MACQUARIE ASSET MANAGEMENT

Macquarie Dynamic Bond Fund

Monthly report – 30 November 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	$580.6m
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.

Fund performance to 30 November 2022

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	2.70	2.65	1.72	0.93
3 months (%)	-0.22	-0.38	-1.11	0.73
1 year (%)	-7.59	-8.16	-7.82	-0.34
3 years (% pa)	-0.80	-1.41	-1.73	0.32
5 years (% pa)	1.68	1.06	0.32	0.74
10 years (% pa)	3.04	2.41	2.24	0.17

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^	30.5
Investment grade credit*	61.0
High yield	3.1
Emerging markets debt⁺	5.4

^Includes Australian government, Australian semi-government, supranational, global sovereign and cash

*Includes Australian and global investment grade credit

⁺May include holdings of sub-investment grade instruments

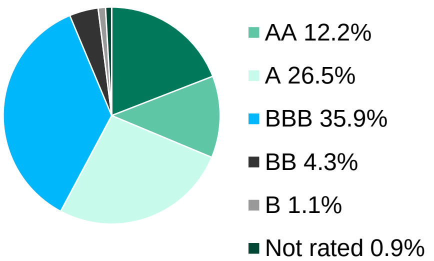
Fund statistics

Credit spread duration	2.9 years
Interest rate duration	5.0 years
Standard deviation^	3.0% pa
Yield to maturity*	4.0% pa

^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 returns 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.

Credit profile breakdown



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

Geographical exposure

	Interest rate duration^(%)
North America	40.0
Europe (ex UK)	9.4
UK	4.5
Australia/New Zealand	49.4
Japan	-5.0
Others	1.7

^Calculated based on security's currency

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Fund highlights

Fund duration was reduced during November taking advantage in the strength in bond prices. There were some changes to geographical allocations with a reduction in Scandinavian exposure amid the rally while the Fund also participated in a new issue of a New Zealand long end bond. The Fund maintains its core allocation to Australian government bonds and US Treasuries along with yield curve flattening biases in major holdings as central banks continue to tighten policy.

The Fund's credit allocations contributed to outperformance for the month. A better than expected US consumer price index print was an initial trigger for significant repricing across credit markets, taking spreads back from recent highs, nearer to long-term averages. Amongst credit sectors, emerging markets and investment grade credit were the strongest contributors: investment grade credit spreads were the best (volatility-adjusted) sector across global markets, and are the largest weight in the Fund – a position that has been added to over previous quarters. US Agency Mortgage positioning was a small detractor: the Fund had added to exposures in this sector in recent months at attractive levels but was still underweight the reference benchmark amid a sharp tightening of spreads.

Key individual names contributing to the credit result included senior bonds issued by US banks Morgan Stanley and Bank of America, which had widened consistently all year and had been gradually added to the Fund, reflecting our view that fundamentals in this sector were very strong, and the spread widening was more technical in nature. Recent additions in Euro also strongly contributed: the focus had been adding names less impacted by Europe's slowing economy, but that had been dragged wider by the broader market. Additions in Euro-denominated bonds issued by PPG (US-based industrial coatings) and Holcim (building materials), are two examples of strong performers this month.

The Fund made small further additions to investment grade credit in the first half of the month but paused buying and moved to small position trims into the end of the month, reflecting tighter spreads and lower new issuance concessions. The Fund's credit exposures overall are heavily weighted to investment grade, with small emerging markets and very modest high yield holdings. We think that best reflects the volatile and uncertain environment looking ahead.

Market overview

Asset markets had a very strong month in terms of absolute returns. Bond yields fell, credit spreads narrowed, the dollar weakened, and equities rallied. Enjoy the ride or "eye of the storm"? Central banks continue to deliver the most aggressive rate hiking cycle since the 1980s even if there is recognition that smaller moves are more likely going forward. Bond yields have been pulled higher in 2022 by both rising inflation but also by central banks tightening monetary policy. However, bond markets provide a feedback loop to policy makers via the yield curve (that is, the spread between short- and long-dated maturities). During November both, the European and United Kingdom yield curves inverted, while the United States, Canadian, and New Zealand curve inversions deepened. Inverted yield curves imply economic fragility and are a reliable historic indicator for recession in 12 months' time. So, it seems that the rally in financial markets is reflecting the prospect that the elusive 'soft economic' landing in 2023 materialises. Our base for 2023 is recession.

Against this background it was notable that the oil price slid by circa 9% in the past month, likely reflecting the slowing global demand environment. While this is good news for inflation, it could be yet another signal of tougher economic times ahead.

Outlook

In trays are beginning to fill up with 2023 outlook papers. Long term experience and the huge uncertainties thrown up by two supply shocks in the past two years suggest that one should have a base case but be alert for unexpected surprises. There is a strong consensus that inflation can fall significantly during 2023, a view we agree with, resulting from as a combination of base effects, on-going supply improvement and the prospect of a demand shift as recessions unfold. However, the bigger question is: where will inflation settle? Central banks understand the uncertainties and the policy lags involved, yet they are speaking with a consistent voice that their greater fear is for under-tightening than overtightening, as the consequence could leave inflation stubbornly above target. This suggests that central banks could continue to hike further than is expected – take note that the Reserve Bank of New Zealand, an early adopter of tighter policy, actually increased the size of its rate hike at the meeting in November. In addition, central banks could hold onto tighter policy for much longer than expected, to ensure that inflation does return sustainably to target.

For this reason, our base case outlook for 2023 also assumes that demand destruction can become a dominate theme. If demand falls into recession, as we expect, and supply continues to adjust this should ensure lower inflation through the coming year. This is good news for sovereign bond yields, which should be in the process of peaking. However, demand destruction is bad news for consumer spending and corporate earnings. This implies that credit spreads are vulnerable to widening from current levels.

We therefore expect sovereign bond yields to offer attractive value for investors during 2023, with the added attraction of offering portfolio protection against risky assets. We are cautious on corporate credit, preferring highly rated investment grade issuers that are not exposed to the cycle. Our approach to higher yield corporates and emerging market debt is more cautious, preferring selective opportunities.

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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