MACQUARIE

Macquarie Real Return Opportunities Fund

(formerly Macquarie Multi-Asset Opportunities Fund)

Monthly report – 31 March 2023

Investment objective

Aims to provide positive returns of 3% to 5% per annum above Australian inflation[1] over the medium term (before fees). It also seeks to provide regular income.

[1] Defined as the Consumer Price Index (**CPI**) as measured by the Reserve Bank of Australia Trimmed Mean and as published by the Australian Bureau of Statistics.

Key information

Fund details	
APIR code	MAQ3069AU
Inception date	30 September 2013
Fund size	$521.6m
Distribution frequency	Monthly
Management fee*	0.70% 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 statistics

Credit duration	1.5 years
Interest rate duration	4.1 years

Fund performance to 31 March 2023

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)	Australian inflation
1 month (%)	2.37	2.31	0.28	2.03	0.56
3 months (%)	3.44	3.26	0.79	2.47	1.70
1 year (%)	-0.22	-0.91	2.04	-2.95	6.98
3 years (% pa)	3.72	3.00	0.73	2.27	3.61
5 years (% pa)	5.55	4.79	1.08	3.71	2.80
Since inception (% pa)	5.03	4.24	1.61	2.63	2.47

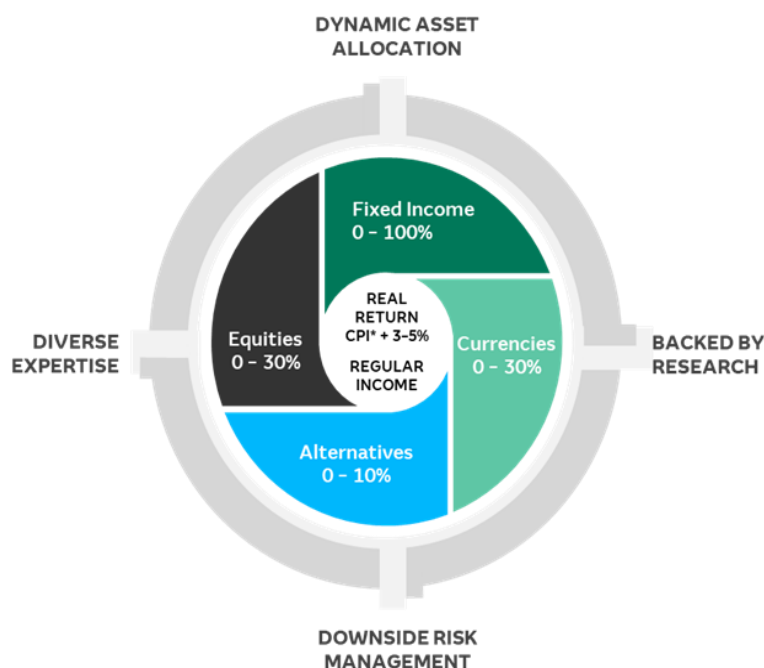
Past performance is not a reliable indicator of future performance.

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



Sector	Security Type	Fund (%)
Fixed income and cash	Investment grade credit	36.8
	Structured securities	3.8
	High yield credit / Emerging markets debt	10.3
	Cash and government bonds	36.5
Listed equities	Australian equities	3.4
	International equities	0.3
Alternatives	Alternative assets	8.9

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Fund performance and positioning

The Fund delivered a positive return over the month, which was driven by both the Model Portfolio's growth asset and defensive asset exposure.

Asset allocation changes

In March, market performance was driven by lower-than-expected inflation prints as well as a crisis of confidence regarding segments of the banking sector. During the month hedged international and Australian equities delivered mixed results with volatility increased significantly, contributing +2.6% and detracting -0.2%. With regard to fixed interest, the sector delivered a positive result, contributing +3.2% domestically and +2.5% offshore.

Our Fund maintained a highly defensive stance. Given the market conditions, we continue to anticipate the possibility of increased volatility and plan to maintain this position for the time being. However, if growth assets show significant improvement in valuation or global monetary policy becomes less aggressive, we will re-evaluate and adjust our focus to capture upside opportunities within growth assets.

During the month, we bought Australian equities taking profit on put option protection we acquired in January. We also noted a substantial decrease in volatility, particularly in Australia and Europe, in late March. We see this as an opportunity to utilise some of the profit we gained from our delta-hedging activities to acquire more put-option protection with expiry extended to September.

Asset allocation strategy and outlook

In first quarter of 2023, the market has been impacted by a number of developments, including the liquidity crisis at Silicon Valley Bank and the "forced marriage" between UBS and Credit Suisse. The complete write-off of Credit Suisse's additional tier one (AT1) capital before equity holders, despite AT1 ranking above equity in the corporate capital structure, had significant implications for most market participants. (See banking crisis of confidence further down)

Macroeconomic developments continue to develop unfavourably, with inflation remaining above central bank targets and therefore a continuation of restrictive monetary policy. Many market participants expect the US Federal Reserve (Fed) to pause rate hikes after the 25bps increase in interest rates in March, regardless, we view the current level of interest rates as restrictive enough to have a significant impact on corporate earnings, unemployment, consumption, and asset prices. The crisis in confidence engulfing the banking sector will likely lead to a further reduction in credit availability.

In Australia, the Reserve Bank of Australia (RBA) increased the cash rate by 50bps during the quarter. The market has now priced in a peak RBA cash rate of 3.6%, with the first rate cut expected in September this year. However, should the RBA indeed cut rates in September, despite a level of inflation likely still considerably above its price stability target, we expect the market will subsequently start to price in either an imminent recession or decline in financial stability.

In terms of tail risks, we have previously highlighted that sustained high levels of interest rates increase the probability of such events. As such, while it is difficult to identify exactly where tail risks will unfold, including the recent banking concerns, we were broadly positioned for some such event. Given the significant tightening undertaken by global central banks and significant removal of liquidity, we continue to expect more tail risk events to unfold.

Overall, the market movements in March have demonstrated the importance of defensive assets during times of stress, as they can provide a significant capital buffer to our portfolio. We believe in the coming months market participants will increasingly focus on the risk of recession rather than inflation. Therefore, we maintain conviction in our defensive positioning, aiming to protect capital in the event of a recession. Additionally, our defensive position also provides us with ample room to pivot towards more growth-oriented assets should valuations improve meaningfully or if central banks begin to cut interest rates. This is a key focus for our Portfolio in 2023.

Banking confidence crisis

The market was disrupted by the development of Silicon Valley Bank liquidity crisis, as well as the "forced marriage" between UBS and Credit Suisse. The complete write-off of Credit Suisse 's AT1 capital before equity holders, despite AT1 ranking above equity in the corporate capital structure, had significant implications for most market participants.

In our view, the events surrounding Silicon Valley Bank and Credit Suisse represented a crisis of confidence rather than concern over capital and asset quality. As such, we do not view this so-called banking crisis as leading to substantial problems in the financial markets or asset prices in the near term. However, the events that transpired have revealed several problems in the system, which, may have significant investment implications for the months to come.

Firstly, what caused deposits to fall at Silicon Valley Bank? A significant amount of Silicon Valley Bank depositors were tech start-ups, and with the Fed hiking rates aggressively, these cash-burning businesses are burning cash at an accelerating rate. However, these cash-burning activities are unlikely to slow or stop given regulators stepped in to provide protection for depositors and liquidity for the banking sector. As such, eventually it is reasonable to assume some of these start-ups will fail and leading to a broader credit problem for banks, which is much harder to solve compared to liquidity concerns.

Secondly, with confidence in regional US banks severely impacted, the cost of funding for regional banks is inevitably going to go up, which will limit lending and increase refinancing risks for existing clients. Once again, this issue will accelerate and magnify a potential credit problem.

Thirdly, why do regional banks exist, and who do they lend money to? In our view, this is the most critical question and will have significant investment implications. Since the GFC, banks in the US have been heavily regulated, but such regulations are primarily limited to big banks. As such, the cost of capital for big banks is significantly higher than regional banks, which is even more pronounced with commercial real estate and construction loans. As a result, borrowers are more attracted to borrow from regional banks due to the lower cost of borrowing, and regional banks are willing to lend it cheaper that big banks due to a looser regulatory environment. This phenomenon has benefited regional banks notably since the GFC. However, in our view, this has the potential to cause issues in coming months via the impact on commercial real estate.

Commercial real estate suffers from structural challenges post COVID-19 (given the shift to working from home), as such, occupancy rates are very low. Compounding this is the significant increase in funding costs due to the aggressively central bank hiking cycle, with the recent bank run worsen the issue. Therefore, both the top line (rent) and the cost (cost of borrowing) are deteriorating. The total size of US commercial real estate loans is approximately 5 trillion, with 2.5 trillion maturing in the next 5 years. Approximately 70% of these commercial real estate loans are held by regional banks in the US. We struggle to see how all these commercial real estate loans will be refinanced and as such this may result in a broader credit crisis for regional banks.

In summary, the recent liquidity crisis in the banking sector is a negative but solvable problem in financial markets. Nevertheless, it reveals significant credit problems that may lie ahead should the risk-free rate remain at the current level. As a result, we continue to believe that our significant defensive bias within our portfolio is sound. Importantly, we also believe that our plan to pivot the portfolio into more growth-oriented investments if the central bank eases policy rates will be an appropriate response in the coming months.

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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

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.

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