

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	\$240.1m
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 March 2021

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	1.04	1.01	0.80	0.21
3 months (%)	-3.29	-3.38	-3.22	-0.16
1 year (%)	-0.94	-1.39	-1.81	0.42
2 years (% pa)	3.20	2.72	2.40	0.32
3 years (% pa)	4.61	4.11	3.97	0.14
5 years (% pa)	4.13	3.61	3.46	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.

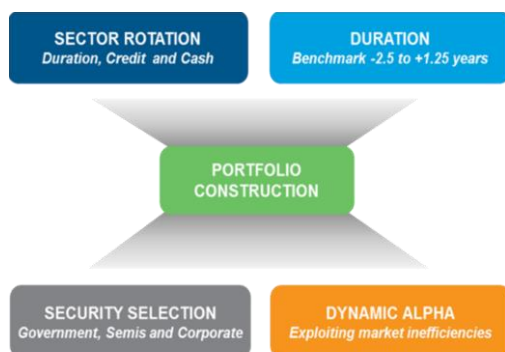
Benchmark is Bloomberg AusBond Bank Bill Index

Asset allocation (based on physical exposure)

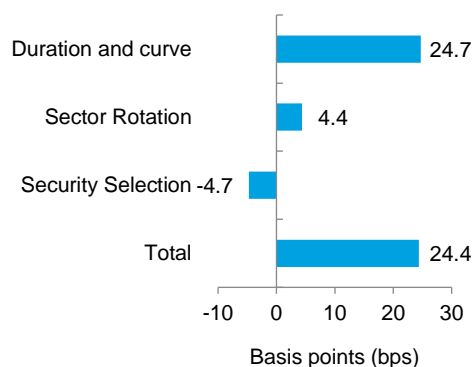
	Fund (%)
Government	51.1
Corporate	27.3
Semi-government	19.2
Cash and equivalents	2.4

Fund statistics

Credit spread duration	1.0 years
Interest rate duration	5.8 years
Yield to maturity (% pa)	1.48%



Key contributors to performance



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Fund highlights

The theme of 'divergence' has been observed over the past months, with uneven impacts of the pandemic across countries and sectors as well as varied fiscal responses by different governments. Adding to the divergence has been the vaccination rollouts. Amongst developed countries, the UK and US have led the way on vaccine administration, which are enabling the gradual re-opening of their economies. In contrast, Europe has laboured and is now dealing with a third wave of coronavirus and a re-tightening of restrictions. The combined result has caused US rates to shoot higher, led by the 10-year bond yields, and yield curves to steepen sharply. European yields, on the other hand, actually fell by a few basis points. So, for fixed income investors, country selection and positioning were key drivers of performance in the month of March.

That said, there should be no allusions to the challenges facing fixed income in 2021, as the volatility across interest rate markets experienced during the first quarter is likely to continue as investors cope with the uncertainties still surrounding the virus, the challenges of the vaccination process and the expected volatility in the month-to-month economic data. Still, supportive policies and a gradual re-opening of economies are combining to underpin risk markets, where credit spreads have remained resilient and close to historic tight.

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

Duration and curve

The Fund has held a similar amount of modified duration to its benchmark, though we have continued to favour an overweight to AUD versus USD duration. This positioning added value as the AU-US spread retraced the previous month's move, narrowing to low single digits by the end of March, at which point we took profit on the trade.

The Fund has maintained its active positioning across the curve. We have been underweight versus the benchmark out to the 3 year point, as the Reserve Bank of Australia's (RBA) yield curve control (YCC) policy, combined with the abundant liquidity in the system, has anchored yields and eliminated the prospect of active return in the front-end. This has been offset by an overweight to the 4-6 year tenors, expressed in both Australian Commonwealth Government Bond (ACGB) and in forward starting swap. While this positioning was a detractor in February, we remained high conviction on the trade, viewing the moves as predominantly driven by market disfunction. The RBA stepped in to address this disfunction on the first day of March by temporarily doubling their scheduled asset purchases, which contributed to the beginning of normalisation in the mid-curve and resulted in a partial recovery to performance in March.

We continue to expect a bumpy recovery as fiscal support programs eventually roll off. Following the global financial crisis, the eventual tightening of monetary policy was far more gradual than initially anticipated by financial markets. We believe this time is no different, and the RBA's eventual move away from the effective lower bound will be more protracted than what markets are still pricing into the belly of the yield curve. While there has been some flattening in the curves this month, current levels still represent an opportunity, and we continue to favour this positioning going forward.

Sector rotation

The Fund has maintained its underweight to the semi-government sector. State government issuance has remained elevated relative to pre-pandemic levels, but regulatory demand for HQLA (high quality liquid asset) paper, combined with weekly semi-government purchases from the RBA, has been supportive for spreads and allowed supply to be absorbed by markets with relative ease.

However, semi-government spreads to bond remained extremely tight, with semi asset-swap spread levels having entered negative territory out to the mid-curve. As a result, we view the yield pick-up in certain parts of the curve as insufficient to compensate for the relatively lower liquidity in the sector, and have favoured owning a larger holding in ACGB instead.

The Fund's credit positioning performed broadly in line with the benchmark. Lower beta bonds were the main driver of the broader weakness in the Australian credit market, with senior financials and other counter-cyclical corporate paper ending the month either sideways or a touch wider. However, this was offset by higher beta and COVID-impacted sectors, which rallied further in March.

Security selection

Within the semi-government portion of the Fund, we have continued to hold a preference for the 10-12 year maturities, where spread curves have remained steep due to a supply-demand mismatch for different tenors, with regulatory demand focussed on shorter maturities while issuers have preferred to term out their debt. The Fund also owns a holding in the 2024 semi's, which have been trading at an attractive spread over ACGB due to the impact of YCC.

The RBA's YCC policy on the front half of the 3 year bond basket has created a scarcity of these bonds in the market, which has seen the 3 year futures contract trade cheap relative to the physical bonds due to this scarcity. The Fund has been paid 3 year efp (exchange of futures for physical) to increase our exposure to the 3 year futures contract, which added value during March.

ACGBs have been actively traded during the month to take advantage of micro relative value opportunities. We have also maintained an overweight to the ultra-long bonds given the steepness relative to global curves and attractiveness to foreign investors on a hedged yield basis. The Fund has been able to lend out bonds which are trading special on repo at a negative interest rate, while investing the cash at a positive yield to increase return.

The Fund's performance in credit security selection continued to benefit from the rally in high beta names such as Brisbane Airport and Qantas, which saw their bonds tighten between 10-15bps on the back of the announcement from the Australian federal government to support the travel and tourism industry. Over the month, the Fund participated in primary transactions from issuers including ALE Property Trust, Stockland, Mirvac Group, Aurizon Finance, Mitsubishi UFJ Financial Group, Toyota, Volkswagen, WestConnex, ZIP 2021-1, FPTT 2021-1 and Salut 2021-1.

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Market review

Australian bond market

US Treasury yields continued to hit new range highs in March, with economic data showing signs of improvement and the US Federal Reserve (Fed) rhetoric suggesting that the yield move is viewed as positive and driven by improvements to the economic outlook. Speculation about whether the supplementary liquidity ratio exemption for deposits and Treasuries would be extended also contributed to the global sell-off in bonds. The exemption was eventually allowed to roll off at the end of March, though the Fed said that they may consider making amendments to the rules in the future.

In contrast, Australian bonds were a strong outperformer, rallying over the month even as US Treasury yields pushed higher. This was largely driven by efforts made by both the central bank and the government financing authority to rectify the market disfunction experienced into the end of February. The Reserve Bank of Australia (RBA) doubled their scheduled quantitative easing (QE) purchases on the 1st of March, before expressing their willingness to bring forward purchases in response to market conditions at their monthly meeting in March. While the Board sounded cautiously optimistic on the macroeconomic outlook, they continued to sound more dovish on the trajectory for monetary policy, with Governor Lowe reiterating that they expect to remain on hold until inflation is sustainably within the target band, which they believe will occur in 2024 at the earliest.

The RBA also made adjustments to the repo eligibility of bonds under their yield curve control (YCC). Previously, the Australian Office of Financial Management (AOFM) was a lender of the Australian Commonwealth Government Bond (ACGB) 2023s and 2024s, but halfway through the futures roll period, the RBA increased the repo rate on these bonds to -1.0%, introducing a significant penalty on borrowers of these lines. This measure was effective in taking the yield on the on-the-run 3 year back to the RBA's target as investors covered shorts in those tenors.

At the same time, the AOFM tapered their supply schedule down to \$1bn per week for the first half of March. These measures were effective in calming bond markets and driving a partial reversal of February's price action, though both outright yield levels and intraday volatility remained higher than they were prior to February. By the end of March, the AOFM had reverted to a normal supply schedule, but only issued \$7bn of nominal bonds over the month, while the RBA bought \$20bn of ACGBs back over the same time horizon.

Local economic data has been exhibiting signs of improvement, with this month's employment report showing another 89k of headline jobs created, and the unemployment rate falling to 5.8% from 6.3%. However, the expiry of Australia's JobKeeper program at the end of March is likely to have some impact on the numbers in the coming months.

The benchmark 3 year ACGB ended the month at 0.12%, almost unchanged in yield as a result of the RBA's YCC policy. In contrast the implied yield on the 3 year futures contract rallied 7.5bps over March to end at 0.29%, as a basket of 3-4 year maturities benefitted from a partial reversal of February's dislocation in the mid-curve ACGBs. The curve flattened, with the 10 year implied futures yield declining 14bps to 1.82%.

Global credit market

March was a volatile month for risk assets with performance relatively mixed. USD-denominated credit markets finished March generally unchanged, though intra-month volatility was higher. Investment grade (IG) spreads hit a wide of 100bps, driven by the volatility in underlying treasury markets, higher new issue concessions and heavy new issue supply. As bond volatility subsided somewhat into month end and offshore investor demand improved, spreads rebounded to recapture almost all of their weakness.

Amongst industry groups, performance was driven by technicals and supply factors. Telecommunications was the strongest single sector, with spectrum deals from Verizon Communications (and a smaller-than-expected deal from AT&T) removing the overhang of significant supply from that industry, while banks and utilities relatively underperformed. Bank spreads were impacted by heavier issuance (Goldman Sachs, JP Morgan and Bank of America all issued sizeable bond deals), as well as underperformance of specific issuers surrounding the unwind of the Archegos Capital leveraged trades. Through the volatility, and despite increased concerns around virus variants and lockdowns in Europe, 'recovery' trades such as airlines continued to hold in relatively well after several strong months, performing generally in line with the market.

Issuance volumes were very strong in the US credit market, which helped keep new issue concessions elevated. There were over \$200bn of new IG bonds issued, headlined by a large \$25bn deal from US telecom company Verizon Communications, and \$60bn of high yield bonds issued. Heavier-than-expected supply was one driver of intra-month spread weakness in the broad asset class. However, expectations are for supply volumes to fall off into the second half of the year, with heavy financing activity already completed and total yields for corporate borrowers now somewhat higher, which should provide a supportive supply/demand backdrop for credit spreads.

Performance in the secondary market was quite technical-driven this month. Areas such as US-based TMT (technology, media and telecom) names performed, with the long end AT&T bonds rallying 15-20bps tighter and the Verizon Communications supply taken down with ease. Corporate hybrids performed well in a rising rate environment, with the index 11bps tighter, and higher beta hybrids as much as 30bps tighter over the month. News surrounding the hedge fund Archegos Capital's margin calls on concentrated single name equities made the headlines this month. Credit Suisse has been the most impacted name, with bail-in senior spreads closing 15-25bps wider. Though it has not had a material impact on the overall banking sector, which was driven more by supply technical this month, and other names linked to the scandal in smaller amounts have only seen minimal spread moves.

European IG spreads finished the month 2bps wider at 90bps. The market did experience technical weakness during mid-month as issuers were forced to pay double-digit concessions in some cases, notably in senior financials as demand for credit declined amid an uptick in supply. However, central bank support remained, with the increase in yields and potential tightening of financial conditions already causing concern within the European Central Bank (ECB). The ECB agreed to significantly increase its bond purchases at this month's meeting, which should have a flow-on impact for corporates of which the ECB already owns around 1/3 of eligible paper. Vaccine Vaccination progress in Europe is also notably slower than several developed regions. Countries such as France and Italy have increased restrictions in

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March amid another increase in virus cases while the UK continues to follow a re-opening plan as the case load has stabilised at lower levels. The outperformance of directly impacted COVID sectors has paused but the negative reaction has certainly been modest in credit.

Issuance in the European market picked up to €67bn. Performance was mixed initially and generally trending wider as demand for beta IG issuance started to weaken. However, positive risk sentiment into month end provided a strong bid for recent issues, with the overall March primary issuance tightening 6bps in spreads from reoffer following a 24bp average revision from initial pricing. The best performers mainly centred around long duration (10+ years) BBB names, which closed 10-15bps inside pricing. We have begun to see a trend of increased reverse yankee issuance in EUR potentially with the increased outright yields in USD, as Coca Cola, Verizon Communications, Mondelez, Booking.com and Eaton all issued here this month. Directly impacted COVID sectors continued to maintain market access, with high yield airline International Airlines Group issuing in EUR as well as Gatwick Airport issuing in GBP.

Australian credit market

The Australian credit market underperformed global peers as indigestion from the sell-off in late February persisted throughout the month, particularly in lower beta bonds. While March did start off with a calmer tone, it was short-lived as a wave of primary deals emerged. Given the pick-up in new issuance, the main focus during the month was on primary deals rather than investors sourcing bonds from the secondary market. Consequently, higher-than-expected issuance, coupled with elevated dealer inventories, led to a more subdued spread performance in the latter half of March. The broader weakness in Australian credit was mainly contributed by lower beta bonds such as senior financials, as well as more counter-cyclical corporate bonds that have performed well throughout the pandemic. This was evident in the newly issued bonds from Verizon Communications, which underperformed considerably in the secondary market relative to other corporate bonds. Meanwhile, higher beta and COVID-impacted sectors remained constructive and rallied further in March. This was particularly true in sectors like retail REITs, airports and airlines. Primary IG deals amounted to slightly over \$A7.7bn in March, which was almost double the volume in February, with \$A4.7bn coming from corporate issuers.

Outlook

The market narrative has embraced the re-opening of economies to date, where a strong growth rebound and a pick-up in inflation are expected. As the movements in bond yields through March attest, one needs to state which country that outlook is referring to. In the coming quarter, the US is poised to lead the way, while Europe is expected to continue struggling. The US will benefit from the upcoming substantial fiscal package, which includes large direct stimulus payments. As the services sector gradually re-open, the benefit should manifest in both spending and employment. These all point to a likely robust rebound in growth in the coming quarter, which will be accompanied by the surge in oil prices and base effects to push headline inflation rates higher. Interestingly, despite the market narrative, central banks have been consistently citing the transitory nature of these factors, expecting the large structural dampeners on inflation to contain the longer-term risks. Thus, a gap has opened between the markets' outlook for inflation and that of central banks. This suggests that bond market volatility is likely to persist until one side shifts their view.

Certainly, this rise in US rates has been larger and quicker than we had expected, but elsewhere the move in rates has been more gradual. Thus, the scene is set for a lot of noise in fixed income markets, where managing duration risk is in focus. We are also alert to any shift by policy makers. We expect central banks to maintain their easy policy stance, which leaves fiscal as the likely factor for surprise. On one hand, as economies re-open the huge fiscal support measures are expected to roll off. The risk here is that there is an 'activity gap' particularly in terms of employment. On the other hand, there is scope for fiscal policy to shift from 'support' to 'direct' stimulus. The US is again leading the way, with President Biden outlining an ambitious infrastructure package. This could be good news, as it tilts policy toward investment into the supply side of the economy, which could help lift the current low level of productivity. While there is a long way to go for what package will eventually be passed, theoretically the US fiscal policy approach is supportive for growth going forward. But as it is supply-driven, the inflation risk should be contained. A side effect to consider is that this fiscal initiative could widen the gap for growth further between the US and regions such as Europe.

We therefore expect a challenging investment climate to persist, where our intention is to maintain discipline and recognise that opportunities will present themselves.

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For more information speak to your financial adviser, call us on 1800 814 523, email mim.clientservice@macquarie.com or visit macquarie.com

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