

Macquarie Australian Fixed Interest Fund

Monthly report – 30 April 2023

Investment objective

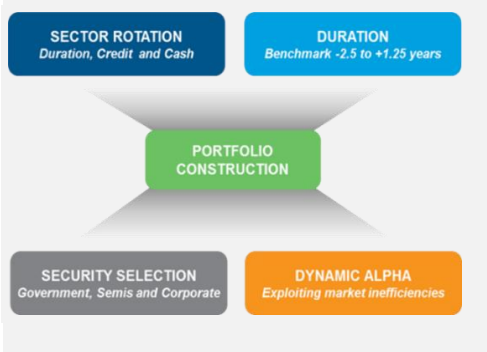
Aims to outperform the Bloomberg AusBond Composite 0+ Yr Index over the medium term (before fees) by using an active investment strategy. It aims to provide regular income and a moderate level of growth.

Key information

Fund details

APIR code	MAQ0061AU
Inception date	15 May 1995
Fund size	\$256.9m
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 April 2023

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.28	0.24	0.19	0.05
3 months (%)	2.47	2.37	1.99	0.38
1 year (%)	3.17	2.77	2.06	0.71
2 years (% pa)	-2.25	-2.63	-2.82	0.19
3 years (% pa)	-1.58	-1.98	-2.28	0.30
5 years (% pa)	1.99	1.54	1.38	0.16

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)

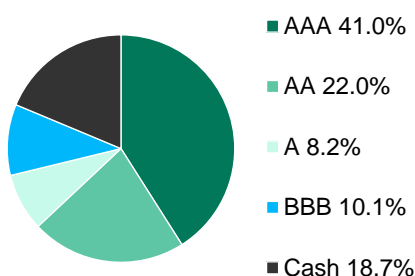
	Fund (%)
Credit	34.1
Semi-Government	25.3
Government	22.0
Cash and Equivalents	18.6

Fund statistics

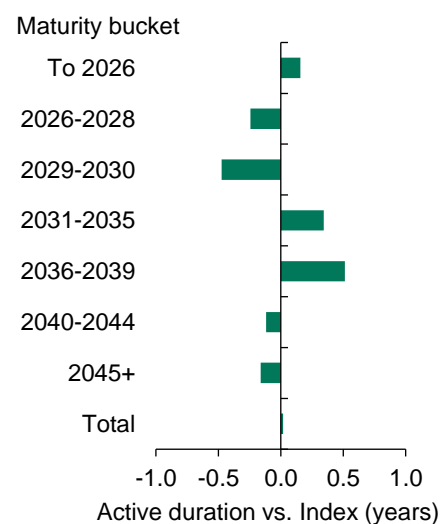
Credit spread duration	0.6 years
Interest rate duration	5.4 years
Yield to maturity*	3.90% pa

*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



Curve positioning breakdown



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Fund highlights

The Fund outperformed the benchmark over the month, driven by sector rotation as well as security selection.

Sector rotation

The Fund maintained its long semi-government exposure, albeit on a hedged basis versus swap. While semi-governments still look attractive on an outright yield basis, the potential for the US regional banking crisis further permeating global markets puts spread product at risk. Thus, the risk-reward for holding the position outright is not attractive. Semi-governments performed well over the month, tightening significantly to Australian Commonwealth Government Bonds (ACGBs) whilst trading largely sideways to swap, which contributed positively to performance. Outside of the financial contagion narrative, the bank high quality liquid assets demand narrative will continue to support the sector, although this effect will begin to wane, so we remain comfortable with the hedged exposure.

The Fund's modest overweight position to physical credit was a positive contributor to performance, as Australian credit spreads moved tighter over the month.

Security selection

The Fund is overweight derivatives vs physical securities both in swap and futures, held in the short and intermediate sector. Physical ACGBs remain 'rich' to the overnight index swap curve, particularly in the front end and belly of the curve. Within ACGBs, we continue to hold our exposure in the back end of the curve where bonds offer more value vs overnight index swap and futures. Within semi-government, exposure was partially shifted into the belly as the spread curve flattened materially. We remain underweight Treasury Corporation of Victoria and overweight Queensland Treasury Corporation and New South Wales Treasury Corporation, with exposure to the latter increasing over the month on a tactical relative value basis, as opposed to an improved issuer outlook.

The Fund's credit security selection was a neutral contributor to performance. Financial paper rallied following the widening in March, with covered, senior and Tier 2 spreads all tighter over the month. Longer-end credit and in particular REITs underperformed, which benefitted the Fund which is mostly concentrated in shorter-dated, high quality paper. Corporate credit performed well, in particular, defensive infrastructure style holdings. Structured securities again contributed to performance, with a small amount of tightening over the month in AAA spreads despite ongoing supply. Higher than benchmark carry also furthered returns. Over the month, the Fund participated in transactions from issuers such as Apollo 2023-1 and Worley.

Duration and curve

The Fund maintained its neutral duration position in April as lingering concerns over the US regional banking crisis muddied the path forward for central banks. The Reserve Bank of Australia (RBA) paused in April, whilst retaining a hawkish bias, which led the market to price the hiking cycle as effectively over as Q1 CPI printed weaker than expected. This tone was in stark contrast to our neighbours as the Reserve Bank of New Zealand (RBNZ) surprised markets with a 50bps hike, citing the fall in the wholesale interest rates and still too high inflation as the primary drivers, with the focus on keeping financial conditions tight. Inflation has kept the Bank of England (BoE) in an uphill battle, printing above consensus and in the double-digits for March, all but guaranteeing they will be forced to deliver another reluctant hike in May. The Bank of Japan (BOJ) held their first meeting under Governor Ueda, which proved to be a non-event with no change to Yield Curve Control, although a long-term review was announced.

Duration was traded tactically over the month as the Fund entered a small short duration position in the very front end of the AU curve early in month, as a somewhat "free hedge" against any hawkish RBA moves. Given the RBA's hawkish tone, further hikes are unclear, and we see no possibility of the RBA cutting rates in the near term. The Fund moved long duration as the AOFM syndicated a new December 2034 bond, which was met with extremely strong demand and printed slightly larger than expected, suggesting future outperformance of AU duration as the issuance task is set to reduce further. The Fund moved back to neutral, via the 10-year part of the curve, as the risk of a hawkish pivot from the BOJ outweighed the relative reward from maintaining the long, given the likelihood for AU duration underperformance on such a move.

Market overview

Fears within the banking system gradually dissipated this month as volatility subsided and calm returned to asset markets, although spots of vulnerability arose due to fears of credit tightening. Risk markets recovered the significant ground that was lost in March, whilst sovereign bond yields retraced higher, they remain well below the levels of February end. As stated last month, we don't anticipate 2023 to be a repeat of 2008 and think that a major banking crisis is unlikely, despite the fact that inverted yield curves have been signalling, for many months that the economic environment has been deteriorating. In this environment things get broken, and the imbalances of this fragile environment have seen the US regional banks come under significant pressure, yet it is important to remember that the problems in US regional banks are symptom not the cause of the problems being faced.

The broad economic data released during April are building evidence towards the case that there will be a recession later this year. The manufacturing sector is either already in or close to recession. Goods prices are moving into deflation mode. The resilient service sector is now slowing as consumer spending disappointed. Meanwhile, the labour market data showed that labour supply is now trending higher just at the time that labour demand is beginning to soften. There was never any wage-price spiral and while wage inflation remains elevated the labour dynamics are pointing towards a softer outlook in coming quarters. This picture of continued improvement in supply and demand deceleration points to lower inflation. This backdrop is underpinning bond yields, where our strategy is to continue to add duration across funds on any meaningful back up.

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Australian bond market

Australia's rate hiking cycle was put 'on hold' this month as the RBA halted increases in the tightening cycle began in May 2022. Australia's inflation looks to have peaked, consumption is plateauing, and the release of the RBA Review 'Fit for the Future' has played on the minds of central bankers, although they have indicated that further tightening will be needed in the months ahead. Bond yields traded a tighter range over April following the large moves in March, with the Australian 10-year bond futures implied yield trading between 3.16% and 3.56% (a range of 41bps vs 84bps in March), ending the month at 3.34%, +4bps on the month. The Australian 3-year bond futures implied yield traded between 2.74% and 3.20% in April (a range of 46bps vs 106bps in March), with the 3-year yield ended the month at 2.98%, +7bps on the month. This 'pause for thought' sits amongst considerable uncertainty in the outlook as inflation is still much too high and the unemployment rate remains at all-time lows. The RBA has indicated that further tightening will be needed over the months ahead, but that they are pausing *for now*, as consumption has significantly slowed due to a combination of tighter fiscal and monetary policy.

Global credit market

Nervousness over the US regional banking sector intensified in the last week of April following earnings reports from First Republic Bank (FRC) and the news that FRC had gone into receivership and immediately sold to JP Morgan. Despite those pressures, strong Q1 earnings results reported so far in April by the US largest tech firms and some of the large US and European banks still saw risk assets generally end the month in the green.

US credit markets were slightly stronger over April, though the overall move was more modest than the months prior. The financial sector was the outperformer, rebounding somewhat after a very weak March – though remaining well off the recent tights in spreads. Supporting the generally positive performance were inflows to higher quality (investment grade) credit, reflecting higher yield levels and strong recent performance; as well as the start of earnings season, which so far has been better than feared (after significant pre-season revisions lower). Issuance was lighter as many companies entered earnings-related blackouts, which was also supportive. The financials sector underperformed late in the month as First Republic, one of the original smaller regional banks that had been under pressure, posted severe deposit outflows, and was taken over by JP Morgan during the last weekend of April.

European investment grade (IG) closed the month 7bps tighter to 162bps. There remains a backlog in supply following banking issues in March, €38bn was issued this month however we have yet to see a material uptick in regular financial issuers post earnings. New issue reception was mixed with deals coming in the latter part of the month seeing double digit concessions especially in cyclical sectors. Interestingly Australian corporate issuers have returned to the European market with Sydney Airport, Transurban and Telstra all issuing this month and CIMIC has also conducted a European roadshow. Notably in financials, UniCredit announced the call of a €1.25bn AT1 security which was the first major bank call event post the collapse of Credit Suisse. Conviction in European credit is mixed at current levels with an uptick in supply expected along with the challenge of higher cash yields as an alternative to credit.

Australian credit market

Australian credit performed largely in line with European IG and outperformed US IG on an option-adjusted spread basis as the index spread tightened 7bps, though much of the option-adjusted spread tightening was driven by the narrowing of swap spreads. Unsurprisingly the main underperformers included REITs and long-dated corporates with most of the REITs widening 5-20bps across the curve over the month as concerns around the commercial real estate sector weighed on spreads. Meanwhile, the financial sector fared better in April across the capital structure with major bank senior and subordinated bonds 5-10bps tighter across the curve. Some of the Total Loss Absorbing Capacity financial paper also performed strongly after underperforming significantly in the second half of March, such as Lloyds which tightened 25-30bps in the 4-6-year part of the curve. In the primary market, there was around \$A3.5bn of IG issuance and \$A3.5bn of structured supply.

Outlook

The economic data continues to point to more supply recovery and greater demand deceleration. This mix will deliver lower inflation, always. However, central banks continue to fear inflation and further rate hikes are expected in upcoming meeting in May. These actions, against the deteriorating economic backdrop, simply increase the probability of recession later this year.

Asset markets can see this picture and are therefore speculating that the expected further rate hikes in May are likely to be soon followed by rate cuts. This 'hope' is underpinning risk markets despite the historical data pointing to 'risk off' if a recession actually materialises. This contrast between hope and likely reality points to further spikes in volatility in the coming months and affirms a key recommendation from our January Strategic forum, that current high level of sovereign yields implies that duration now offers attractive protection against risk assets.

Looking forward, the 'mini' financial crisis during May is expected to see increased scrutiny on central bank reports on the state of financial conditions. Early May will see the release of the US Senior Loan Officers Survey where regional evidence is pointing to further tightening, of already tighter financial conditions. Interest will also be on 'loan demand' from both households and businesses. While this data is actually 'lagging' that is, largely relates to activity in the first quarter, history shows that if loan demand trends weaker a recession typically follows. The earnings season is underway, and while this too largely reflects 'lagging' information there is 'leading' information in the forward guidance provided by companies. Both these data sets will add important detail to the traditional macroeconomic indicators that are watched and feed into the key central bank meetings that will take place in the month of May. We suspect the old adage "sell in May" and go away will be heard several times, but for fixed income clients this should be read as buy duration and feel protected.

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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

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