

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	\$230.3m
Distribution frequency	Quarterly
Management fee*	0.490% 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 November 2020

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.02	-0.02	-0.11	0.09
3 months (%)	1.59	1.47	1.25	0.22
1 year (%)	4.05	3.54	3.04	0.50
3 years (% pa)	6.03	5.53	5.33	0.20
5 years (% pa)	5.38	4.87	4.68	0.19
10 years (% pa)	6.45	5.94	5.61	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.

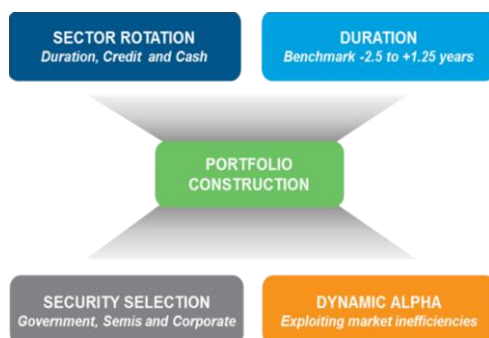
Benchmark is Bloomberg AusBond Bank Bill Index

Asset allocation (based on physical exposure)

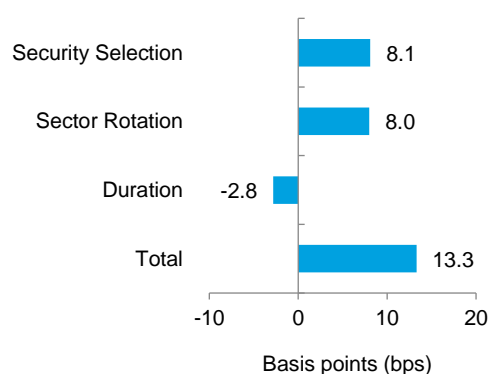
	Fund (%)
Government	52.3
Corporate	28.2
Semi-government	18.0
Cash and equivalents	1.5

Fund statistics

Credit spread duration	1.2 years
Interest rate duration	6.4 years
Yield to maturity (% pa)	1.03%



Key contributors to performance



Macquarie Australian Fixed Interest Fund

Monthly report – 30 November 2020

Fund highlights

November was a solid month for financial markets, driven by positive news on vaccines and more clarity on the outcome of the US election. During the month, three different vaccine developments released results, which showed efficacy at the upper end of expectations, which has raised hopes for a return to more normal life in 2021, much quicker than that had been expected just a month ago. On the US election, a contested result was a source of concern for investors, and while that spectre was briefly raised in the aftermath, the formal process of transition to President-elect Biden has begun. Two potential disruptive concerns are being overlooked at present, namely the logistics of distribution and vaccination for the global population, and a split US Congress.

The pattern of performance in November was led by risk assets across multiple asset classes. In fixed income, high yield credit led the way, while in currencies it was emerging markets. There was a rotation out of safe havens, with gold (-5.4%) and silver (-4.3%) giving back some of their strong gains of recent months. Notably though, global bond yields were resilient, with both US and European yields ending the month lower and spreads in peripheral Europe becoming tighter. However, New Zealand and Australia were the underperformers as their yields rose over the month.

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 curve, which offered favourable rolldown with scope for further performance, as the new 5-year futures contract drove marginal increases in liquidity and demand for bonds in the new basket. The Fund has continued to favour the ultra-long bonds given the steepness relative to global curves as well as their capital efficiency, and used the syndicated tap of the 2041 Australian Commonwealth Government Bond (ACGB) to add to the position in November.

Within the semi-government portion of the Fund, we have favoured securities in the 8 to 11 year curve segment, where spread curves have been steep due to a supply-demand mismatch for different tenors, with issuers preferring to term out their debt. We have continued to switch part of the AA holdings into 10-year Treasury Corporation of Victoria (TCV) bonds, which now offers better value. While we still expect that, due to deterioration in budget positions along the east coast, current credit rating divergence across issuers is unlikely to persist, we believe this is largely in the price with 10-year TCV spreads already trading slightly wider than the other issuers.

The Fund's outperformance in credit security selection in November was mainly driven by a substantial retracement of spreads in high beta and COVID-impacted names such as Qantas, Brisbane Airport, as well as some of the shopping centre REITs. Notably, the Qantas and Brisbane Airport 2030 bonds tightened by 90bps and 50bps respectively in November. Meanwhile, most of the lower beta financials such as major bank 4 year senior paper only edged 5 to 10bps tighter over the month. During the month, the Fund participated in primary deals from issuers including Australia and New Zealand Banking Group, National Australia Bank, Ampol, Bendigo and Adelaide Bank, NBN Co and AGI Finance.

Sector rotation

The Fund began the month with a modest underweight to the semi-government sector, though our exposure has been to the 8 to 12 year curve segment which trades with a higher beta than the rest of the curve. This means the Fund has been trading slightly longer than it looks optically. Spreads continued to narrow early in November as the Reserve Bank of Australia (RBA) included semi-government securities in their regular asset purchasing program, and we used this as an opportunity to make further reductions to the Fund's semi-government exposure.

As the larger States released their budgets and announced sizable funding tasks, issuance expectations began to weigh on the semi-government market, with spreads drifting wider over the latter part of the month.

The Fund's long credit positioning benefitted performance as Australian credit spreads rallied strongly along with global risk markets in November. An additional driver of outperformance in the Australian credit market was the comprehensive package of easing measures from the RBA, which encouraged greater investor risk appetite further out the risk spectrum. The Fund's performance benefitted significantly from the easing of State restrictions, especially in Victoria, and the gradual border reopening as COVID-impacted sectors such as airlines, airports and other higher beta industrial names outperformed other sectors.

Duration

The Fund has been positioned with an overweight bias to duration, though this has been actively managed around yield levels and supply events over the month. The long position has been expressed in the belly of the swap curve, which offered favourable rolldown due to the RBA's anchoring of front-end yields.

Market review

Australian bond market

Australian bonds took their lead directionally from global market drivers in November, with the US election and unwind of the blue wave trade being a focal point early in the month. Though attention quickly shifted to the positive vaccine news, with both the Pfizer/BioNTech vaccine and the Moderna vaccine showing efficacy rates of well above 90% after phase-3 trials. While this news initially pushed yields higher, the price dip was quickly bought as bond markets weighed the likelihood of an imminent vaccine against the rising case numbers and increased social distancing measures in Europe and the US.

Domestic rates slightly underperformed equivalent global maturities over the month, due to skewed market positioning in anticipation of the well-telegraphed monetary policy easing. Having spent several months signalling that further accommodation was imminent, the RBA delivered on these expectations at their November Board meeting, announcing a cut in the cash rate, term funding facility rate, and 3-year yield target from 0.25% to 0.10%; a cut in the rate on excess Exchange Settlement balances from 0.10% to 0.00%; and a \$100bn purchasing program across the 5 to 12 year Commonwealth and State government securities over a 6 month horizon, which will commence immediately

Macquarie Australian Fixed Interest Fund

Monthly report – 30 November 2020

and run in addition to any buybacks required to keep the 3-year yield at target. Approximately 80% of the program will be in ACGBs and the remaining 20% in semi-government holdings. Remarks from Board members continue to suggest policy will remain accommodative until employment outcomes improve and inflation reaches target.

During November, the RBA also announced that due to the increase in outstandings they were permitting authorised deposit-taking institutions to increase their reasonable holdings of high quality liquid assets (HQLA) to 27% by the end of 2020, and up to 30% by the end of 2021, effectively bringing the 30% threshold forward by 3 years.

During November, many of the larger State Government budgets were released. The RBA had been vocal that the State Governments needed to do more to support the economy following the pandemic. In general, the numbers aligned with a 'Team Australia' mentality, with further deteriorations in budget positions and sizable issuance programs announced due to the need for fiscal support. Funding tasks are particularly large for the AAA-rated States, with Treasury Corporation of Victoria announcing \$45.8bn of supply and New South Wales Treasury Corporation announcing a \$35.8bn program for the current financial year. Queensland Treasury Corporation intended to issue \$21bn worth of bonds, broadly in line with their estimates at the last update. Semi-government spreads continued to narrow earlier in the month as the RBA commenced quantitative easing, but retraced later in November as investors took stock of the sizable issuance ahead.

Benchmark 10-year ACGBs ended the month 4bps higher at 0.90%, with the 10-year spread to Treasuries dis-inverting over the latter half of the month to close at 5bps. The RBA's Yield Curve Control policy continues to keep the front-end of the curve contained, with benchmark 3-year bonds closing the month nearly unchanged at 0.11%.

Global credit market

Markets entered into November with a cautious tone due to the uncertainty of the US election. However, we did see a strong performance in risk assets on the back of a Biden victory despite the outcome not being as certain as had been expected, with the House remaining split. This performance was assisted by three positive announcements in relation to a COVID-19 vaccine, even though case counts had risen sharply both in Europe and the US.

US credit markets performed well during the month, with most of the performance driven by large gains in the 'recovery' trades over the month. This clearly reflected the better than expected efficacy results in the key vaccine candidates from Pfizer and Moderna, which appear likely to receive emergency authorization and first uses before the year is over. The moves were broad-based but weighted to sectors most impacted by the virus, such as travel and leisure. For example, airline spreads tightened by over 100bps in November for some issuers. But even less affected sectors generally performed well, with the average spread on senior financials falling by almost 20bps. Issuers with lower credit ratings generally outperformed, mirroring the previous few months, with BBB credit outperforming single A and high yield (HY) generally outperforming investment grade (IG).

In a surprise move, the US Treasury announced that they were requesting a return of any remaining funds from the US Federal Reserve's emergency bond-purchasing programs, effectively ending these facilities at the end of 2020. The programs were hugely successful, in that they returned function to credit markets, were a key factor in driving credit spreads tighter since March, and has so far spent very little money relative to the amount initially set aside to fund those programs. In the last several months, the secondary market corporate credit facility (SMCCF) was only spending around \$US100m on average per week, a drop in the ocean compared to monthly issuance volumes that routinely exceed \$US100bn. The market took the withdrawal in stride given the backdrop of positivity around vaccines, and expectations remain that similar programs would be returned to service if historically significant volatility were to return to credit markets.

Issuance volumes remained solid and ahead of expectations, despite earnings season, the election, and other events during the month. A total of almost \$US100bn was issued, though the theme of continued strong maturities and tender activity means the amount of bonds being retired almost offset the new issue volume, with a total of less than \$US10bn net new issuance over the month. The theme of low (or negative) net new issuance is likely to intensify into year-end with lower new supply expectations, which should remain a strong tailwind to the market. New issuance was well received, such as large deals from US telecommunications provider Verizon and healthcare company Bristol-Meyers, and new issuance concessions remained low.

Positive news on vaccine results and a removal of uncertainty surrounding the US election outweighed the strong second wave of COVID-19 across the continent where national lockdowns are becoming more prevalent. European IG spreads closed the month 23bps tighter at 93bps, which was only 4bps from pre-COVID levels as the majority of defensive, central bank-eligible sectors now trade inside such levels. The IG credit index now yields a mere 0.24%, which is within touching distance of all-time lows as the proportion of the index trading at negative yields continues to grow.

Supply in November totalled only €41bn, below expectations especially on the corporate side, which added to the already strong technical tailwind for the market. The main themes this month were spreads compression, and outperformance of COVID-sensitive sectors such as transportation and leisure. Higher beta assets materially outperformed, with European HY tightening 111bps and Bank Tier 1 tightening 100bps as the 'chase for yield' mentality grows ever stronger. Within the COVID-impacted sectors, top performers included Ryanair, Heathrow Airport and InterContinental Hotels Group.

Australian credit market

Australian credit performed strongly, in line with global IG credit markets in November. In addition to the broader risk-on sentiment globally post the results of the US election, what also helped drive the performance in Australian credit was the RBA announcing a comprehensive package of easing measures, cutting rates by another 15bps. In addition, the RBA announced a reduction in the interest rate on Exchange Settlement balances from 0.10% to 0% and initiated a quantitative easing (QE) program to purchase \$100bn of government bonds. These policy actions catapulted the market into a chase for yield frenzy.

Most credit sectors outperformed, with spreads generically tighter by 20bps over the month. Unsurprisingly, with further easing of coronavirus restrictions and the gradual reopening of State borders, COVID-impacted sectors such as airlines, airports and other higher beta industrial sectors contributed the most to the outperformance of Australia credit over the month. In particular, Qantas bonds tightened by 80-85bps across the longer part of the curve. Corporate issuance added up to \$4.8bn, with \$1.2bn of this coming from a single 5-year fixed NBN Co

Macquarie Australian Fixed Interest Fund

Monthly report – 30 November 2020

transaction. Another \$1.9bn came from subordinated debt issued by National Australia Bank, Bendigo and Adelaide Bank, and Ampol (formerly known as Caltex). The Ampol transaction was of particular interest as it was the second AUD corporate hybrid deal in just over two months. Similar to the AusNet transaction, Ampol's hybrid deal attracted an enormous orderbook of nearly \$1.2bn.

Outlook

December is seasonally a good month for risk assets and indeed financial markets are in the mood to extend the rally started in November. However, the fundamental backdrop remains challenging. The services sector remains under pressure despite high hopes for a return to normal sometime during 2021. Virus cases are still rising globally, tight restrictions are in place across Europe and the UK, and pressure across the US is for tighter restrictions. These facts suggest a real risk for a double-dip recession in Europe and the UK. While the US is less likely to double-dip, we expect a bumpy ride through 4Q20, and possibly 1Q21. While the vaccine development is positive news, we consider what a return to normal would look like. Reflecting on the situation in January 2020, simply returning to that point, which will take several quarters for many countries, was an environment of uninspiring, low inflationary growth.

Financial markets are looking past the current fundamentals and focusing on the release of 'animal spirits' during 2021 once the vaccination process is underway. At their back is a very strong commitment by central banks to maintain easing monetary policy and even do more if necessary. Fiscal policy was significantly engaged during 2020 to counter the impact of the pandemic, and the support measures prevented a worst-case scenario for the global economy. Expectations are that fiscal support will extend through 2021 and that actual fiscal stimulus will also be embraced. However, with fiscal policy 'politics' involved, experience says that nothing can be taken for granted.

Thus, as we consider the 2021 outlook, the prospects are for a return to growth. However, the key risks are clear in that growth may disappoint, and that fiscal policy makers may either fail to deliver enough support or consider fiscal tightening. This environment suggests that fixed income investors should not be fearful of inflation and that yields are likely to remain lower for longer. The absence of yield in sovereign markets is expected to keep the hunt for yield continuing in riskier markets. Investment grade spreads are likely able to grind tighter in this environment, and we expect compression on high yield and emerging markets spreads. Though the path is expected to be pocketed by spikes in volatility as markets reassess fundamental risks and/or policy actions. In this environment, leveraging sector rotation, assessment of credit quality, curve and security selection will play an important part in portfolio performance.

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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