Macquarie Dynamic Bond Fund

Monthly report – 31 May 2023

Investment objective

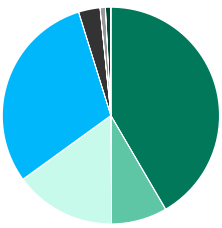
Aims to generate attractive returns by dynamically investing in global fixed income instruments. It aims to provide diversification against equity risk as well as capital growth and some income.

Key information

Fund details	
APIR code	MAQ0274AU
Inception date	30 September 2002
Fund size	$915.9m
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



- AAA 41.6%
- AA 8.3%
- A 15.1%
- BBB 30.2%
- BB 3.2%
- B 0.8%
- Not rated 0.8%

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

Fund performance to 31 May 2023

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-1.01	-1.06	-0.54	-0.52
3 months (%)	2.00	1.84	1.97	-0.13
1 year (%)	-0.08	-0.70	-2.62	1.92
3 years (% pa)	-1.08	-1.68	-3.43	1.75
5 years (% pa)	1.95	1.33	0.25	1.08
10 years (% pa)	2.98	2.35	2.43	-0.08

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 Global Aggregate Index (Hedged to AUD). From 7 January 2019 to 31 December 2022, the benchmark was Bloomberg 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^	41.4
Investment grade credit*	52.1
High yield	2.1
Emerging markets debt⁺	4.4

^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	2.6 years
Interest rate duration	4.9 years
Standard deviation^	3.5% pa
Yield to maturity*	4.1% 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	68.4
Europe (ex UK)	9.9
UK	11.1
Australia/New Zealand	20.2
Japan	-15.6
Others	6.0

^Calculated based on security's currency

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Fund highlights

The Funds core duration strategies remained stable in May, with the Funds main exposure largely held in US Treasuries as the US Federal Reserve (Fed) gets closer to completing this aggressive policy tightening cycle. The Fund also added some exposure to UK gilts given the cheapening of that curve as recent inflation data has been higher than expected. Overall Fund duration fell as the rally in Japanese bond yields provided a good opportunity to put in place hedge strategies to protect the portfolio on the chance that the Bank of Japan relaxes its yield curve control policy – an event, that if it were to occur should see a sharp rise in Japanese bond yields.

The Fund's credit positioning added value over the month, even as credit spreads widened modestly. The value was added chiefly through protective option positions – these were removed mid-month amidst a weak market backdrop, locking in gains. Security selection within investment grade corporates and Emerging Markets also contributed positively.

The Fund made modest additions to credit exposures during the month, adding exposure in US, European and Australian new issuance, with elevated overall spreads and some deals offering attractive concessions. The Fund added Australian utility Ausnet Services, European insurer Allianz, and US cable operator Comcast – all high-quality issuers with new bonds sold during the month. The Fund removed some high yield credit hedges in the first weeks of the month, with spreads at year-to-date wides (excluding the brief spell of volatility during March), banking profits as those positions were put in place at much tighter spreads in February. The Fund also further added to the US Agency Residential Mortgage-Backed Securities: an asset class that had performed very poorly through 2022 and early 2023, and that now offers historically wide spreads. We continue to expect opportunities to add to credit positions over time - but at higher spread levels, given the likelihood of economic weakness or recession later this year.

Market overview

The noises surrounding the US debt ceiling negotiations were very distracting, but asset markets mainly focused on the facts they understood, namely that inflation was falling only slowly, labour markets remained resilient and while the Fed may prefer to hold policy, the data may yet force another rate hike. The above combination enabled risk markets to largely end the month flat or in positive territory, while bond yields pushed higher led by the front end of yield curves as expectations for further rate hikes increased in the month.

The US debt ceiling was a major talking point because of the skew of risk to the downside. While fear of a default was probably overplayed the greater risks lay in the prospect of the Republicans forcing significant spending cuts to agree a lift of the debt ceiling. Memories of 2011 haunted financial markets, where President Obama's was forced to agree to the Budget Control Act and Sequester that prematurely ended his planned fiscal expansion and set the scene for the subsequent period of uninspiring growth. While the current agreement has not yet passed through Congress the details available point to a modest reduction in net spending going forward, essentially neutralising the fiscal risk from a market perspective.

Outlook

During May our research and investment teams undertook a deep dive into our views using our triannual Strategic Forum process. The review of the macroeconomic outlook noted that the supply recovery continues on a slow, steady, sustainable path; and while demand has decelerated it has not turned into a destructive force. Importantly, our analysis noted the unexpected positive impulse from US fiscal policy in the early months of the year (from increased defence spending and cost of living adjustments to benefits). This combination has caused inflation to start turning lower, however it remains well above target which has induced central banks to tighten further. Our proprietary analysis suggests that US central bank policy is already in over-tightening mode, and historically when this occurs something breaks – the recent US regional bank turmoil is a good example.

A key dilemma for central banks and markets is the fact that monetary policy works with long and variable lags, and this has been the fastest and largest tightening cycle for several decades. In addition, yield curve inversion analysis had been pointing to late 2023 for recession. This highlights a key debate on the outlook- should focus be on leading or lagging indicators? Employment, inflation and wages are all lagging reflections of the economic cycle. Spending data and forward guidance are leading indicators. For the consumer, despite higher nominal wages, spending has remained constrained in real terms as the scars of the supply shocks has increased prices. Thus, with the positive impulse from government cash handouts dissipating and concurrent monetary tightening grinding, the overall impact is we still see recession as our base case outlook for late 2023.

The skew of risks debated at our Strategic forum were biased to expecting a harder landing for the economy. The first risk lay with the debt ceiling and at the time of writing this may have been neutralised. Secondly, is that monetary over-tightening persists, potentially exacerbated by the chance of another hike in June. Thirdly, credit conditions have tightened, already to levels that historically correlate with the near-term onset of recession, yet we expect even more tightening to come. Finally, economic fragility brings financial dislocation. Concerns surround Commercial Real Estate and Private markets for example.

We therefore remain constructive strategically on duration and cautious of risk markets, recognising that the pathway ahead is potholed by a high level of uncertainty.

MACQUARIE ASSET MANAGEMENT

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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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