Macquarie Investment Management

Macquarie Dynamic Bond Fund

Monthly report – 31 October 2021

Investment objective

Aims to generate attractive returns by dynamically investing in global fixed income instruments. It aims to provide diversification against equity risk as well as capital growth and some income.

Key information

Fund details	
APIR code	MAQ0274AU
Inception date	30 September 2002
Fund size	$731.0m
Distribution frequency	Quarterly
Management fee*	0.614% pa
Minimum investment (Direct)	$20,000
Unit prices and spreads	**macquarie.com.au/unit_prices**

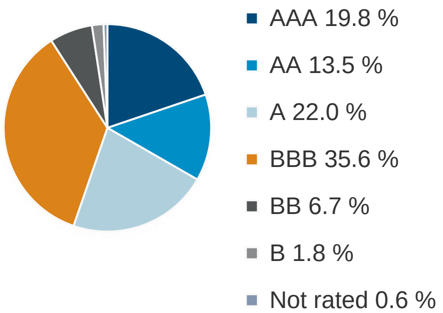
*Read the Product Disclosure Statement for more details on fees and costs.

Fund performance to 31 October 2021

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-1.53	-1.58	-0.56	-1.02
3 months (%)	-1.92	-2.07	-1.20	-0.87
1 year (%)	-0.51	-1.12	-0.69	-0.43
3 years (% pa)	4.74	4.10	3.04	1.06
5 years (% pa)	3.89	3.26	2.31	0.95
10 years (% pa)	4.95	4.31	4.01	0.30

Past performance is not a reliable indicator of future performance.
Total returns are calculated based on changes in net asset values and assumes the reinvestment of distributions.
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.
From 7 January 2019, the benchmark is Bloomberg Barclays Global Aggregate 1 to 10 years Index hedged to AUD. Prior to this, the benchmark was Bloomberg AusBond Composite 0+Yr Index. The performance information shown above is against the current benchmark. Further information in relation to the performance against the previous benchmark is available on request.

Credit profile breakdown



Average credit rating: A
Less than BBB includes residual exposure to issuers held through global investment grade allocation

Asset allocation

	Fund (%)
Sovereign bonds[1]	44.6
Investment grade credit[2]	44.7
High yield	6.4
Emerging markets debt[3]	4.3

[1] Includes Australian government, Australian semi-government, supranational, global sovereign and cash
[2] Includes Australian and global investment grade credit
[3] May include holdings of sub-investment grade instruments

Fund statistics

Credit spread duration	2.3 years
Interest rate duration	3.3 years
Standard deviation[1]	3.0% pa
Yield to maturity[2]	2.0% pa

[1] Statistical measure of variance of Fund's post-fee monthly returns from its average post-fee return since inception used as gauge of volatility.
[2] Pre-fee return Fund would earn over next year based on current market conditions if there were no changes to interest rates or holdings of Fund. It is not an actual or estimated return.

Geographical exposure

	Interest rate duration[1] (%)	Credit spread duration[2] (%)
North America	11.1	39.1
Europe (ex UK)	-1.7	10.7
UK	17.1	7.6
Australia/New Zealand	60.1	27.8
Japan	-0.2	0.1
Others	13.6	14.7

[1] Calculated based on security's currency
[2] Calculated based on security issuer's currency

Fund highlights

The Fund delivered a negative return in October, with duration positioning a detractor amid the sharp moves in short-dated bonds.

Bonds were the key focus during the month, with markets testing central bank commitment to maintaining low rates by pushing yields of shorter maturity bonds significantly higher. The dramatic moves were also exacerbated by apparent unwinding of positions in markets such as Australia.

The Fund is positioned with a lower strategic level of interest rate duration compared to previous years and the reference benchmark, given lower overall global yields and the ongoing fear of inflation. Much of the duration exposure was held in Australia, which was amongst the most heavily affected by the market moves. Notably, while month-end marked the peak of the volatility, some rebound in the Australian bond market has already been evident in early November, reversing some impact had on the Fund. We also believe that the market pricing for rate hikes by the Reserve Bank of Australia, which were brought forward to over the next 2 years, remains fundamentally unjustified and extreme at present, in our view. In the Fund's geographical allocations of duration, we took the opportunity to add to the positions in short maturity Australian rates as the rates sell-off intensified, including some additions near the peak of the market stress and at levels we viewed as extreme. We also added European exposure during the month as investors began to price in the unlikely event of the European Central Bank increasing policy rates next year along. The US exposure was increased slightly following the rise in yields there, while Chinese sovereign exposure was reduced on valuation considerations.

The Fund's credit positioning managed to contribute positively to returns, with excess running yield on key credit sectors (high yield and investment grade, principally) providing positive carry in a month of otherwise very minimal moves in credit markets. This also provides some offset to the near-term impact of bond market volatility. The Fund made modest changes to its credit positioning over the month, with limited attractive new issuance reflecting the overall tight credit spread environment. Overall, we maintain a 'barbell' approach within the Fund, with reduced investment grade exposure (particularly the higher quality, fully valued sectors), higher liquidity, and higher emerging markets and high yield exposure. The Fund participated in a new deal from aircraft lessor AerCap, which brought a $US21bn multi-tranche deal to fund its purchase of General Electric's leasing business – we had reduced some air transport exposure in previous months in anticipation of the deal.

Market overview

Financial markets have witnessed the surge in supply-driven inflation for months but remained comforted by central banks consistently remaining relaxed, underpinned by an assessment that the inflation pulse was transitory. The rate hikes across many emerging countries, and even in New Zealand, were viewed as idiosyncratic and therefore did not rattle the market's confidence. However, much changed during the course of September. Specifically, the Bank of England announced its intention to raise rates in the near term. This was followed by a more aggressive tone from the Bank of Canada. The Reserve Bank of Australia (RBA) surprised by not defending the yield curve control purchases on the April 2024 bond. Finally, the stoically easy policy of the European Central Bank was put to the test and the defence put forward by President Lagarde was considered too weak. The net impact of this apparent shift in tone from global central banks brought forward the expectations for rate hikes, causing a significant rise in shorter maturity rates, but interestingly the moves on longer maturity rates were contained and in fact 30 year yields ended lower in many countries. Thus, yield curve flattening was the major theme across bond markets during October.

Risk markets remained buoyant. Equities rallies and equity volatility fell. Credit spreads remained contained in narrow ranges and near historic tight spread levels.

Outlook

The market repricing of short-term rate expectations and the change in tone by several central banks have unsettled the rate markets but, to date, these are being largely ignored by risk markets. Our sense is that the reaction across markets are not consistent, but the key test may not come until 2022 on whether central banks follow the markets lead and actually deliver tighter monetary policy.

Meanwhile, the macro fundamentals continue to fuel the debate over whether current inflation will prove transitory or structural. Commodity prices, particularly oil and gas, are re-fuelling the upside risk for inflation. Labour shortages and wage pressures are keeping central banks restless. However, growth during the third quarter was soft and in many cases the start of the fourth quarter remains soft. This mix of data has the stagflation debate raging across media, economists and market participants.

The core of the debate is around whether current inflation is being driven by supply chain problems or rising demand. In addition, the word 'transitory' was used to describe the inflation surge in 2021 without any clear definition of what transitory means. We sit firmly in the camp that the world continues to be driven by a unique event as a result of the pandemic and while this persists, so will the supply chain problems. Demand surge is largely the result of a redistribution of spending from services to goods, which was supported by unprecedented government transfers/support to displaced workers. The world is working together to move on from the pandemic and when this happens the supply chain problems too should be released, the problem is that we do not know when that will happen.

We fear that central banks could repeat the errors of the 1970s by using a demand tool to try and fix a supply driven problem that could simply make the situation worse. This means the current volatility spike could repeat in the months/quarters ahead as markets navigate this difficult fundamental path at the same time central banks are seemingly changing their tune (or not).

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For more information speak to your financial adviser, call us on 1800 814 523, email mim.clientservice@macquarie.com or visit macquarie.com