

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	\$235.6m
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 December 2020

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-0.18	-0.22	-0.27	0.05
3 months (%)	0.20	0.08	-0.10	0.18
1 year (%)	5.62	5.10	4.48	0.62
3 years (% pa)	6.13	5.63	5.41	0.22
5 years (% pa)	5.25	4.75	4.56	0.19
10 years (% pa)	6.42	5.91	5.58	0.33

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.

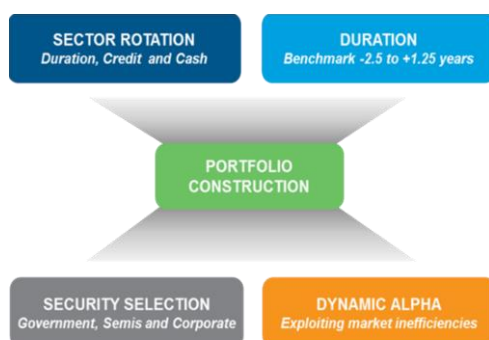
Benchmark is Bloomberg AusBond Bank Bill Index

Asset allocation (based on physical exposure)

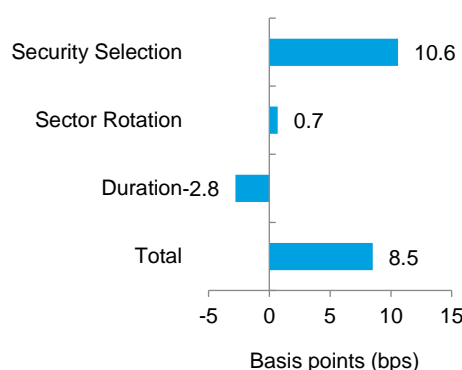
	Fund (%)
Government	51.0
Corporate	24.6
Semi-government	17.8
Cash and equivalents	6.6

Fund statistics

Credit spread duration	1.0 years
Interest rate duration	6.4 years
Yield to maturity (% pa)	1.05%



Key contributors to performance



Macquarie Australian Fixed Interest Fund

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Fund highlights

Financial markets ended a tumultuous 2020 with the expectation that the new year will be a pathway to returning to normality. Risk assets continued to rally into year end, buoyed by the news that mass vaccination has begun. But at its core, the rally has been underpinned by the unprecedented monetary and fiscal responses across the globe. Global sovereign yields, in contrast, only edged cautiously higher while embracing the fundamental reality that the global economy has experienced a massive deflationary shock as a result of the pandemic, and that the road to recovery is likely to be long and rocky.

The combination of very low sovereign bond yields and direct central bank support has been driving a search for yield by investors. This was illustrated by the fact that high yield and emerging markets USD-denominated sovereign spreads were back to their February (pre-pandemic) levels despite the significant deterioration in macroeconomic fundamentals. While global sovereign yields are now higher than their mid-year historic lows, the overall level of yields has remained well below their pre-pandemic levels.

The Fund outperformed the benchmark this month, driven by security selection and sector rotation.

Security selection

The Fund has maintained an overweight to the belly of the Australian Commonwealth Government Bond (ACGB) curve, which offers favourable rolldown given the impact of Yield Curve Control on the front-end. The Fund continues to favour the ultra-long bonds given their steepness relative to global curves, though we have taken advantage of micro relative value opportunities in this space with a modest shortening of the 30 year holdings and offsetting extension of the 20 year holdings.

Within the semi-government portion of the Fund, we hold a bias towards the 8 to 12 year maturities where spread curves have been steep due to a supply-demand mismatch for different tenors, as issuers have preferred to term out their debt. The Treasury Corporation of Victoria and New South Wales Treasury Corporation spreads drifted slightly wider following their S&P rating downgrades in early December. Following on from this move, the Fund has been selling Queensland Treasury Corporation holdings into these two issuers, which now offer better value.

The Fund's outperformance in credit security selection over the month was in part driven by a further retracement in the spreads of higher beta and COVID-impacted names, such as Pacific National, Downer Group and Brisbane Airport, which tightened approximately 30 to 40bps over the month. Meanwhile, given the extent of the rally in low beta financial paper since April, most of the repo-eligible bank paper traded sideways in December. Over the month, the Fund participated in primary deals from issuers including Western Sydney University, University of Wollongong and AMP Life.

Sector rotation

The Fund has continued to hold an underweight to the semi-government sector, though the exposure has been held in the 8 to 12 year curve segment, which trades with a higher beta than the rest of the curve. This means the Fund should trade slightly longer than it looks optically. There is still material supply expected to come over the remainder of the financial year, though the impact of this will be partially offset by the Reserve Bank of Australia's (RBA) asset purchasing program. Spreads were broadly trending sideways into year-end, though there was some issuer-specific widening following the S&P rating downgrades in early December.

The Fund's long credit positioning benefitted performance as the rally in Australian credit continued. Further easing of restrictions and reopening of state borders drove the rally in Australian credit despite a jump in locally transmitted COVID-19 cases, which prompted state border closures in numerous states and new restrictions towards the end of the month. The strong technical tailwind continued to provide strong demand for higher beta assets, which helped drive outperformance in the COVID-impacted sectors.

Duration

The Fund has continued to hold an overweight bias to duration, with the long position expressed in the belly of the swap curve. We believe this positioning offers favourable rolldown due to the RBA's anchoring of the front-end through Yield Curve Control.

Market review

Australian bond market

Australian bonds have continued to take their lead from the offshore price actions. Yields climbed early in December in sympathy with volatility in the US Treasury market, with 10 year domestic yields briefly climbing back above the 1% level before stabilising again following the futures roll during mid-month. Benchmark 10 year ACGB yields closed the month 7bps higher at 0.97%, while the front-end of the yield curve remained contained given the current RBA policy.

Following suite of new policy measures in November, there was nothing noteworthy out of the RBA December meeting, with continued guidance that policy will remain accommodative for an extended period of time, and the Board is 'prepared to do more if necessary'. The market focus has already started to shift towards what will happen at the end of the RBA's 6-month purchasing program; whether it will be extended, and if so, in what size. COVID-19 cases in New South Wales began to rise again into year-end, prompting another round of border closures and further clouding the economic outlook.

The Australian government's Mid-Year Economic and Fiscal Outlook revealed a slightly better fiscal outlook, with the estimated deficit for the current financial year reduced from \$214bn to \$198bn. This improvement was largely driven by a faster-than-expected recovery following the initial round of COVID lockdowns, as well as an improvement in commodity prices. While this estimate still constitutes a hefty 9.9% of gross domestic product, S&P have indicated that they will be looking through the deficit in the short-term, as the pandemic response is not representative of the government's usual fiscal approach. Following the update, the Australian Office of Financial Management announced a \$10bn reduction to their nominal funding task, down to \$230bn.

S&P also announced a double-notch downgrade on Victoria to 'AA/Stable' in December, along with a single-notch downgrade on New South Wales to 'AA+/Stable'. The announcement drove a modest widening in Treasury Corporation of Victoria and New South Wales Treasury

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Corporation spreads. While the market had been anticipating a downgrade on Victoria for some time, consensus had been for only a one-notch to AA+.

Global credit market

Most asset markets performed well in December, wrapping up a remarkable year of financial market performance. Most sectors in fact closed out the year close to or better than levels from the beginning of 2020, recovering historically steep losses experienced in almost all asset classes in March. The rebound of the second half of 2020 continued in December. Many markets set new highs (or tights in spreads, for credit markets) even as the economic fundamentals lagged, while virus news got steadily worse in the northern hemisphere. Overall, USD IG spreads closed the year at 96bps, the S&P 500 Index finished up 16%, and the 'tech-heavy' NASDAQ was up 43%, far removed from the pain earlier in the year and an unprecedented rebound.

The compression in spreads continued to be the theme for credit markets in December, repeating similar moves in November as investors embraced the vaccine progress and sought 'laggard', virus-impacted sectors. In this vein, high yield (HY) outperformed IG credit and the lowest rung of HY (CCC-rated) outperformed all other rating bands, tightening by 90bps (single-A spreads only tightened by 6bps, in comparison). Virus-impacted sectors were the outperformers. IG airlines tightened by 35bps, with similar moves in hotel and REIT names.

Interestingly, heavily impacted sectors such as airlines performed well against a deteriorating virus news backdrop. New lockdowns and tighter restrictions were announced across Europe, with some regions returning to restrictions almost as severe as those in the initial weeks of the pandemic. In the US, case counts and hospitalisations broke all previous records. In addition, the difficulties of implementing mass vaccinations became steadily more apparent, with progress in delivering the vaccine (and even providing approvals) moving much slower than target pace. Investors have clearly continued to take a longer-term view that the most directly impacted sectors will recover strongly once a vaccine is rolled out, and that another poor quarter or two of performance has limited bearing on the long-term investment thesis.

Politics were again a theme during the month. Firstly, an 11th hour Brexit deal was finalized after years of negotiations and numerous delays. While the details of the deal and its implementation are not immediately positive, the fact that a deal was done removed a significant tail risk, particularly for UK-linked assets. More importantly, from an overall market perspective, the US finally agreed a new \$900bn round of fiscal stimulus, including direct payments and support to specific impacted industries. The politics and the tedious negotiations involved in getting these agreements in place have indicated the difficulty of continuing to provide much-needed, long-term support to individuals and businesses hit hard by the pandemic and subsequent lockdowns.

Overall, credit markets finished on a strong note, with lower issuance volumes and market liquidity reflecting the traditionally quieter holiday period. In Europe, in particular, total credit issuance volumes were only €9bn and occurred almost all in the first week of the month, a significant step down from previous months. Similarly, but less extreme in the US, \$42bn was issued, bringing the year's total to over \$1.8tn, by far a record.

Australian credit market

Australian credit market capped off a strong year of performance, driven by unprecedented monetary policy easing put in place to counter the economic impact of COVID-19, though it slightly underperformed global IG credit markets in December. The positive performance in the Australian market could be attributed to the further reopening of state borders and a drop in COVID cases in the first half of the month. However, as locally transmitted cases started picking up again towards the end of the month in New South Wales and Victoria with new restrictions reintroduced, spreads performance stalled, though with limited flows given the holiday period. While most sectors continued to perform solidly in December, albeit at varying pace, with spreads generically tighter by 3bps over the month, it was again the COVID-impacted sectors that led the rally. This includes REITs, airports, and other higher beta industrial sectors, which tightened by 30 to 40bps in spreads over the month. Corporate issuance for the month totalled \$3bn, with half of it coming from Macquarie Bank's 5-year AUD floating-rate note transaction and the rest from Goodman Australia Industrial Finance, Western Sydney University, University of Wollongong, NBN Co, as well as subordinated debt issued by AMP Life.

Outlook

What are the themes that will shape 2021? First, the virus is still very much with us and likely to extend through the first quarter and probably longer. The global vaccination process has begun but the pace is expected to vary across geography, particularly depending on supplies and the particular choice of vaccine being used. While the manufacturing sector has continued to recover, the service sector in much of the northern hemisphere has been devastated. The overhang of unemployment and destruction to many small businesses will likely take a number of years to get back to where things were in January 2020. Central bankers have extended their already massive level of support to unbelievable levels, with a commitment to do even more if necessary. Left wing politicians have been arguing for years for an expansive fiscal policy, and in 2020 budget deficits and debt soared globally. However, we would argue that the expansion of fiscal policy was largely due to the delivery of necessary 'support' to those most severely impacted by the pandemic, rather than 'stimulus'. This will be a challenge of 2021, that is, whether governments can shift their support to growth-generating stimulus.

What about valuations? Risk assets have ended the year at levels that seemingly ignored the fundamental shock to the economy. The solving ingredient is the overwhelming policy support. Central bankers have acted, since the financial crisis of 2008, to contain each crisis with increasing levels of stimulus. In addition, lessons have been learned from actions to reverse, for example, the taper tantrum (2013) and the Fed tightening through 2017-18, such that markets are assuming that the bar for policy reversal will be much higher in the future. Turning to fiscal policy, where politics has often been seen to get in the way of common sense, it is far less certain how the path will look in 2021. So our expectation is that the decisions made on fiscal policy could be an important driver on how asset markets re-assess their outlook through the coming year.

To date, we have acted to participate in the risk asset rally, leveraging sector rotation, assessment of credit quality, curve and name selection to generate performance. Duration holdings have been near historically low levels and we expect it to gradually accumulate if yields push higher.

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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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