SALT
Funds Management

Salt NZ Dividend Appreciation Fund Fact Sheet – June 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.

Benchmark

S&P/NZX 50 Gross Index

Fund Assets at 30 June 2018

$71.1 million

Strategy Assets at 30 June 2018

$150.3 million

Includes all Funds and separately managed accounts that employ the same investment strategy as the Salt NZ Dividend Appreciation Fund.

Inception Date

30 June 2015

Portfolio Manager

Matthew Goodson, CFA

Unit Price at 30 June 2018

Application	1.4132
Redemption	1.4075

Investment Guidelines

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

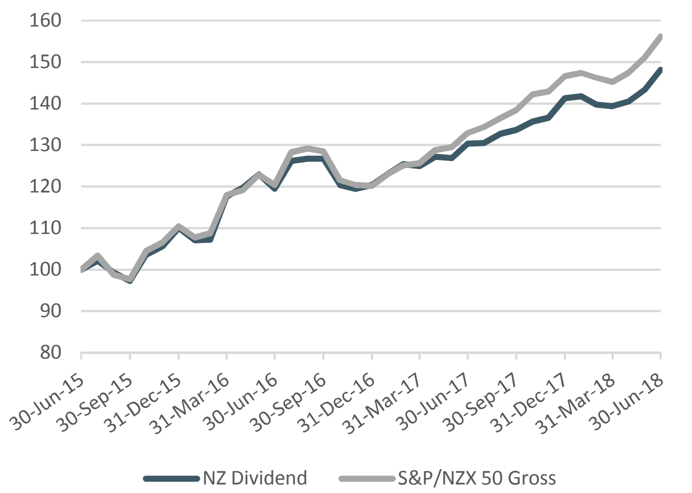
NZ shares	95% – 100%
Cash	0% – 5%
Unlisted securities	0% – 5%
Maximum active position	8%

Fund Performance to 30 June 2018

Period	Fund Return	Benchmark Return
1 month	3.32%	3.28%
3 months	6.29%	7.50%
6 months	4.83%	6.49%
1 year	13.68%	17.50%
2 year p.a.	11.35%	13.87%
Inception p.a.	14.00%	16.02%

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

Cumulative Fund Performance to 30 June 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.

Fund Allocation at 30 June 2018

NZ shares	97.96%
Cash	2.04%

Top Overweights	Top Underweights
Turners Automotive Group	Ryman Healthcare
Investore Property	Mainfreight
Tower	Infratil
Scales Corporation	Trade Me
Metlifecare	Fisher & Paykel Healthcare

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Monthly Equity Market Commentary

Despite a flat month in June, global markets still posted a positive June quarter with the MSCI World Accumulation index lifting +1.7%, notwithstanding considerable emerging market stress in countries such as Turkey, Argentina and Brazil.

The S&P 500 and NASDAQ ended the quarter up +2.7% and +6.3% respectively as the US economy continued to grow with solid momentum, with this outweighing concerns regarding the escalating tensions on trade between the US and China as President Trump and President Xi play hard ball in the public arena. The same cannot be said for Chinese equities which in the face of new tariffs on exports, US$ strength and a marginal slowdown in activity has seen the Shanghai Composite down -9% over the quarter and an eye opening -22% since the highs achieved in January this year.

The FOMC lifted rates by +0.25% as expected however they also signalled an additional hike this year citing higher confidence in the pick-up in inflation and the economy more generally. Despite this the US 10-year Treasury rose by just +0.12% to 2.86% over the quarter well below the high of 3.11% reached during the period. Foreign exchange markets have also seen significant moves over the quarter largely driven by USD strength, with the Chinese currency around 5% weaker against the USD. This came as the Peoples Bank of China cut the Reserve Requirement Ratio to help encourage lending and stimulate the economy for the third time this year.

The UK's FTSE 100 was down mildly (-0.2%) in June to remain up a solid +9.6% for the quarter as the Brexit saga continues, whilst Germany's DAX was down -2.4% in the month bringing the return for the quarter down to a modest +1.7% as Chancellor Merkel struggles to keep her coalition together. The ECB also signalled it will end QE in December.

In Australia, the S&P/ASX200 had a strong quarter, returning a solid +8.5% with the biggest contributing sectors Energy (+16.5%) aided by a +14% lift in Oil, Consumer Staples (+11.9%) and Materials (+11.7%), whilst the biggest drag on performance was Telecommunications (-13.7%). The RBA left both rates and its forward guidance unchanged in June, with the Board citing uneasiness around international trade, a soft housing market and weak wage growth.

The New Zealand S&P/NZX 50 Gross Index posted a strong result in June +3.3% to round out another strong quarter of returns (+7.5%). The most significant moves over the quarter include; Synlait Milk (SML, +36%) surging following a strong but one-off driven result, Fletcher Building (FBU, +20%) following an equity raising to restore its balance sheet, Kathmandu (KMD, +20%) after a strong trading update which belied tepid retail conditions. Notable decliners included Comvita (CVT, -15%) which warned on soft honey season and announced a potential bidder has walked away and A2 Milk (ATM, -8%) which posted a somewhat disappointing trading update.

Monthly Fund Commentary

The Fund lagged a powerful surge in the market in the June quarter, rising by +6.29% after all fees and expenses compared to the remarkable +7.50% recorded by the Index. The low beta nature of the Fund which focuses on high and sustainable dividends made it a little difficult to keep pace with such an advance and the NZ market one year forward PE now appears extremely extended at a record 25.0x. Earnings forecasts are not rising, bond yields are relatively steady and the domestic business confidence outlook is at its weakest level in some years.

In common with markets globally, much of the strength in NZ appears to have been driven by "price momentum" and "growth" as factors which have ridden rough-shod over other factors such as "valuation", "quality" and "dividend yield". For example, the MSIC Australia Growth Index has outperformed Value by 24% over the past year versus a historical underperformance that has averaged 3.2%.

The main headwind for the Fund was the large underweight in Ryman Healthcare (RYM, +14.1%) which rose sharply post what we considered a mediocre result. Bulls appeared to focus on the sharp rise in NTA from long term house price assumptions being lifted, which seemed odd when property prices have now peaked. We are concerned at the lack of free cashflow generation, early timing of sales recognition, the large multiple of NTA and the leveraged risks to an equity-light model from weakening house prices and housing turnover. With numerous Government measures to improve housing affordability yet to come, RYM is a high risk investment at this point in the cycle.

The second notable laggard was our zero-weight in Synlait Milk (SML, +36.4%) which is very much flavour of the month amongst a raft of bubbly Aust/NZ food export stocks. SML delivered a strong result in late March but this was due to surprisingly high gross margins thanks to volatile seasonality and commodity related factors that are unlikely to be repeated. SML's forward PE of 27x is quite extraordinary for a toll processor which is not a brand-owner.

Other headwinds came from zero-weights in several high multiple growth names, with the largest such drag being Mainfreight (MFT, +13.0%). The sole overweight which dragged notably on returns was a modest holding in AMP Limited (AMP, -26.4%) which came under enormous pressure following the revelations at the Australian Royal Commission Enquiry. In our view, the share price decline is out of all proportion to the direct issues themselves and a robust response led by the highly respected new Chairman, David Murray could potentially see a retrieval of some of the enormous gap that has opened up to our assessment of fair value.

The largest positive was having no holding in CBL Corporation, which was removed from the Index at a zero valuation. The Fund never owned CBL despite superficially attractive metrics given concerns regarding the background of the business and the risks around very long-tail policies that appeared to be written at aggressive pricing.

A number of other key positives included Turners (TRA, +8.0%) which rebounded somewhat following a solid result and it retains a very attractive combination of solid growth on low valuation multiples; Investore (IPL, +7.8%) which is at a steep discount to what is a conservative NTA that they are franking by selling non-core assets at strong premia; Contact Energy (CEN, +11.4%) which is finally beginning to deliver solid operating results; and Evolve (EVO, +16.9%) whose result was at the top end of guidance that had earlier been downgraded.

Cash levels were largely unchanged at 2.1% and portfolio changes were relatively limited over the quarter. Strength was used to lower Auckland Airport, NZX, Ryman and Z Energy, while weakness was used to add to Mercury, Sanford and Spark. A small Vista (VGL, +33.9%) holding was exited as it rose remarkably amongst a cluster of growth stock peers.