Macquarie Investment Management

Macquarie Dynamic Bond Fund

Monthly report – 31 December 2021

Investment objective

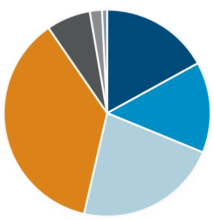
Aims to generate attractive returns by dynamically investing in global fixed income instruments. It aims to provide diversification against equity risk as well as capital growth and some income.

Key information

Fund details	
APIR code	MAQ0274AU
Inception date	30 September 2002
Fund size	$725.1m
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.

Credit profile breakdown



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

Fund performance to 31 December 2021

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.27	0.22	-0.17	0.39
3 months (%)	-0.57	-0.72	-0.37	-0.35
1 year (%)	-0.77	-1.37	-0.95	-0.42
3 years (% pa)	4.58	3.94	2.60	1.34
5 years (% pa)	4.42	3.78	2.51	1.27
10 years (% pa)	4.73	4.09	3.90	0.19

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.

Asset allocation

	Fund (%)
Sovereign bonds[1]	40.7
Investment grade credit[2]	48.1
High yield	6.8
Emerging markets debt[3]	4.4

[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	2.4 years
Interest rate duration	3.3 years
Standard deviation[1]	3.0% pa
Yield to maturity[2]	1.8% 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	14.1	38.9
Europe (ex UK)	-2.6	11.1
UK	16.9	7.8
Australia/New Zealand	57.7	28.0
Japan	-0.2	0.0
Others	14.1	14.2

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

Fund highlights

The Fund delivered a positive return over the month of December.

The Fund's duration positioning has remained stable in December at around 3.3 years. We did shift some US Treasury exposure into Europe and the UK as the US Federal Reserve (Fed) communicated a greater chance of rate hikes in Q1 of 2022. Australian sovereigns have remained a core holding of the Fund as there is a clear divergence between Australia's inflation profile and central bank policy relative to its global counterparts. Australian sovereigns have also exhibited higher yields and more attractive carry.

The Fund's credit allocations contributed to the outperformance in December. The year-end rally in credit spreads had several drivers, including much lower issuance volumes into year-end, low liquidity (making buying new bonds more difficult), reduced concerns about the new Omicron variant, and apparent comfort from broad markets with the Fed's approach of accelerating the tapering of their asset purchases. The key credit sector drivers for the Fund's performance were allocations to high yield and emerging market credit, which benefited from the improved economic outlook and have been somewhat more shielded from government bond market volatilities. Within credit holdings, some of the top performers included travel-sensitive sectors such as airlines – including International Airlines Group and Air Canada – reflecting the reduced fears around Omicron.

During the month, the Fund has continued to add short-dated credit with some yield on offer and limited interest rate duration exposure – this remains our preferred use of cash when there is limited new issue or higher yielding options. After a rebound in investment grade spreads, small travel exposures were trimmed during the month after very strong long-term performance and at fair value.

Market overview

Asset markets were buffeted during December by the prospect that the path of global monetary policy tightening was spreading from emerging market to developed market central banks and by the surge in new cases from the arrival of the Omicron variant. That said, risk markets performed, largely because they already reacted (negatively) heading into the end of November and partly because there is a consensus building that the health risk from Omicron is less than the Delta variant despite being more contagious. Amidst this were three key central bank meetings: the US Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE). In summary, the guidance was more hawkish than markets expected, which was a bias for tighter monetary policy going forward. In fact, the BoE delivered a 0.25% hike in its base rate, while the Fed guided its intention to hike rates earlier (in 2022) and more quickly. Even the perma-dovish ECB was leaning more hawkish. The driving factor behind their messaging was "higher and persistently higher-than-expected inflation".

With central banks moving to remove the pandemic stimulus, at the same time Omicron has created uncertainty on the economic outlook. Despite this uncertainty, asset markets ended the year with an aura of calm. Bond yields were broadly contained within ranges and yield curves were relatively flat given the elevated fears on inflation. Credit spreads, while off their lows, ended the year at the tighter end of valuations. Only emerging market spreads are cheaper, albeit modestly, and not a surprise given the stronger bias of the dollar of late.

Outlook

The pandemic has defined the past two years' investment climate. While the signs are positive that the world is reaching a turning point in 2022, the legacy of the pandemic will linger for some time. As we consider the outlook for 2022, two questions come to the forefront: as fiscal stimulus wanes and central banks begin to withdraw support, where will the trend of economic growth settle; and how persistent is the inflation impulse?

We previously identified that the future trend of monetary policy was shifting from easing to tightening. The fiscal shift is less clear and even less understood. Asset markets embraced the global fiscal stimulus through 2020-2021. However, with the US seemingly unable to get the promised new fiscal stimulus through Congress it is a timely reminder that government spending is in fact decelerating from the initial surge, which will act as a drag on growth during 2022. And it should not be lost that many governments have an intent to begin the process of clawing back the explosion of government deficits. How these play out in 2022 will have important implications for growth, where our bias is that with the gyrations the trend will likely settle on the pre-pandemic trend.

The inflation outlook is complicated by the global disruption to supply. If this disruption persists, then even the uninspiring pre-pandemic growth trend would likely be enough to keep inflation elevated relative to pre-pandemic averages. Yet, forward looking asset markets could foresee a scenario where policy tapering begins to slow demand at the same time the supply chain begins to normalise, which could deliver a disinflation impulse.

Thus, we confront the outlook having to balance investors' need for yield against tight valuations and a high level of uncertainty and multiple possible scenarios for 2022. We remain invested but with balance, with the intention of using periodic volatility to selectively participate in opportunities.

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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