

# Macquarie Dynamic Bond Fund

Monthly report – 31 May 2022

## Investment objective

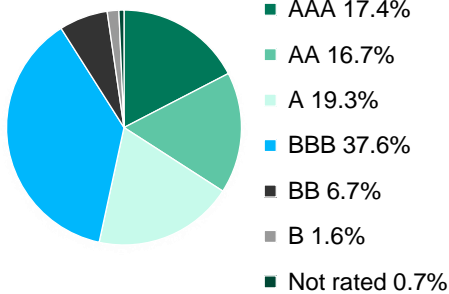
Aims to generate attractive returns by dynamically investing in global fixed income instruments. It aims to provide diversification against equity risk as well as capital growth and some income.

## Key information

Fund details	
APIR code	MAQ0274AU
Inception date	30 September 2002
Fund size	\$634.3m
Distribution frequency	Quarterly
Management fee*	0.614% pa
Minimum investment (Direct)	\$20,000
Unit prices and spreads	<a href="https://macquarie.com.au/unit_prices">macquarie.com.au/unit_prices</a>

\*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 May 2022

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-0.27	-0.32	0.22	-0.54
3 months (%)	-4.18	-4.33	-3.48	-0.85
1 year (%)	-6.05	-6.62	-5.48	-1.14
3 years (% pa)	0.71	0.09	-0.25	0.34
5 years (% pa)	2.33	1.71	1.03	0.68
10 years (% pa)	3.49	2.86	2.92	-0.06

### 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 <sup>^</sup>	32.5
Investment grade credit*	56.9
High yield	5.8
Emerging markets debt <sup>+</sup>	4.8

<sup>^</sup>Includes Australian government, Australian semi-government, supranational, global sovereign and cash

\*Includes Australian and global investment grade credit

<sup>+</sup>May include holdings of sub-investment grade instruments

## Fund statistics

Credit spread duration	2.8 years
Interest rate duration	4.3 years
Standard deviation <sup>^</sup>	3.1% pa
Yield to maturity*	4.5% pa

<sup>^</sup>Statistical measure of variance of Fund's post-fee monthly returns from its average post-fee return since inception used as gauge of volatility.

\*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 <sup>^</sup> (%)	Credit spread duration*(%)
North America	30.6	49.1
Europe (ex UK)	-4.1	12.9
UK	15.4	4.8
Australia/New Zealand	56.8	24.0
Japan	-0.5	0.0
Others	1.8	9.2

<sup>^</sup>Calculated based on security's currency

\*Calculated based on security issuer's currency

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## Fund highlights

The Fund delivered a negative return during the month amid the continued broad-based volatility in markets and rising bond yields, driven by central bank tightening and concerns around rising inflation.

With central banks becoming myopic on fighting inflation in the short term, by raising rates “expeditiously” to neutral levels, the commencement of quantitative easy (QE) and ongoing hawkish rhetoric regarding future rate moves, yields have continued to drift higher. However, given our views around the amount of tightening already priced in by markets and our expectation for more volatility ahead if they do deliver what is priced, we believe this will ultimately cap how far yields can rise. As such, a further drift higher in yields we would view as an opportunity to accumulate duration. As a result, we have recently increased the strategic interest rate duration target of the Fund back up to 4.75 years from 4.25 years (which was a historically low level) as we look to prudently extend our duration position at better levels as a counterbalance to the portfolio’s risk positions.

Our geographical duration allocation remains overweight Australia. We continue to believe that market pricing for Reserve Bank of Australia hikes remains overly aggressive, given the high levels of household debt and high interest rate sensitivity of the economy, resulting in a greater impact of policy rises on growth. We remain underweight European government bonds. Inflation remains a major concern in Europe, as globally, however, as the sole inflation-only targeting central bank, we believe the European Central Bank (ECB) may be more incentivised to hike more aggressively in order to regain control of inflation. As a result, we have been reluctant to accumulate any Europe duration into the drift higher in yields, particularly given the ECB is yet to commence tightening traditional policy (with QE ending next month).

The Fund’s credit allocations negatively contributed to performance for the month. Credit markets were volatile and ultimately finished mixed, with higher quality US denominated credit tighter, whilst other regions and lower credit quality securities were materially weaker. This reflects a continued lack of liquidity as well as uncertainty over the direction of global growth. Within the Fund’s credit exposure, positions in a small number of European and higher beta US credit holdings were the main individual detractors – such as European toll roads and a hybrid security issued by US financial issuer Silicon Valley Bank. Positive contributors included higher quality investment grade credit, and specific higher rated high yield issuers, such as Charter, a US cable operator.

The Fund remains positioned with significant liquidity, offering attractive possibilities to consider opportunities in a sharply higher yield environment, without needing to stretch into lower quality credit. For example, the Fund added holdings in A3/BBB+ rated coatings company PPG, and A3/A- Swiss bank UBS, both in new issue offshore. We consider these types of higher quality issuers offer attractive value (particularly with new issue concessions) and are well set up to perform despite the difficult market backdrop. Offsetting this, the Fund reduced exposure to some high yield issuers during the month, including Air Canada (which rebounded strongly after airlines sold off in March, post the invasion of Ukraine), and hybrids issued by Volkswagen. We remained fundamentally comfortable with the issuers, but higher beta exposures are clearly more impacted by the market volatility and we view as appropriate to trim in periods of strength.

## Market overview

Repeating the theme from last month, the upward pressure on inflation and increasing hawkishness by global central bankers have continued to be the main theme impacting fixed income markets. The second supply shock (following the first, which is the pandemic) from the invasion of Ukraine has been pushing inflation higher, with energy and food the key drivers. Central bankers continue to talk tough and deliver rate hikes or have signalled that a rate hike cycle will soon commence. This global pressure on interest rates have continued to pressure returns from fixed income portfolios.

That said, a new theme has also emerged, that is, risk for a recession as the global economy is facing strong headwinds from both inflation and policy. Consumer confidence surveys are very weak despite the robust position across labour markets. Thus, markets are weighing up the relative significance between strong lagging indicators (employment) with softening leading indicators (new orders). In the corporate world, the focus is on current strong earnings against signs of weaker guidance.

Asset market volatility is already reacting to this debate. Fears of weaker growth/recession hit risk markets and provide relief to sovereign bond yields, which is then followed by hopes for less central bank tightening, providing a bid for risk assets and returns the pressure on sovereign bond yields. This environment has just started, and this ebb and flow of market sentiment is likely to persist for months, or even quarters, and provide a volatile backdrop for all investors.

## Outlook

Economists continue to debate whether currently higher inflation is due to strong demand or a supply shock. Central banks share that same debate, but these institutions face a credibility problem, that is, inflation is still rising and is so far above their target. Rate hikes have been delivered and more will come. But the real question is: will the rate hikes work effectively to fix the problem? Central banks have tools to manage liquidity and the demand side of the economy. So, if inflation is (as we believe) largely a supply-driven problem then hiking rates is unlikely to resolve the core of the inflation problem. What higher rates will eventually do is slow aggregate demand. Meanwhile, when will the supply shock end?

We therefore see stagflation as the most likely description of the economic environment in the second half of 2022, where inflation remains sticky at higher levels while the demand side of the economy is slowing. Recession is a risk, but not a certainty. A ‘double supply shock’ could be enough to deliver a recession, but the household and corporate sector balance sheets imply a level of resilience to the headwinds. This puts central bank tightening in the crosshair of focus, where policy makers target a soft landing for the economy, but markets fear that high inflation will cause over-tightening and therefore recession in 2023.

The economic and policy environment facing asset markets is challenging. We should expect periodic spikes in volatility to continue in the months and quarters ahead. As investors we are sailing in rough seas and into the wind and therefore must keep the sails trim and be alert and flexible.

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**For more information speak to your financial adviser, call us on 1800 814 523, email [mam.clientservice@macquarie.com](mailto:mam.clientservice@macquarie.com) or visit [macquarieim.com](http://macquarieim.com)**

### Important information

Macquarie Investment Management Australia Limited ABN 55 092 552 611 AFS Licence 238321 is the issuer of units in, and responsible entity of the Fund. Macquarie Investment Management Global Limited ABN 90 086 159 060 AFSL 237843 is the investment manager of the Fund.

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