

Macquarie Australian Fixed Interest Fund

Monthly report – 30 June 2022

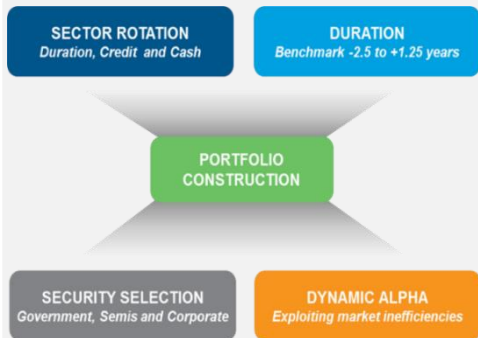
Investment objective

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 | \$226.1m |
| 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 30 June 2022

| | Total Fund return (gross) | Total Fund return (net) | Benchmark return | Total excess return (net) |
|----------------|---------------------------|-------------------------|------------------|---------------------------|
| 1 month (%) | -1.61 | -1.64 | -1.48 | -0.16 |
| 3 months (%) | -4.07 | -4.16 | -3.81 | -0.35 |
| 1 year (%) | -10.73 | -11.08 | -10.51 | -0.57 |
| 2 years (% pa) | -5.57 | -5.96 | -5.80 | -0.16 |
| 3 years (% pa) | -2.16 | -2.59 | -2.58 | -0.01 |
| 5 years (% pa) | 1.29 | 0.82 | 0.87 | -0.05 |

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.

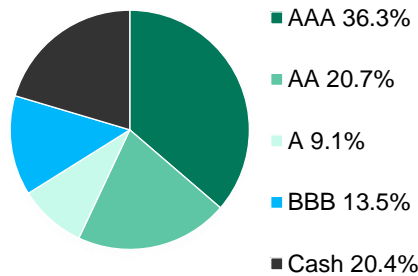
The management fee was reduced to 0.390% pa from 8 January 2021.

Benchmark is Bloomberg AusBond Bank Bill Index

Asset allocation (based on physical exposure)

| | Fund (%) |
|----------------------|----------|
| Credit | 39.5 |
| Government | 20.7 |
| Semi-Government | 20.4 |
| Cash and Equivalents | 19.4 |

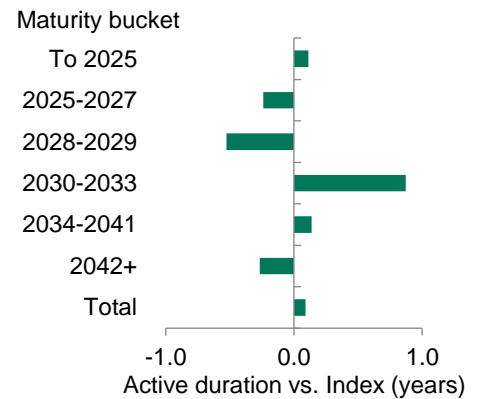
Credit profile breakdown



Fund statistics

| | |
|--------------------------|-----------|
| Credit spread duration | 0.9 years |
| Interest rate duration | 5.5 years |
| Yield to maturity (% pa) | 5.05% |

Curve positioning breakdown



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Fund highlights

The Fund underperformed the benchmark in June as a result of the ongoing rates volatility and the move wider in credit spreads.

Duration and curve

The Fund holds a modest long bias to duration which was a detractor from performance this month. Early in June bonds continued to sell off on the momentum of the recent move with global central banks continuing to aggressively raise rates. However, bonds rallied back into month-end with Australian rates outperforming after the Reserve Bank of Australia (RBA) Governor Lowe pushed back on market pricing and said current conditions only call for a 25 basis point or 50 basis point hike, which saw a moderation of the effect on performance.

We believe the RBA faces a lower terminal rate than other developed markets as there is a significant difference in the inflation outlook domestically versus overseas. RBA hikes will have a sharper impact on household spending given we have a higher proportion of variable mortgages, and have higher household indebtedness, than other countries. Markets continue to price in higher expectations for RBA hikes than the US Federal Reserve (Fed), which we think is unlikely to be realised in practice. As such, we have maintained our overweight to AU duration versus US in the front-end of the yield curve.

Sector rotation

The Fund changed its sector positioning over the month as we initiated a modest overweight to the semi-government sector taking advantage of the better levels available. Semi-government spreads have widened materially given the sharp move in swap spreads which has left semi-governments at multi-year wides to Australian Commonwealth Government Bonds. The State Governments have had notable funding tasks, with significant supply still to come and the FY23 funding programs totalling \$A75bn, with New South Wales Treasury Corporation and Treasury Corporation of Victoria making up the lion's share of supply. However, the outlook is more balanced going forward and are cognisant that balance sheets have large high quality liquid assets requirements and will take down a significant proportion of this. If levels remain attractive, we will look for opportunities in the primary market to increase our exposure to this sector going forward.

The Fund's credit positioning was a detractor to performance in June as credit spreads widened further. Even though major bank senior curve remained relatively anchored as offshore demand continued to be supportive, the higher-beta subordinated bonds moved wider given concerns around supply and generally weaker backdrop. Remarketing of spreads in structured securities, particularly residential mortgage-backed securities, detracted from performance. The underperformance in credit was broadly based, though higher than benchmark carry as well as protective credit default swap positions continued to provide a positive offset to the spread widening.

Security selection

The Fund has been overweight derivatives versus physical securities both in swap and futures. Collateral shortages remain in the front-end and physical securities have continued to trade 'rich' in valuation relative to futures for longer than we expected following the end of the Reserve Bank of Australia's quantitative easing program. We have continued to sell expensive 3 year basket bonds back into the equivalent futures maturity.

Within Australian Commonwealth Government Bonds we went underweight to the ultra-long end following the persistent flattening in the curve, with the 10s30s curve virtually flat and the 20s30s curve inverted. The Australian ultras no longer look attractive relative to offshore, and the Australian Office of Financial Management (AOFM) has issued regularly into any demand in the 30 year bond and extended out the maturity curve which we think limits scope for further performance. At their recent updated, the AOFM ditched plans to issue a new 20 year bond due to lack of demand, but flagged the possibility of a new 30 year bond to extend out the curve, demand permitting.

Within semi-government bonds, the underweight to New South Wales Treasury Corporation added value as spreads widened versus other issuers following the NSW Budget update, which saw projected issuance higher than expected. Western Australian Treasury Corporation was upgraded to AAA by S&P late in the month but there was limited impact on spreads with the stronger economic outlook already fully priced by markets.

The Fund's credit security selection performed broadly in line with the benchmark over the month. Even though corporate bonds generally traded sideways to slightly wider over the month, pockets of strength in the COVID-impacted names re-emerged with Qantas rallying anywhere between 5-15 basis points depending on the tenor. Over the month, the Fund participated in a primary transaction from Lloyds Banking Group.

Market review

Inflation is the 'problem' facing central bankers, a fact strongly reiterated at the recent central banking forum in Sintra, Portugal by the heads of the US Federal Reserve, the European Central Bank and the Bank of England, who are committed to bringing inflation back down to target ranges. Globally, central bank target rates rose again in June, though the Bank of Japan stands in contrast by remaining committed to its yield curve control target. Whilst inflation and central bank action remain dominant themes, for asset markets there has been a rapidly emerging concern that this combination will push economies into recession in 2023. Recent data is suggesting growth is already slowing, and with inflation being underpinned by a second supply shock stemming from the war in Ukraine, asset markets fear central bankers are heading for a policy mistake by overtightening. We have already seen consumer confidence drop lower to well below average levels, and parts of the housing market have begun to turn. There have been some tentative signs, in spending data too, of some softening demand, and this is a difficult investment climate where volatility will continue.

Australian bond market

Yield movements were broadly in line with the global moves, though Australian bonds tended to underperform in the sell-off and outperform on the rally. Inflation continues to print to the high side and the labour market remains strong, although consumer sentiment continues to deteriorate, causing volatility in yields as incoming data was digested. The Reserve Bank of Australia delivered a 50-basis point hike in the June meeting, surprising the market consensus for either a 25- or 40-basis point hike, as they mark their intention to front-load the tightening

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cycle. The Australian 10 year bond futures implied yield traded between 3.43% and 4.33% in June (a range of 90 basis points versus 47 basis points in May), with the 10 year yield ended the month at 3.72%, up 36 basis points on the month. The Australian 3 year bond futures implied yield traded between 2.97% and 4.04% in June (a range of 107 basis points versus 55 basis points in May), with the 3 year yield ended the month at 3.37%, up 44 basis points on the month.

Global credit market

June was another volatile month for risk assets with equities making new lows and credit marking new wides for the year. Thinning liquidity amid concerns around further monetary policy tightening in the face of a growing recession risk exacerbated the volatility in risk markets.

US credit was weaker again in June as the benchmark investment grade (IG) index widened 25 basis points to new year-to-date wides to finish the month at 155 basis points and high yield (HY) spreads were +163 wider to 570 basis points. This marked almost the worst first half of a year for US investment grade credit on record – second only to the extreme moves around the 2020 pandemic. Spread decompression continued to be a theme, with HY underperforming IG as BB credits were +140 basis points wider on average, sharply outpacing the +35 basis points move in BBBs. Amongst industry sectors, cyclicals generally performed poorly, with materials the weakest sector, reflecting sharp falls in industrial metals prices amid lower growth expectations.

New issuance was lighter than expected for the month with just over \$71bn new deals in the US IG market, and approximately \$10bn of high yield, marking the softest month for new issue volume in high yield since 2010. New issue concessions remained elevated and performance of new deals was mixed. Investors also continued to withdraw from credit markets, with over \$20bn leaving the investment grade asset class over the last four weeks.

European credit ended the month materially wider closing 54 basis points wider to 218 basis points, underperforming global peers, as net purchases of corporate bonds through the Corporate Sector Purchase Programme ended in June and this coincided with the highest volatility in the credit market since March 2020. The weakness in secondary was broad based but the theme of decompression is becoming more evident as the market focuses on growth concerns. At a sector level, real estate investment trusts (REIT) continued to underperform with the ICE BofA Euro Real Estate Index through the COVID wides of March 2020 and 102 basis points wider this month. The sector is suffering from higher funding rates, very weak technical, asset valuation concerns and single name issues in the sector from Adler. Cyclical sectors such as airlines were also very weak up to 200 basis points wider in IG names and several off-the run illiquid low BBB names finished 100 basis points+ wider this month.

Primary supply was manageable at €29bn, concessions in the 10-20 basis points range for generic IG risk is becoming the norm however there were cases of less well known or off run IG names printing with 40 basis points+ concessions such as JAB Holdings. High Yield issuance remains benign and market access is proving challenging.

Australian credit market

Australian credit sold off further in June as global central banks continued with their hawkish rhetoric amid soaring inflation numbers around the globe. In the major bank space, senior spreads remained relatively anchored as levels ended the month close to unchanged given the demand from offshore investors. Meanwhile, the higher-beta subordinated debt widened further with spreads moving 15-18 basis points wider on the month. Structured securities, particularly residential mortgage-backed securities, were remarked 10-15 basis points wider given a slew of issuance and better selling from offshore. The corporate sector softened further despite limited issuance over the month. Even though REITs underperformed over the month given a further increase in interest rates potentially impacting margins, it is worth noting there were pockets of outperformance particularly in industries that were most impacted by COVID restrictions, such as airport and airlines. Over the month, there was only \$A2bn of issuance given the extreme market volatility.

Outlook

Our outlook for the economy is that the global economy has entered a stagflationary environment, where inflation remains well-above target but growth slows significantly. Recession is a risk, but not a certainty, for 2023 as we have experienced twin supply-shocks to the global economy and central bankers have the potential to deliver policy overtightening with aggressive rate hikes. Central banks are attempting to solve inflation problems, which are largely a result of supply chain issues, by restricting demand, yet these demand management tools will not directly impact the source of the inflation problem. Rate hikes will weaken demand and the prospect is that a sharp downshift in demand will be needed to match reduced supply levels so as to lower inflation. This points to a difficult environment where there is scope for higher yields and flatter curves amongst the volatility and momentum, but also one that will ultimately see a bid return to rates and duration.

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