MACQUARIE

Macquarie Australian Fixed Interest Fund

Monthly report – 31 August 2023

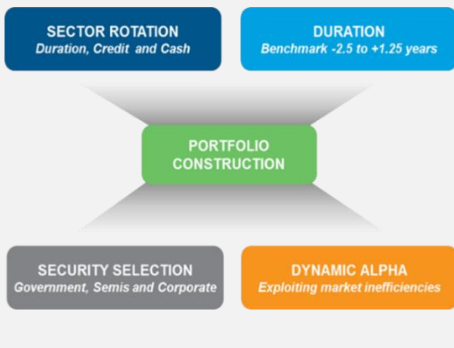
Investment objective

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	$254.5m
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 31 August 2023

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.92	0.89	0.74	0.15
3 months (%)	-0.43	-0.53	-0.72	0.19
1 year (%)	3.13	2.73	1.78	0.95
2 years (% pa)	-4.46	-4.83	-5.09	0.26
3 years (% pa)	-2.46	-2.85	-3.09	0.24
5 years (% pa)	1.22	0.78	0.56	0.22

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)

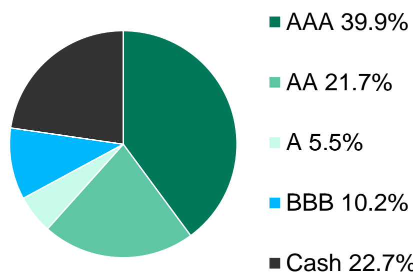
	Fund (%)
Credit	37.8
Cash and Equivalents	22.7
Semi-Government	22.2
Government	17.3

Fund statistics

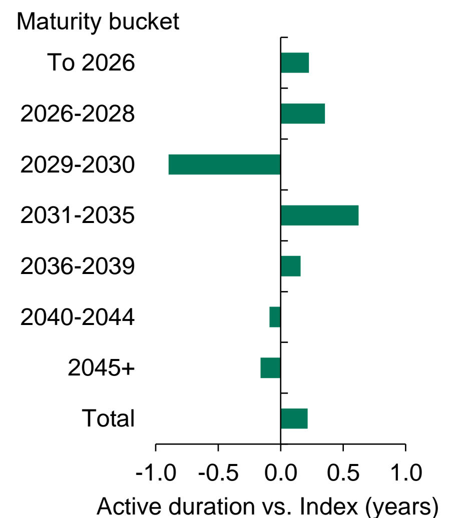
Credit spread duration	0.7 years
Interest rate duration	5.3 years
Yield to maturity*	4.50% pa

*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



Macquarie Australian Fixed Interest Fund

Monthly report – 31 August 2023

Fund highlights

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

Sector rotation

The Fund reduced its long semi-government position in August from flat to slightly long, as the spread to bond is at the lower end of the range. We retain a short swap spread exposure, albeit no longer as a hedge to the semi-government exposure, as swap spreads are near post pandemic lows, with this position marginally increasing as the short 2y payer swaption matured out of the money. As the roll off of the first tranche of the Term Funding Facility completes in September, the high quality liquid assets demand from bank balance sheets is no longer a certain support for the semi-government sector.

The Fund's modest overweight physical credit positioning was a positive contributor to performance as Australian credit spreads marginally tightened in August.

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, although this did normalise considerably in August as the market moved to price in the change of active quantitative tightening from the Reserve Bank of Australia (RBA). 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 positive contributor to performance. Financials continued to be an important driver of performance in August, with significant contribution particularly from some of the European names. The corporate sector also contributed positively to excess return with higher beta industrials and wider-trading names narrowing materially in spread. Structured securities continued their recent robust performance with new deals providing further proof of the strong demand for high quality bank Residential Mortgage-Backed Securities (RMBS) paper. Over the month, the Fund participated in transactions from issuers such as ANZ, CBA, Westpac, NBN Co, LT 2023-1 and IDOLT 2023-1.

Duration and curve

The Fund moved to a long duration position in August, after beginning the month slightly short. August was marked by a dearth of central bank meetings to guide sentiment, with the RBA on hold as expected and the Bank of England hiking 25bps at the start of the month, with the rest of G4 on break for the Northern Hemisphere summer. In lieu of central banks, the market's focus turned to the fiscal side with yields beginning the month with a sell off as the US Treasury revised their quarterly funding estimate higher to $1tn, triggering Fitch to downgrade the US credit rating and curves to steepen to accommodate higher duration supply. The annual Jackson Hole symposium came and went with little fanfare, with Chair Powell largely sticking to the script, while locally weaker inflation and labour data saw the market resolve that the RBA has likely delivered their last hike. Towards the end of the month, yields began to rally, with some local outperformance, as Chinese economic data continued to deteriorate.

The Fund added duration in the front end of the curve early in the month as the short 2-year payer swaption drifted out of the money, expiring there later in the month. We retained the short September bank bill position as a hedge against the RBA turning more hawkish, but RBA pricing near term finished largely unchanged over the month. We also added a small long duration in the front end of the AU curve as a spread to the back end of the TY curve mid-month, with the AU front end looking cheap given the RBA is likely finished and the back end of the US yield curve facing supply issues. Following the Bank of Japan's (BOJ) yield curve control tweak at the end of July, we took profit on the short Japan 2-year/1-year overnight index swap as the likelihood of another near term move is small. On curve positioning, we remain overweight the front end, underweight the belly of the curve and long the 10-12-year sector, which generates a small steepening bias as we approach the end of the cycle.

Market overview

August marks the holiday season in the Northern Hemisphere but it was no holiday for financial markets, which were taken on a wild roller-coaster ride. US 10-year yields spiked from 3.96% to 4.34% during the month, before closing at 4.09%. This was despite a benign inflation print and a weaker than expected employment reports. The much stronger than expected retail sales report was a key driver of the bond market sell-off. This combined with ongoing tough talk from US Federal Reserve (Fed) Governors, which translated into the market (again) debating a rate hike at the September meeting but more importantly revising back expectations for rate cuts in 2024.

The market narrative with regard to the economic outlook has evolved toward a belief that a soft landing can be achieved, and this has been fuelled by surging GDP. The estimate for Q3 growth, provided by the Atlanta Fed, moved from 3.9% to 5.9% (annualised quarterly growth). While stronger growth is theoretically good news for equities and credit, both risk markets came under (modest) pressure in the month, largely reflecting concerns about the Fed's interest rate hiking cycle. Like rates, credit spreads retreated from higher levels into month end, where high yield (HY) notably outperformed in the month.

The picture globally is more mixed, where China remains a key area of concern. Here, policy efforts to drip stimulus into the economy are being met with scepticism as the consumer has hunkered down, the export sector is struggling with slowing global demand and the property sector remains a key structural concern. Inflation is likely to pressure more rate hikes in Europe and the UK, despite clearly softening economic growth. Meanwhile the Australian central bank is edging towards neutral with a new Governor at the helm and an economy that is slowing but with inflation sticky in its decline.

Macquarie Australian Fixed Interest Fund

Monthly report – 31 August 2023

Australian bond market

Australia's inflation remains well above the target band, lagging the normalisation in inflation shown elsewhere in the global economy. However, the RBA was granted some reprieve as the monthly CPI for July printed at 4.9%, whilst the Q2 Wage Price Index also printed softer than expected at 3.6%, allaying any fears of a wage-price spiral. Activity data continues to slow, particularly in real terms, and the RBA confirmed their relative dovishness in the August Statement of Monetary Policy with their bias to remain on hold, despite inflation not set to return to the target band until end 2025. The Australian 10-year bond futures implied yield traded between 3.94% and 4.33% in August (a range of 39bp vs 47bp in July), ending the month unchanged at 4.00%. In the shorter end, the Australian 3-year bond futures implied yield traded between 3.66% and 4.00% in August (a range of 34bp, vs 50bps in July), ending the month 10bps lower at 3.72%. The 3-year/10-year future curve steepened in sympathy with global yield curves, hitting an intra-month high of 37.5bps before retracing to close at 28bps.

Global credit market

Risk markets were modestly weaker in August, which was impacted by continued rates volatility as markets tried to determine whether central bank tightening has come to an end or whether a softer than expected landing may see more work to be done.

US Credit markets finished marginally wider over the month, reversing the rally in the final days of July. The strongest negative influences to performance were the continued volatility in underlying government bond markets, with negative total returns contributing to consistent weeks of investment grade (IG) outflows for the first time this year. A lack of supply in the second half of the month helped to stabilize spreads, with new issuance markets essentially closed for the end of the Northern Hemisphere Summer. IG spreads finished +6bps overall, with HY outperforming, +5bps – with the longer duration of IG increasing its exposure to rate volatility. Amongst sectors, performance was mostly consistent, with cyclicals such as automotive, metals and mining the underperformers. The primary market is expected to open significantly in the beginning of September, providing some pricing clarity and potentially testing the supply-demand balance.

European IG underperformed global peers closing 8bps wider. Supply for the month came to €31.4bn, issuance was concentrated towards month end with almost 75% of the monthly issuance coming in the past week. IG failed to keep up with the macro bounce in the latter part of the month especially as concessions in new deals have begun to increase, high quality utilities such as Engie paid at least 15bps in mid-long end. Key underperforming sectors include auto's +14bps as US names led the widening on potential strikes, cyclical sectors such as metals & mining were also notably weak +18bps led by Glencore. The primary market has been the main focus for European credit over recent sessions and is likely to be the maintain attention over the coming weeks especially as issuance transitions to higher beta names.

Australian credit market

Australian credit performed solidly again with Index option-adjusted spread tightening 8bps in August, though this was largely driven by narrowing of swap spreads. The outperformance was broad-based across sectors with utilities and higher beta transportation continuing to grind tighter. REITs performed broadly in line with the general credit beta, though industrial REITs outperformed while some of the longer dated bonds with greater office exposures lagged. In financials, major bank senior paper ended the month 1-3bps tighter with 3-5year part of the curve flattening 2bps despite a deluge off senior primary issuance from major banks as 13bn for the 19bp issuance in IG primary market was accounted for by supply from 3 major banks in August. Major bank subordinated bonds finished broadly unchanged in August, though this masked the intra-month volatility which saw spreads widen during the month as some switching activity followed Lloyds Banking Group's 10NC5 T2 issuance as well as Mizuho's 6NC5 TLAC deal. In the structured space, RMBS spreads were marked tighter again in August given the strong demand and oversubscription for primary deals. There was circa 19bn of IG primary issuance in the Aussie credit market with majority of the supply coming from financial institutions.

Outlook

Globally inflation has peaked and in retreat, the debate now is, can this move lower be sustained? The narrative on growth has been more volatile, with a once high conviction on a recession coming under attack in recent months as economic data continued to surprise on the upside.

While attention continues to be on central banks and "will they / won't they" hike rates again, we continue to point to fiscal policy being the big surprise in 2023. In fact, the fiscal impulse from the US through 2023 to date has also been behind the "US exceptionalism" narrative. In Q1, fiscal provided a boost via large cost of living adjustments and military spending. In Q2, the debt ceiling process threatened to reverse this thrust, but the battle was ultimately won by the Democrats and fiscal spigots remained firmly open, including through Q3. Our analysis suggest that this fiscal action has worked to underpin growth or temper the slowdown that was underway, rather than kick start to higher growth. On the other side, this action has made the job for central bankers harder, which is why their rhetoric implies that monetary policy will err on over-tightening.

Our Strategic Forum is set for mid-September, where we comprehensively review the drivers of the outlook and re-assess each of the asset classes. Our base case outlook for a recession will be hotly debated in the context of the changing policy mix that has been experienced. If the US new year fiscal process (starts 1 October) stalls or reverses, the recession/soft landing debate is likely to swing again, especially with monetary policy being pushed into even greater over-tightening mode. The debate is keeping interest rate markets and duration as the source of volatility across portfolios, with risk markets remaining remarkably resilient. This balance could shift decisively in the coming months if recession fears elevate again, with potential further cracks in the employment market tipping that balance.

Macquarie Australian Fixed Interest Fund

Monthly report – 31 August 2023

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.

The above information is not personal advice and does not take into account the investment objectives, financial situation or needs of any person. Please review the Target Market Determination for the Fund available at **macquarieim.com/TMD** and consider if the Fund may be suitable for you. Investors should consider the offer document relating to the Fund in deciding whether to acquire or continue to hold units in the Fund. The offer document is available by contacting us on 1800 814 523. Past performance is not a reliable indicator of future performance. Future results are impossible to predict. This report includes opinions, estimates and other forward-looking statements which are, by their very nature, subject to various risks and uncertainties. Actual events or results may differ materially, positively or negatively, from those reflected or contemplated in such forward-looking statements. Forward-looking statements constitute the investment manager's judgement as at the date of preparation of this report and are subject to change without notice.

In preparing this document, reliance may have been placed, without independent verification, on the accuracy and completeness of information available from external sources. To the maximum extent permitted by law, no member of the Macquarie Group nor its directors, employees or agents accept any liability for any loss arising from the use of this document, its contents or otherwise arising in connection with it.

Other than Macquarie Bank Limited ABN 46 008 583 542 ("Macquarie Bank"), any Macquarie Group entity noted in this material is not an authorised deposit-taking institution for the purposes of the Banking Act 1959 (Commonwealth of Australia). The obligations of these other Macquarie Group entities do not represent deposits or other liabilities of Macquarie Bank. Macquarie Bank does not guarantee or otherwise provide assurance in respect of the obligations of these other Macquarie Group entities. In addition, if this document relates to an investment, (a) the investor is subject to investment risk including possible delays in repayment and loss of income and principal invested and (b) none of Macquarie Bank or any other Macquarie Group entity guarantees any particular rate of return on or the performance of the investment, nor do they guarantee repayment of capital in respect of the investment.

Bloomberg Finance L.P. and its affiliates (collectively, "Bloomberg") are not affiliated with Macquarie and do not approve, endorse, review, or recommend the Portfolio. Bloomberg and the Bloomberg AusBond Index or Indices referred to in this document are trademarks or service marks of Bloomberg and have been licensed to Macquarie. Bloomberg does not guarantee the timeliness, accurateness, or completeness of any data or information relating to the Bloomberg AusBond Index or Indices referred to in this document.

PRRP-MAFIF-ANZ