

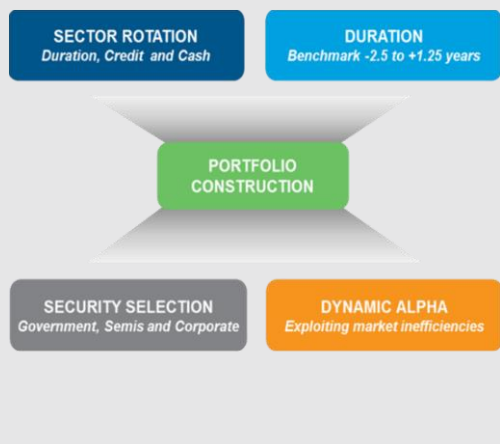
Investment objective

Aims to outperform the Bloomberg AusBond Composite 0+ Yr Index over the medium term (before fees) by using an active investment strategy. It aims to provide regular income and a moderate level of growth.

Key information

Fund details	
APIR code	MAQ0061AU
Inception date	15 May 1995
Fund size	\$270.9m
Distribution frequency	Quarterly
Management fee*	0.390% 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 30 November 2021

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	2.30	2.30	2.08	0.22
3 months (%)	-3.11	-3.18	-3.04	-0.14
1 year (%)	-3.04	-3.39	-3.23	-0.16
2 years (% pa)	0.44	0.02	-0.14	0.16
3 years (% pa)	3.96	3.49	3.35	0.14
5 years (% pa)	3.86	3.38	3.30	0.08

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.

The management fee was reduced to 0.390% pa from 8 January 2021.

Benchmark is Bloomberg AusBond Bank Bill Index

Asset allocation

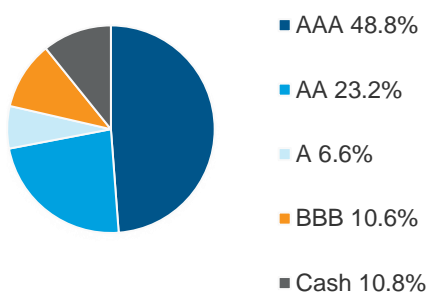
(based on physical exposure)

	Fund (%)
Government	35.3
Credit	31.3
Semi-Government	22.6
Cash and Equivalents	10.8

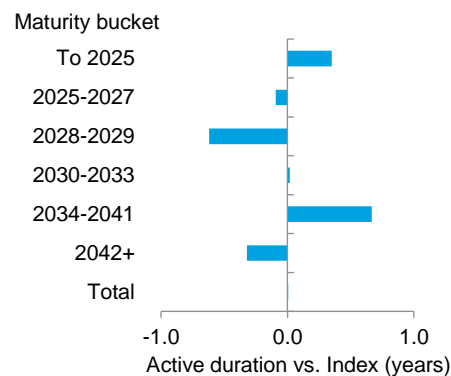
Fund statistics

Credit spread duration	0.9 years
Interest rate duration	5.9 years
Yield to maturity (% pa)	2.07%

Credit profile breakdown



Curve positioning breakdown



Macquarie Australian Fixed Interest Fund

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Fund highlights

The Fund outperformed the benchmark during the month, driven by its duration and curve positioning as well as security selection.

Duration and curve

The Fund was positioned long duration during November, which contributed to performance as bond markets began to stabilise. We reverted back to neutral positioning at month-end as yields continued to move lower on the emergence of the new Omicron strain.

We have continued to hold an overweight to AU versus US duration, which performed strongly in early November as the market disfunction of late October faded. We hold the bulk of this position in the front-end as Australian rates remain very elevated versus equivalent US tenors in this part of the curve. We believe this does not make sense fundamentally given the differences in the inflation outlook, with core CPI in Australia having undershot the Reserve Bank of Australia's (RBA) target by more than any other developed country over the last decade except Japan. The RBA continues to sound dovish and we expect they will lag behind other central banks in hiking rates. In addition, we believe they will not be able to hike as quickly as many other central banks and will face a lower terminal rate, given the sensitivity of the Australian consumer to rate rises as a result of high household leverage and the domestic mortgage market being predominantly floating-rate or short-term fixed. We also hold an overweight to AU versus US duration in the 10 year part of the curve, though this is more modest in size given the need for a liquidity premium in the Australian market following several bouts of volatility over the past 12 months.

Security selection

The Fund's security selection is overweight to the ultra-long Australian Commonwealth Government Bonds (ACGBs) given the steepness relative to global curves, but we have reduced this overweight slightly in size given it has performed well in recent months. The tapering of quantitative easing (QE) should drive the outperformance of the ultras long maturities given the RBA has only purchased sub-12 year tenors and we will see the relative scarcity of those shorter tenors reverse as QE ends. We have taken advantage of relative value opportunities in the ACGBs and have been moving into the front of the 10 year basket given how flat the basket is. We are slightly overweight the swap spread exposure given its value on offer versus bonds, and believe that derivatives should outperform physical securities as the RBA continues to taper their asset purchasing program.

The Fund's credit security selection contributed positively to performance over the month. Even though spreads of subordinated financial paper widened in sympathy with senior paper, a number of the higher-beta corporate bonds, such as Qantas, Pacific National and Brisbane Airport, tightened throughout the month as the economy reopened and recovered further. Given the lack of liquidity heading into the new year, with a slightly weaker technical backdrop as global central banks have turned more hawkish, and the new Omicron variant starting to spread around the world, the Fund added more credit default swap protection positions to allow selective participation in primary transactions that offer value without adding to credit duration risk. Over the month, the Fund participated in primary transactions from issuers such as Mercury NZ, Australia Pacific Airports Melbourne, Computershare US and Bank of Queensland.

Sector rotation

The Fund remains short the semi-government sector, having slightly increased the size of this short this month. Swap spreads continued to widen during November given mortgage paying in the front-end and re-positioning ahead of the futures rolls next month. However, semi-government spreads have not drifted wider with swap and, as a result, they now look very expensive on an asset swap spread measure. We continue to believe there is scope for semi-government spreads to drift wider as the RBA continues their taper, with many now expecting the central bank could taper down to zero when they review in February.

The Fund's credit positioning marginally detracted from performance in November as Australian investment grade credit spreads widened given the ongoing volatility in rates. The allocation to structured securities was also a slight deduction in November, as the phasing out of the Committed Liquidity Facility continued to have an impact on the demand side of the equation in the major bank senior and residential mortgage-backed securities space with spreads remarking wider during the month. Nonetheless, the Fund's underweight credit positioning in SSAs added value and provided a partial offset as SSA spreads widened.

Market review

The inflation debate has been building into a crescendo, culminating in surging headline rates in many countries. Most emerging market countries have already tightened monetary policy, in some cases significantly. The Reserve Bank of New Zealand raised rates in November and focus was turning to the Bank of England to shortly follow, while the US Federal Reserve (Fed) is expected to kick start tapering its asset purchases in December. Bond yields had been rising, but most were still within existing ranges. Risk markets were still well supported, though emerging markets were struggling with the strength of the US dollar. This environment changed rapidly when news of the Omicron variant risk hit the newswires, magnified by low liquidity due to the US Thanksgiving holiday. By month end, bond yields were lower, dramatically so in Australia, while credit spreads were wider in emerging markets, particularly with local currency debt underperforming.

Uncertainty is never welcomed by financial markets, and it may take a few weeks until substantive facts become available on the significance of the new variant. Against this backdrop, the Fed, European Central Bank and Bank of England all meet in December and markets will be scrutinising their signalling closely to see if Omicron has changed their thinking, though Fed Chair Powell strongly suggested that inflation risk is at the forefront of their consideration when they meet in December.

Australian bond market

Bond markets reversed the sell-off of the previous month over November and liquidity began to improve as concern over the central bank outlook began to subside, and the market reaction to data surprises moderated. Central banks remained a key focus. The reappointment of Jerome Powell as US Federal Reserve Chair provided continuity of policy, but the Board is expected to increase the pace of tapering at their next review, with the market now front loading expectations of a rate hike to June next year. The Bank of England's messaging was to expect a hike and, when the hike was not delivered, dramatic moves in Gilts led to moves in other major sovereign curves. The Reserve Bank of New Zealand also hiked the cash rate by another 25bps in November.

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Closer to home, the Reserve Bank of Australia (RBA) confirmed at the beginning of the month that it would cease targeting the April 2024 bond yield at 0.10% as part of its Yield Curve Control policy, but remained resolute that rate hikes were not coming nearly as quickly as market pricing indicates. RBA Governor Lowe emphasised that domestic inflation pressures remain much lower than what is being experienced offshore, and also highlighted that the outlook for wage inflation is more muted in Australia given the success of the JobKeeper program in keeping workers attached to their employer. The dovish tone of these remarks combined with the increased clarity of messaging saw the domestic rates market outperform relative to global rate moves.

The emergence of the new Omicron strain of COVID-19 saw the bond market rally extend later in November given current uncertainty about the variant's transmissibility, severity, and resistance to vaccines. 10 year benchmark Australian Commonwealth Government Bonds (ACGBs) ended the month 41.5bps lower at 1.70%, an outperformance of over 30bps relative to the equivalent US Treasury maturity.

The Australian Office of Financial Management (AOFM) increased their issuance during November, though most of the increase was managed via their short-dated Treasury Note program.

Global credit market

Global markets finished November on a weaker note, with credit markets underperforming equities. There were several triggers for the weakness, with the emergence of a new virus variant the most cited, though the weakness was in place before that. Persistent inflation weighed on expectations for future stimulus, and so did the US Fed Reserve's apparent U-turn late in the month, abandoning their characterisation of inflation as 'transitory' and hinting at an accelerated taper.

US investment grade (IG) credit spreads widened from 88bps to 100bps over the month – the widest level this year to date. Adding to the sell-off is the fact that liquidity is seasonally lower with the Thanksgiving holiday and investors eyeing year end. The weakness was generally orderly, and markets remained open for new issuance, but there appeared to be reduced appetite for risk taking. Overall, IG spreads finished the month 12bps wider and high yield 50bps wider. Amongst sectors, weakness was broad-based, with limited differentiation. Some COVID-related sectors, such as airlines and cruise operators, fared somewhat worse, though generally did not materially underperform the broader market over the month.

Risk assets performed poorly in Europe with the largest move in IG spreads since the peak of the COVID outbreak in 1Q20. IG spreads closed 22bps wider to 108bps, and the weakness was broad based across credit curves and ratings in IG. The catalysts for the weakness included a widening of European swap spreads from Q3 (which has been maintained at wider levels), high new issue concessions, the emergence of the new Omicron variant, and most likely an environment in 2022 with less supportive conditions from global central banks.

Australian credit market

The Australian credit market weakened further as some of the idiosyncratic factors, such as the phasing out of the Committed Liquidity Facility (CLF), continued to have a negative impact on residential mortgage-backed securities and senior financial paper. Additionally, hawkish central bank rhetoric on the back of rising price pressures contributed to further volatility in rates and swap spreads. This had a negative flow-on impact to performance of the Australian credit market as swap spreads marched wider despite credit spreads to swap remaining well-contained. Despite the underperformance of the broader credit index, some of the higher beta corporate bonds that were impacted by lockdowns continued to outperform in November. However, given the underperformance of senior financial paper, financial subordinated paper also moved wider in sympathy. Given the volatility in the rates market, primary supply was more subdued than the previous month with approximately \$4bn of total issuance.

Outlook

The very recent developments around the Omicron variant reminds that, with the pandemic, nothing is assured and the year-ahead outlook has a cloud of uncertainty on top of all the more obvious uncertainties faced when looking ahead. We ponder whether markets will be revising their outlook before year end?

That aside, the debate on the outlook is keenly focused on inflation risk. Rightly so, with headline rates soaring, core rates being pulled higher and increasing reports of wages growth. Initially, the belief that inflation would be proven transitory was strong as the world had obviously experienced a sharp supply shock. Many now believe that demand is behind inflation. A core problem is that supply only adjusts slowly and this can only be done once the pandemic influence has passed, that is, where society has moved on from pandemic to endemic. Demand though can change quickly, and government support, re-opening after restrictions were lifted and re-distribution from services to goods have all made demand appear strong. The key question is: will these moves be sustained?

Current inflation, driven by energy and supply blockages is crushing real income. Wages are rising in some sectors but economy wide the consumer is under real income pressure. This demand risk is not part of the consensus narrative but is central to the risk of stagflation risk for coming quarters. With fiscal stimulus already turned into fiscal drag, if monetary policy tapering/tightening is layered on top then the demand theme will soon be tested.

We have positioned cautiously in recent months fearing a spike in volatility. This approach enables the opportunity to selectively add risk and duration. However, the level of uncertainty suggests there will be further volatility episodes ahead, so maintaining a cautious and disciplined approach to investing is the preferred path.

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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

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