

Macquarie Dynamic Bond Fund

Monthly report – 31 December 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.

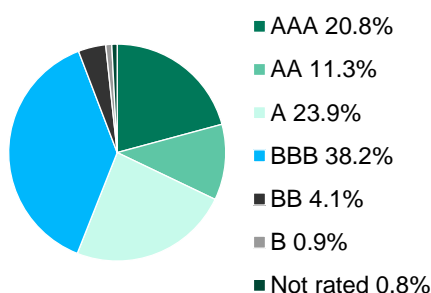
Key information

Fund details

| | |
|-----------------------------|---|
| APIR code | MAQ0274AU |
| Inception date | 30 September 2002 |
| Fund size | \$738.6m |
| 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.

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 2022

| | Total Fund return (gross) | Total Fund return (net) | Benchmark return | Total excess return (net) |
|------------------------|---------------------------|-------------------------|------------------|---------------------------|
| 1 month (%) | -1.06 | -1.12 | -0.71 | -0.41 |
| 3 months (%) | 1.91 | 1.75 | 0.86 | 0.89 |
| 1 year (%) | -8.82 | -9.38 | -8.32 | -1.06 |
| 3 years (% pa) | -1.13 | -1.74 | -1.96 | 0.22 |
| 5 years (% pa) | 1.55 | 0.93 | 0.15 | 0.78 |
| 10 years (% pa) | 2.89 | 2.26 | 2.13 | 0.13 |

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 1 January 2023, the benchmark is Bloomberg Barclays Global Aggregate Index (Hedged to AUD). From 7 January 2019 to 31 December 2022, the benchmark was 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 benchmarks is available on request.

Asset allocation

| | Fund (%) |
|--------------------------------------|----------|
| Sovereign bonds [^] | 36.8 |
| Investment grade credit [*] | 55.5 |
| High yield | 2.8 |
| Emerging markets debt ⁺ | 4.9 |

[^]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 | 2.5 years |
| Interest rate duration | 4.8 years |
| Standard deviation [^] | 3.4% pa |
| Yield to maturity [*] | 4.6% 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.

Geographical exposure

| | Interest rate duration [^] (%) |
|-----------------------|---|
| North America | 35.2 |
| Europe (ex UK) | 9.8 |
| UK | 3.8 |
| Australia/New Zealand | 55.3 |
| Japan | -5.5 |
| Others | 1.4 |

[^]Calculated based on security's currency

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Fund highlights

Fund duration was trimmed again last month taking advantage of the continued strength in bond prices as markets anticipate a top in inflation and potentially less central bank tightening. 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.

Credit positioning added value to the strategy over the month: investment grade credit benefitted from tighter spreads and increases in allocations made over the last several months, and emerging markets were also positive. The largest industry sector contributions were from financials, transportation, and capital goods.

Key individual names contributing to the credit result again included major financial issuers, such as bonds issued by US banks Morgan Stanley, as well as subordinated debt from Australian major banks. Underperformers included Aroundtown, a European REIT, and Warner Bros Discovery: hit by continued elevated integration costs as the issuer moves to get the costs of its streaming content down to an appropriate level.

The Fund trimmed its credit positioning over the month – mostly in investment grade - reflecting much tighter spreads near the lows of the post-Ukraine invasion environment. Investment grade allocations in both USD and EUR had been added earlier in the year at more attractive spread levels, and reducing the exposures somewhat sets the portfolio up well for an uncertain economic outcome. 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 environment looking ahead and look forward to opportunities to add to higher beta sectors.

Market overview

The event calendar through December was dominated by numerous central bank meetings. As expected, further rate hikes were delivered. However, it was the messaging from central banks that really caught attention where each reiterated a laser focus on returning current high inflation back to target. The signal from the European Central Bank (ECB) was perhaps the strongest guidance and this caused a significant repricing of sovereign bond yields across the yield curve. And yet it was the Bank of Japan (BoJ) that pulled out the biggest surprise of all, where they delivered an unexpected shift in their ultra-dovish Yield Curve Control (YCC) policy that has anchored the Japanese bond market in recent years. The shockwaves from this position change, just before the festive holidays, caused bond yields to slump and the Yen to spike.

So, what did asset markets make of this deluge of central bank change? Sovereign bond yields, which had been grinding lower, quickly reversed and surged higher causing yield curves to steepen in the process. Perhaps more interesting was the reaction of forward expectations: in the US they actually fell, signalling the markets belief that the US Federal Reserve (Fed) hiking cycling is almost done and that rate cuts will be in focus by late 2023; in Europe, expectations for total hikes in this cycle rose by around 50bps; in the UK forwards remained steady, discounting multiple further hikes; while in Japan bond yields all moved positive for the first time since November 2015. Equities markets embraced the change and repriced lower, expecting weaker earnings to dominate in 2023. However, credit markets, somewhat surprisingly remained very resilient, with spreads closing tighter in the month for investment grade and emerging markets, with high yield spreads modest wider.

Outlook

The past year has been dominated by escalating supply tensions emanating from the war in Ukraine which pushed inflation much higher and for longer than anyone was expecting. The ramped-up response by central banks, in retrospect, should have been widely expected.

Looking into 2023 we feel that asset markets will have to work through the consequences of the above events of 2022. First, we must recognise that geopolitical tensions are likely to remain elevated and also assume that these tensions could take an unexpected turn at any time. Be warned and be prepared to adapt. Secondly, we can observe that many supply problems have dissipated and while there is no return to the pre-Covid norm, the economic impact from supply is likely to be much less in 2023. Third, we are expecting the year ahead to be the report card on demand destruction wreaked by the most aggressive monetary policy tightening cycle since the 1980s. And finally, we recognise that prevailing conditions for households and corporates have been robust compared to past tightening cycles, however the signalling from central banks is they intend to cause stress for both groups.

Again, we will thoroughly review our portfolio management strategy from the bottom up via the Strategic Forum during January. Our base case call has been for a recession in 2023 and that inflation will continue to fall through the year. We believe this combination will prove to be good news for sovereign bond yields. However, demand destruction is bad news for consumer spending and corporate earnings. This implies that credit spreads are vulnerable to widening from current levels.

Thus, sovereign bond yields can 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

Important information

Macquarie Investment Management Australia Limited ABN 55 092 552 611 AFSL 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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