ECB, slowing economic growth highlighted by Germany and significant turmoil in France from protests against the Macron reform agenda.

Closer to home, the Australian market was buffeted by the global rout in equities coupled with a quickly deteriorating housing market and consequent fears of a negative spill-over to the broader economy. The Australian S&P/ASX 200 index fell -9% over the quarter to end the year down -6.9%. The NZ market however was remarkably resilient, with the S&P/NZX 50 Gross Index falling -5.8% in the quarter, remaining one of the few global indices generating a positive return for the year +4.9%. The biggest movers in NZ over the quarter were Trade Me (TME +21.7%) on a takeover proposal, and Fletcher Building (FBU -25.4%) and Gentrack (GTK -27.8%) after they negatively revised guidance.

Monthly Fund Commentary

The Fund fractionally lagged its benchmark during what was a brutal December quarter for many investors. It declined by -6.18% after all fees and expenses compared to the -5.77% turned in by the S&P/NZX 50 Gross Index. While perhaps being a touch disappointed to have not outperformed during such a period, the stand-out area of strength within the market came from very expensive defensive stocks, which in many cases are paying out dividends in excess of their cashflows. Somewhat more cyclical stocks came under heavy pressure, with valuation and dividend yield support being trumped by perceived defensiveness in a headlong "flight to safety".

Contributors

A very strong tailwind came from our large underweight in Ryman Healthcare (RYM, -23%), whose result was typically opaque. We did cover a little near its lows but we remain concerned there is a sizeable overbuild occurring in the retirement village sector at a time when the domestic housing sector has peaked out. The harsh treatment meted out to Aveo Group in Australia illustrates what can happen when a highly geared balance sheet meets a slowdown in unit sales.

Other positives were led by our moderate overweight in Methven (MVN, +33%) which received a takeover bid from GWA Group. Bolting Methven's products onto GWA's distribution makes eminent sense and in our view the deal is highly likely to close. Other smaller positives came from having no holdings in Ebos (EBO, -11%), Synlait Milk (SML, -17%), PushPay (PPH, -23%) and Gentrack (GTK, -28%).

Detractors

Headwinds were relatively broadly based and the largest was our medium-sized holding in Turners (TRA, -18%) which came under heavy pressure post a result that was weaker than their earlier upbeat comments had suggested. While used car sales are holding up well, we underestimated the margin impact from a squeeze on car inventories due to greater difficulty and costs in sourcing Japanese imports. We remain major fans of TRA's unique vertical and horizontal integration in a highly fragmented industry with large profit pools. In the short term we have called the cycle wrong but in the long term we think this is a business on a sub 10x PE with many years of earnings and dividend growth ahead of it.

A small holding in Evolve Education (EVO, -26%) has turned into a very disappointing saga. We bought in the days when it was a strong free cashflow generator which funded a solid dividend. Latterly, we had held for a turnaround of a business that has been poorly run and on the strong possibility that private equity interest in the sector could extend to EVO. This may have come close but has not eventuated outside the purchase of a strategic stake by the successful Australian investor, Chris Scott. Recent evidence does tentatively point to a stabilisation at weak levels but the balance sheet is now stretched.

Other sources of pain came from being moderately underweight Trade Me (TME, +22%) which received a surprise takeover bid from private equity; being moderately overweight Sanford (SAN, -15%) which had a slightly weak result due to unusual climatic conditions; being overweight Scales (SCL, -10%) which declined despite an attractive expansion of its pet food business; and being overweight Metlifecare (MET, -17%) which was one of many weak performers in a retirement sector that finally began to come under pressure from house price fears.

The Fund remained fully invested over the period, with cash levels moving from 2.1% to 1.0%. Positional changes were highlighted by moving the overall property stock weighting from a slight overweight to an underweight given relative strength in that sector. Small holdings in Fonterra and Tilt were exited while small new holdings were bought on weakness in Vista and Kathmandu. Weakness was used to move to a moderate overweight in Fletcher Building and a slight overweight in Sky City. The Ryman underweight was lessened a touch while we sold some of the Oceania Healthcare holding into strength.

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