

Macquarie Australian Fixed Interest Fund

Monthly report – 30 June 2023

Investment objective

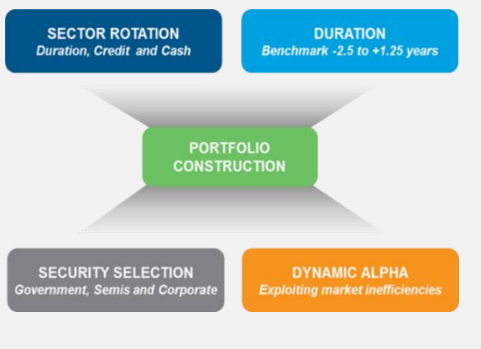
Aims to outperform the Bloomberg AusBond Composite 0+ Yr Index over the medium term (before fees) by using an active investment strategy. It aims to provide regular income and a moderate level of growth.

Key information

Fund details

APIR code	MAQ0061AU
Inception date	15 May 1995
Fund size	\$242.0m
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 2023

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-1.99	-2.02	-1.95	-0.07
3 months (%)	-2.86	-2.95	-2.95	0.00
1 year (%)	2.60	2.20	1.24	0.96
2 years (% pa)	-4.30	-4.67	-4.81	0.14
3 years (% pa)	-2.92	-3.31	-3.51	0.20
5 years (% pa)	1.10	0.66	0.51	0.15

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)

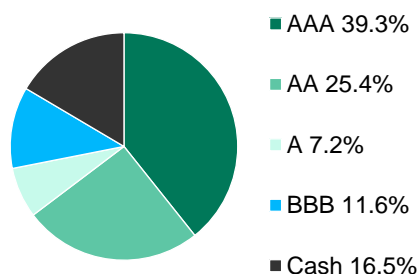
	Fund (%)
Credit	38.3
Semi-Government	25.7
Government	19.5
Cash and Equivalents	16.5

Fund statistics

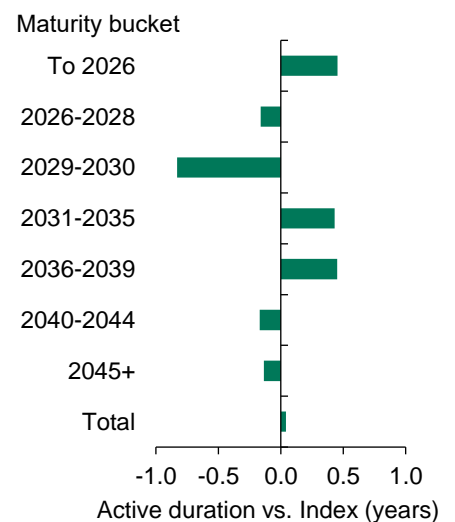
Credit spread duration	0.7 years
Interest rate duration	5.3 years
Yield to maturity*	4.80% pa

*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 underperformed the benchmark over the month, amid the ongoing rates volatility and the move wider in credit spreads.

Sector rotation

The Fund largely maintained its long semi government exposure, hedged with swap, drifting marginally shorter at month end with the index extension. Semi-governments tightened to bond over the month but widened versus swap due to a relentless tightening in swap spreads, seeing them detract from performance. Despite the tailwind to the sector from Bank high quality liquid assets demand being well past its peak as the Term Funding Facility maturities ramp up, the continued reduction in AOFM issuance should see the semi-government sector retain some high-quality liquid assets bid. The Fund's short swap spread exposure was reduced over the month as a function of the short payer swaptions, with the duration contribution of the positions increasing as yields rise.

The Fund's modest overweight physical credit positioning was a positive contributor to performance as Australian credit spreads continued to grind tighter.

Security selection

The Fund remains overweight futures vs physical securities, held in both the short and intermediate sector. The physical Australian Commonwealth Government Bonds (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 is concentrated in the 7-10-year part of the curve. We remain underweight Treasury Corporation of Victoria and overweight Queensland Treasury Corporation and New South Wales Treasury Corporation, for relative value considerations.

The Fund's credit security selection was a broadly neutral contributor to performance. Senior financial paper moved a touch tighter, though Tier 2 spreads were the outperformer following Westpac's long-awaited transaction and were a solid returner. Corporate performance was more muted with recent utility deals outperforming alongside defensive infrastructure names. Securitised credit had a busy month which saw the highest volume in primary issuances so far in 2023. Spreads moved 10bps tighter in senior-AAA deals and were a strong performer for the Fund. Protective credit default swap positions were a modest detractor as spreads rallied into the half-year close. Over the month, the Fund participated in transactions from issuers such as Harvey 2023-1, Lion 2023-1, Westpac Banking Corporation, QBE Insurance Group, AGI Finance and Transpower New Zealand.

Duration and curve

The Fund moved from short duration to slightly long in June, with duration increasing naturally over the month as the sell off increased the delta on the swaptions. The Reserve Bank of Australia (RBA) hiked 25bps in June, which the market took as hawkish, and saw Australian yields underperform peers early in the month as the rates sell off gathered steam. A string of upside surprises in economic data saw the market abandon the impending recession narrative, particularly as US core CPI and UK CPI showed persistence. The US Federal Reserve (Fed) opted for a hawkish pause in June, but flagged two more hikes were likely this year via the updated dot plot, whilst the Bank of England (BoE) surprised the market with a 50bps hike as they struggle to contain inflation. Yields began trading sideways towards the latter half of the month and Australia began to outperform as the RBA's June minutes proved the June hike was in fact dovish, with the decision between a pause and a hike finely balanced. Yields moved higher into month end, although heading in the US summer this was likely a position covering move rather than a rapid shift in sentiment.

As yields sold off, duration naturally moved longer as we approached the strikes on the 2-year and 10-year swaptions. Prior to the RBA, we took profit on a short June bank bill position, which had contributed positively to performance as a hedge against the RBA moving more hawkish. The yield curve flattened aggressively throughout the month, providing attractive levels to begin entering a steepening position as the RBA is very likely close to the end of their hiking cycle. The sell off in yields saw the market begin testing the Bank of Japan on their resolve to keep the Japanese Yen from depreciating significantly, which provided an opportunity to deploy excess cash in Japanese T-bills for a pickup over Bank Bill Swap Rate. Across the curve, we are overweight the front end as a reflection of central banks nearing the end of their hiking cycles, underweight the belly and relatively neutral further out the curve.

Market overview

While the leading indicators for economic growth continue to point to slowing in the quarters ahead, the pace of slowdown continues to confound expectations. This in part has been due to the better starting position for both households and business balance sheets but also to the role of fiscal policy, which has continued to prove less contractionary than expected. In fact, in the US the debt ceiling agreement has enabled the Federal Government to maintain this stronger than expected spending through the fiscal year (ends October). Headline inflation continues to grind lower and while core inflation measures too are slowing (excluding the UK) the pace has not been sufficient to convince central banks that their job of tightening policy is done. In June, The Fed may have paused hiking but signalled that there could be two more hikes in the pipeline. The European Central Bank, BoE (who hiked 0.5%) and RBA continued to hike and signalled more to come.

Rate markets bore the brunt of this hawkish monetary policy action, with short term yields shooting higher, dragging longer-dated yields higher. The spread (or yield curve shape) flattened further – with the Australian benchmark 3-year/10-year spread inverted for the first time since 2008. Risk markets remain surprisingly resilient with equities higher and credit spreads tighter, with the higher risk ratings outperforming.

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Australian bond market

Australia is reflective of the global economic backdrop with high inflation and slower growth, though the fall in our inflation is lagging that of other developed counterparts. The RBA hiked this month and signalled more to come, but with the caveat that the rate decision was finely balanced. Australian 10-year bond futures traded between 3.56% and 4.06% (a range of 50bps vs 56bp in May), ending the month 42bps higher at 4.03%. The Australian 3-year bond futures implied yield traded between 3.33% and 4.04% in June (a range of 71bps vs 69bps in May), finishing the month 63bps higher at 4.00%. The 3-year/10-year bond curve inverted for the first time since 2008 and the AU-US 10-year bond spread widened through the month from around -10bps to +27bps. The RBA is considering the possibility of active quantitative tightening given the comparatively slow roll off of the balance sheet beyond the next 12 months, using the liquidity drain of tranche one of the Term Funding Facility as an indication for how the system may cope.

Global credit market

Risk assets ended June on a much stronger note as credit spreads improved, and equities rallied with the NASDAQ posting its second-best 6-month period ever despite the rates volatility given the uncertainty around the future paths of global central bank policy.

US credit finished June tighter, approaching the tights of the year so far. Investment grade credit tightened by 15bps, to 123bps, and high yield by 69bps, to 390bps. Financials are the only significant sector still meaningful off their year-to-date tights, after the march stress events – this sector performed strongest over the month as it continued to recover. The strength was driven by stronger economic data – Q1 GDP in the US was revised higher to 2% QoQ, from 1.3%; and employment indicators remain very strong, as well as strong performance in the equity market, particularly from large cap growth (tech) names. Aligned with the 'recession delayed' theme, the strongest performing sub-sectors were the prior laggards: Office REITs, media and entertainment, higher beta oil producers, and US regional banks.

European credit closed 8bps tighter in June while high yield was 42bps better, both underperforming the US market. REITs were the standout performer rallying 20bps but still remain the widest trading sector in Europe, we have started to see some creditor friendly actions such as Unibail Rodamco hybrid exchange and several tenders on investment grade lines. Chemicals underperformed with the index closing +4bps, this was driven by Lanxess issuing a profit warning cutting its FY23 EBITDA by ~30% which resulted in underperformance of the overall sector.

Issuance was broadly in line with expectations at €53bn and concessions have normalised with the stronger risk backdrop.

Australian credit market

Australian credit tightened 9bps on option-adjusted spread basis in June with a portion of the performance driven again by tighter swap spreads. Contribution to the performance was broadly based with credit spreads across sectors marginally tighter over the month. Even though financial senior paper edged 1-2bps, bank subordinated bonds outperformed with spreads narrowing around 10bps despite Westpac's 15NC10 and 10NC5 and QBE's subordinated transactions during the month. Corporates were broadly unchanged to slightly tighter over the month despite more primary supply from three more utility companies in the 7-year part of the curve. The primary market remained active in June with more than \$A10bn of new supply as three utility companies issued more than \$A1.2bn in aggregate in the 7-year part of the curve. Higher beta issues were also well-supported with Westpac and QBE printing \$A2.9bn and \$A300m subordinated deals, respectively.

Outlook

Given the move in asset markets over the past month our team view from the May Strategic Forum, to hold a constructive view on duration and cautious outlook for risk markets was challenged. That said, we recognised that the path forward held a high level of uncertainty. Our investment process uses our weekly global meetings to view new information and review our strategy.

At the macro level, the key change since the Forum has been on fiscal policy, where the resolution of the debt ceiling has enabled stronger than expected Federal spending through the early months of the year. This was largely due to military and cost-of-living adjustments to social benefits which has been extended through the second quarter and likely the third quarter. Government spending has a rapid transmission into the economy, compared to the long and variable lags and impact of monetary policy, and this is working to soften the slowdown in growth that is underway. However, this is placing more of the burden of reducing inflation onto monetary policy. We concluded at the Forum that for many economies, monetary policy was already near or had crossed into over-tightening territory. The action and guidance from Central Banks in the past month shows that their intent is to keep going on hiking rates. This sends a clear message that monetary policy over-tightening is now a key risk for asset markets. History shows that while tighter monetary policy does not always end in recession it does, particularly if credit conditions are tightening at the same time, end with something 'breaking'. We therefore believe that financial risk is more elevated, where the stress around US Regional Banks in Q1 could manifest in other areas of financial assets in the quarters ahead and this could be the trigger that tips economies into recession.

From a risk perspective, again history guides that risky assets do not tend to react significantly until evidence of a downturn or financial risk become clearly evident. We therefore maintain a strategically constructive view on duration and cautious of risk markets, recognising that the pathway ahead is potholed by a high level of uncertainty.

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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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