

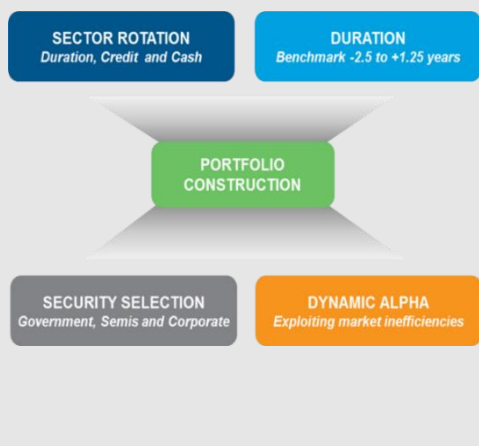
Investment objective

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	\$256.1m
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 28 February 2022

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-1.17	-1.21	-1.21	0.00
3 months (%)	-1.90	-2.00	-2.13	0.13
1 year (%)	-0.43	-0.79	-1.09	0.30
2 years (% pa)	-1.33	-1.74	-1.95	0.21
3 years (% pa)	2.25	1.81	1.57	0.24
5 years (% pa)	3.29	2.82	2.73	0.09

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

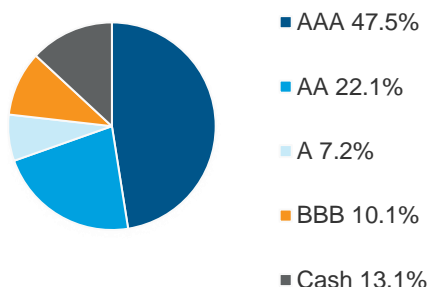
(based on physical exposure)

	Fund (%)
Government	32.4
Credit	31.9
Semi-Government	22.6
Cash and Equivalents	13.1

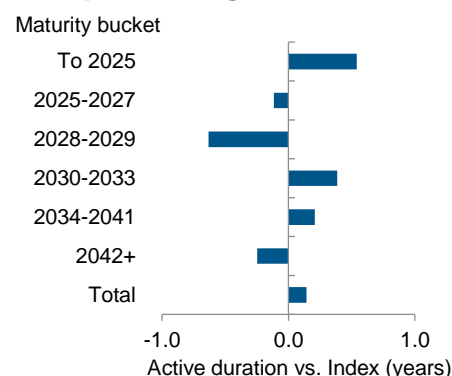
Fund statistics

Credit spread duration	0.9 years
Interest rate duration	5.8 years
Yield to maturity (% pa)	2.76%

Credit profile breakdown



Curve positioning breakdown



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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's duration positioning has been actively traded around the market volatility this month. The Fund is currently positioned long duration overall, with an overweight bias in the front-end of the curve. We took profit on our Australia-US yield spread position in the front-end of the curve early in the month, as pricing in the US front-end had moved materially higher in recent months to be consistent with what was already priced in the Australian front-end. We continue to hold the Australia-US spread in the 10 year maturity, as we believe the Reserve Bank of Australia (RBA) will be slower to hike rates than the US Federal Reserve (Fed). This is because Australian households have a higher sensitivity to interest rate rises, given high household leverage as well as the construct of the Australian mortgage market being predominantly short-term fixed rate debt. The spread widened in February as the Australian rates market lagged behind on the safe-haven bid for US Treasuries as a result of Russia's invasion of Ukraine.

Security selection

Within security selection, we unwound the Fund's overweight to the ultra-long maturity Australian Commonwealth Government Bonds (ACGBs) during the month, following a flattening in the yield curve earlier in the year, with the back-end of the Australian yield curve now similar in shape to global curves. The lack of 20 year syndications from the Australian Office of Financial Management (AOFM), combined with the tapering of quantitative easing (QE), had contributed to the outperformance of ultra-long ACGBs in recent months (given the RBA had only purchased sub-12 year maturities), with the relative scarcity of those shorter maturities starting to reverse now that QE has ended.

Within semi-government securities, we have added holdings in the 10 year maturity bucket where curves are already steep as markets anticipate more supply. The Fund has remained overweight to swap spread exposure as a partial hedge against the semi-government underweight. We expect that derivatives should also outperform physical securities now that the RBA has finished its asset purchasing program, with supply from the AOFM also likely to increase next financial year.

The Fund's credit security selection performed broadly in line with the benchmark over the month. While recent senior financial deals have outperformed the broader market, the Fund's higher-beta and Tier 2 positions underperformed in the risk-off moves, and RMBS spreads also edged wider in sympathy and ahead of a busy pipeline of issuance. The higher-than-benchmark carry earned in the Fund continued to provide a positive offset to the spread widening over February. Over the month, the Fund participated in primary transactions from issuers such as National Australia Bank, Newcastle Permanent Building Society and Metro 2022-1.

Sector rotation

The Fund's sector positioning was actively managed over the month. We shifted the positioning closer to a neutral level. In addition, we started the month with a sizable underweight to the semi-government sector but reduced this position materially over the month. We had held this underweight bias, expecting that spreads would drift wider when the RBA ended QE. Now that levels are becoming more attractive, we have been using opportunities in primary market supply to cover the position.

The Fund's overweight credit positioning was a minor detractor to performance in February as spreads moved wider. This was partly offset by the performance of the Fund's overweight position in the front to mid part of the curve, as the curve steepened with the long-end selling off the most over the month.

Market review

February was a month of two halves. The first half continued the theme from January, where central banks were focusing on the current higher-than-expected inflation and either hiking or preparing the market for higher rates. However, geopolitical events intervened during the month as the conflict between Russia and Ukraine turned into an actual war. The combination of themes during the month caused volatility to rise across asset markets, and trading ranges for most assets were wide. Markets were left wondering at the end of the month just how central banks will juggle the dilemma they are facing, that is, elevated inflation and increasing stress across asset markets. In the end, markets have navigated to a mid-point that still expects rate hikes in coming months but have pared back their worst fears for higher rates over the cycle.

In net terms, commodity prices have risen across the board. While the surge in energy prices rightly grabs the headlines, the rise in many key soft commodities will be felt directly by consumers and feed into inflation expectations. Markets therefore still expect central banks to act to contain inflation risks, but there is a concern that the combination of higher rates and more supply-driven inflation will hurt growth. Thus, while bond yields have shifted higher, yield curves (the spread between short and long maturity yields) have narrowed (or flattened). Faced with these forces, risk markets suffered in particular, with emerging market spreads underperforming and European investment grade credit spreads underperforming the US.

Australian bond market

Renewed optimism with which we started 2022 came to a head in February, as the globe faced Russia's invasion of Ukraine with volatility erupting, inflation expectations exploding higher, and spreads widening. The Australia-US 10 year spread widened as bond volatility jumped, and the Australian bond curve steepened in the 3-10 year slope but flattened in the 10-30 year slope. The start of the Fed's hiking cycle is approaching, with Fed chairman Powell ultimately endorsing the likelihood of a 25bp rate hike in March to combat inflation. The RBA ceased their QE program in Australia, and this, combined with the flight to quality assets, saw Australian rates underperform on a cross-market basis over the month.

The Australian data remains strong, but more sanguine in terms of achieving the 'sustainable' inflation outlook with which the RBA has said they need to give them confidence to hike rates. The Australian wages data is materially below what RBA Governor Lowe has said they need to see, and our view continues to be that too much is priced into the front-end of the Australian yield curve, given the RBA will be patient and wait for at least another CPI print before they hike. The RBA announced changes to its open market operations (OMO), offering an unlimited

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quantity of repurchase agreements at a set price, initially at OIS +5bps, which will eventually transition to a floating rate – this should improve liquidity in stressed markets going forward.

The Australian Office of Financial Management (AOFM) continued to issue over February, selling A\$10bn of bonds in four weeks. The issuance was spread over the entire yield curve, but with the bulk going to either the 3-5 year maturity bucket or the 10 year bucket. The Australian states also continued to chip away at their funding tasks as semi-government spreads tightened slowly, with NSW Treasury Corporation issuing \$A800m, Queensland Treasury Corporation issuing \$A2bn, and WA Treasury Corporation issuing \$A1bn.

Global credit market

February was a poor month for risk assets as geopolitical tensions reached a crescendo with Russia invading Ukraine, ensuring that a relief from supply shocks and accompanying inflationary pressures will not be eminent.

US credit was weak, with benchmark investment grade (IG) credit spreads 16bps wider to a post-pandemic wide of 122bps. This continues the theme of weak year-to-date performance, with 2022 recording the worst start to the year (in total return) in at least 20 years. Key drivers of the moves were: continued concerns around interest rate volatility and US Federal Reserve support, and the war in Ukraine. Amongst sectors, banks and telecom were the worst major industry performers, reflecting more so their relatively strong liquidity as investors are able to exit these holdings, rather than a link to the conflict. Spread decompression was only modest, with BBB, single-A, and BB credit (the highest credit rating category in high yield) all widening by a similar amount. New supply during the month was over \$80bn, with large deals from the US banks a key swing factor driving relatively strong volumes – issuers are clearly willing to pay higher spreads to raise debt, in case yields continue to rise. New issuance concession was elevated, with double-digit concessions paid on some deals, which kept pressure on secondary markets.

It was the worst month for European IG credit since March 2020, with IG spreads closing 39bps wider to 144bps. Initially, European credit underperformed, as a hawkish tone taken by the European Central Bank brought forward the timeline for ending quantitative easing to Q3 and markets priced in rate hikes immediately after. European yields traded heavy as a result, with German bund yields as much as 30bps higher and Italian 10 year yields 70bps higher – almost trading to 2% mid-month.

In the latter half of the month, the tragic events in Ukraine added further volatility to European credit, which was the most exposed of global markets. In broad terms, spreads decompressed across rating bands in IG credit and curves bear flattened. The worst performers were areas with direct exposure to Russia and/or Ukraine, such as ENOAPHO (Czech gas, +300bps), Wintershall (oil & gas, +200-250bps) and Coca-Cola HBC (+100bps). Among banks, the most exposed name is Raiffeisen, while SocGen, UniCredit and Deutsche Bank underperformed among European large cap names by 50-60bps wider.

Issuance on the month was below expectations as several names stepped back from coming to market due to the heightened volatility. In addition, the swap spread widening was an additional negative technical impact on European credit, with 5 year swap spreads widening circa 15bps.

Australian credit market

The Australian IG market weakened by 10bps in February, outperforming offshore credit markets. While the softness in Australian IG was broad-based this month, the spread curve steepened marginally again with long-dated BBB credit wider in spreads. Despite the lack of issuance since the start of the year, long-dated corporate bonds underperformed further as sentiment turned more negative in an already fragile market. Long-end airport bonds such as Brisbane Airport and Melbourne Airport widened around 20bps over the month. In the primary market, there was approximately \$9.5bn of IG issuance, with \$4bn coming from National Australia Bank's senior 3 year and 5 year senior deal. Most of the deals issued in February are trading around the re-offer level to slightly wider. In addition, there was around \$3bn of structured deals issued in February, a trend expected to continue given the level of financing seen in 2021.

Outlook

Our recent Fixed Income Strategic Forum noted that while aggregate demand had rebounded, it was settling into the pre-pandemic trend that underpinned the lower-for-longer environment for policy and rates. Analysis shows that current elevated inflation is therefore largely a result of aggregate supply remaining compromised by the effects of the pandemic. If indeed the pandemic begins to fade as a dominant influence, the supply side of the global economy is expected to gradually repair, and with base effects kicking in, the path for inflation was forecast to trend lower during the second quarter and accelerate through the second half of 2022. Oil was a big risk to that view. And not only have the events in Ukraine pushed energy/commodity prices higher, but the resulting sanctions are also providing more difficulties for the supply side of the economy. We therefore modify our assessment and see risk in the short term for inflation to remain more elevated. However, we feel that the downside risks for growth have also increased in the medium term.

We came into 2022 expecting periodic volatility and a tricky investment path to navigate. Indeed, the price action in recent months is actually creating value opportunities. During 2021, our investment approach was cautious, holding low levels of duration and low levels of exposure to risk assets. This positioning provides our portfolios the opportunity to take advantage of expected volatility and a cheapening of valuation and add duration and risk, from both our top-down and bottom-up processes.

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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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