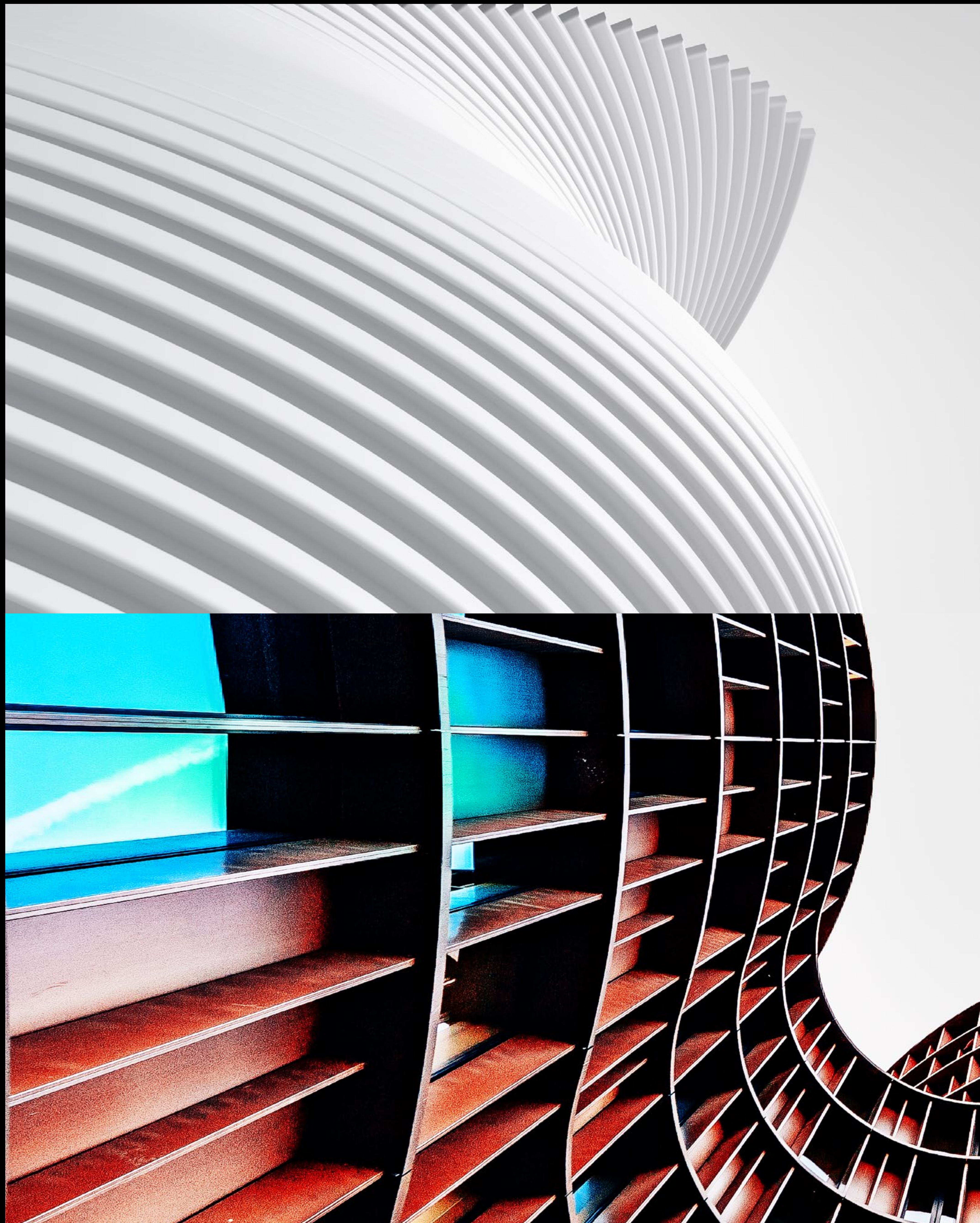
MACQUARIE

Macquarie Asset Management | Fixed Income

Staying Curious

Simple principles that have shaped a long term track record



Knowing where we are going starts with remembering where we have been

Macquarie Asset Management has been at the forefront of investing for more than 40 years – and the recent 20-year anniversary of the Macquarie Income Opportunities Fund is a unique vantage point from which to reflect on four decades of financial market history.

This period has been marked by a sequence of significant market events, from the floating of the Australian dollar and the Black Monday crash of the 80s to the bursting of the tech bubble in the early 2000s, the seismic shifts of the 2008 Global Financial Crisis and the unprecedented challenges of the pandemic and its inflationary aftermath.

Over 40 years, markets have provided a real-time laboratory for evaluating the principles of investment strategy, risk management, and asset allocation.

Longevity in markets is seldom a function of luck. Instead, it is the product of a dedicated 120-strong team of people intrigued by what it takes to create a sustainable business in investment management.

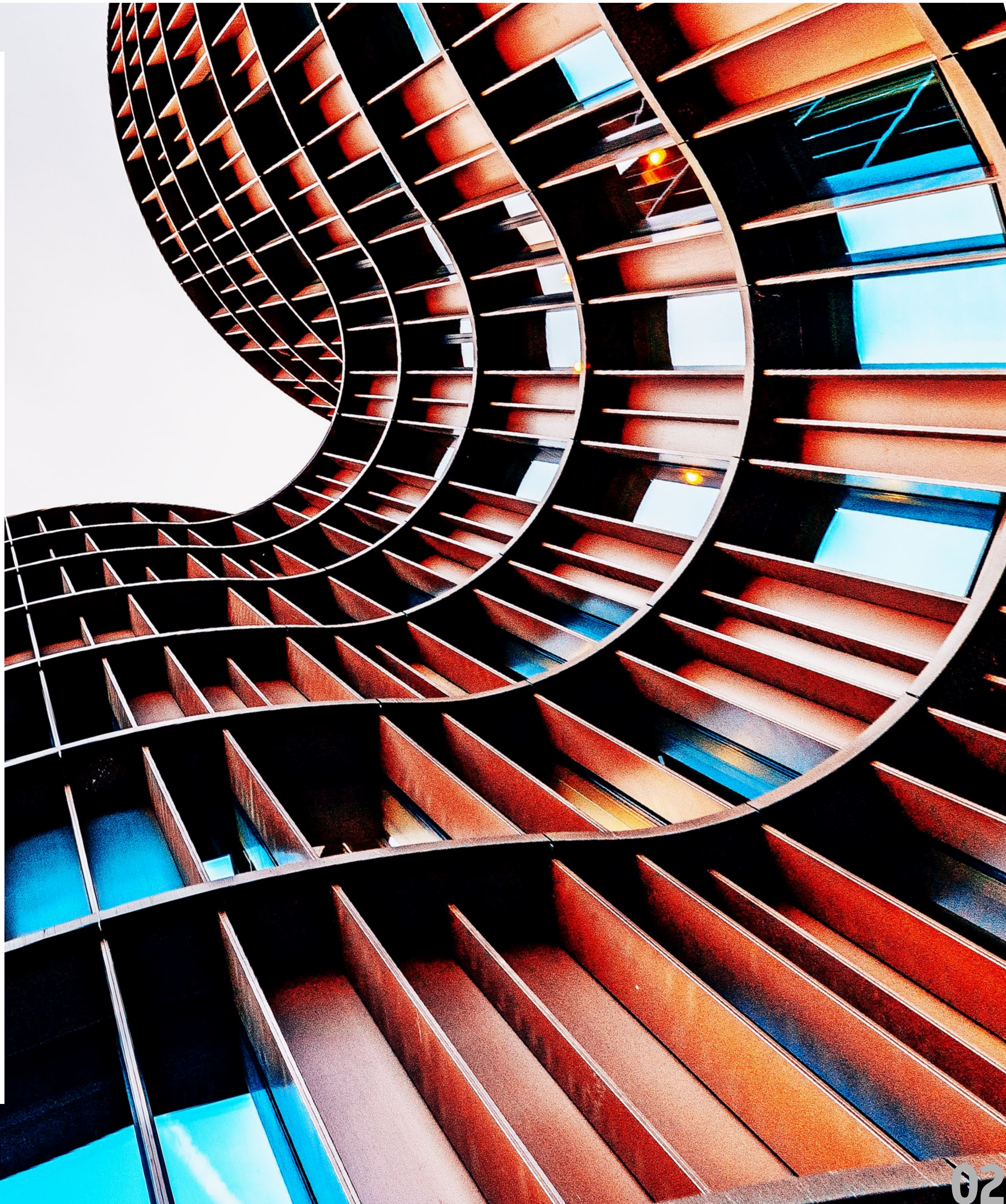
The financial landscape is constantly changing — shifts in the global economic landscape, advancements in technology, geopolitical changes, changes in regulation and the rise of sustainable investments have each made an impact.

Equally, clients are always evolving and adapting, as too are financial institutions.

The question then becomes — what does it take for an investment team to achieve sustained success amid constant change?

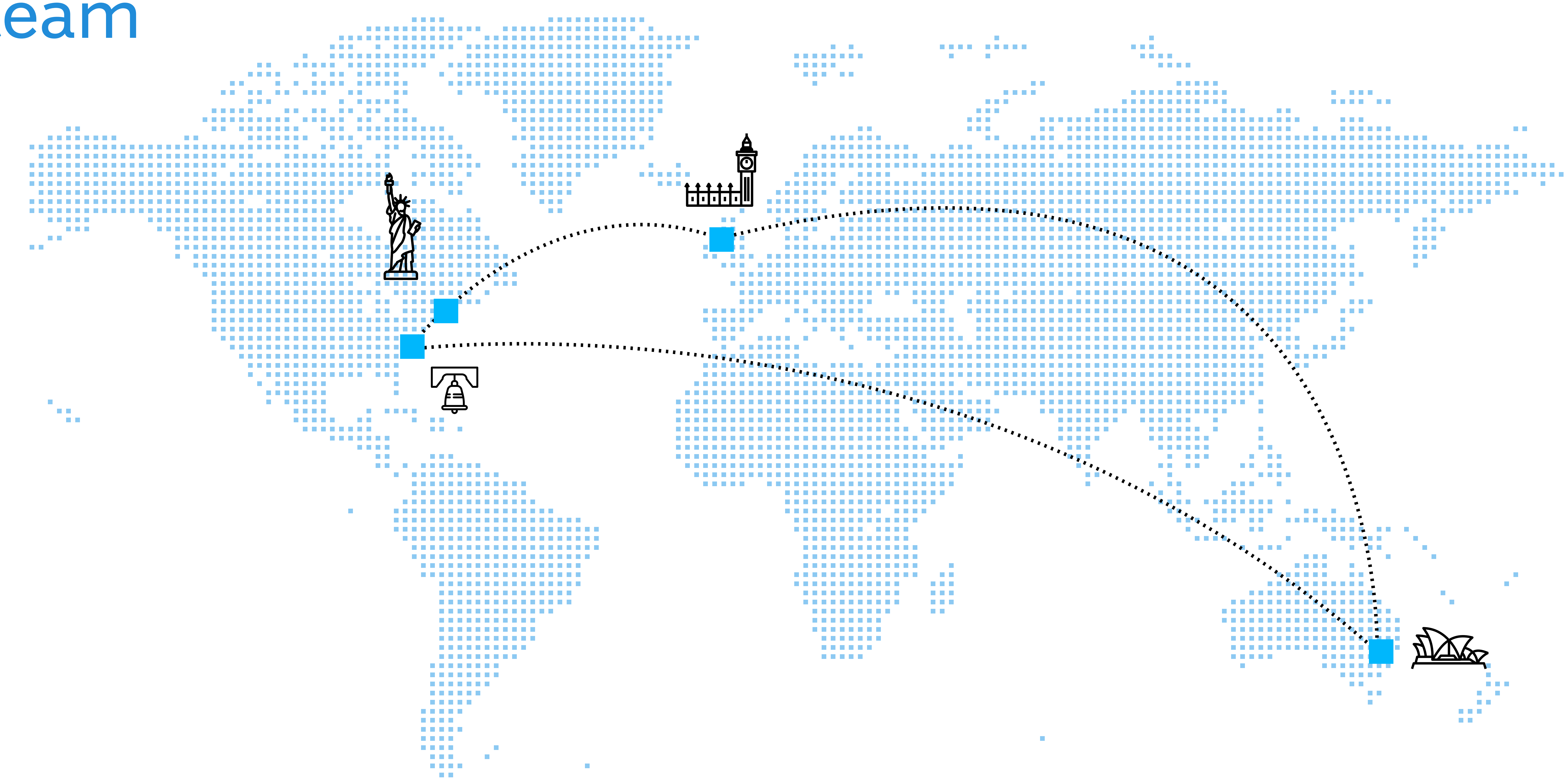
This paper distils the pertinent reminders of the often-forgotten principles from these past decades.

The intent is that these reminders are not merely a reflection but instead form part of a framework for informed thinking about markets in years to come.



A global presence and experienced team

Over **120 investment professionals** across **key global hubs**, managing over **$300bn in assets**.

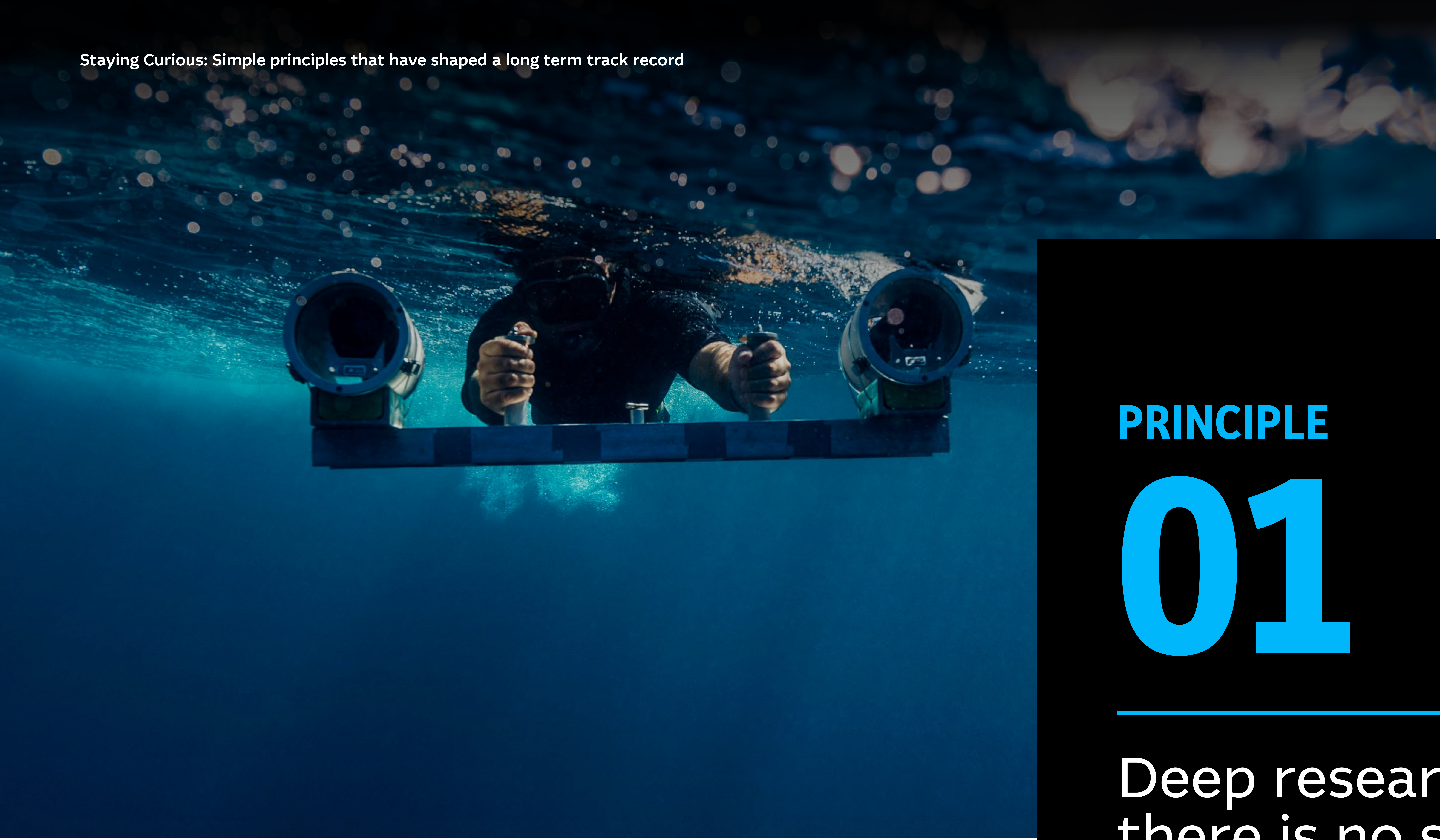


120 Investment professionals

11 Years of tenure

18 Average years experience

As at December 2023.



PRINCIPLE

01

Deep research: there is no substitute for doing the work

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Extracting value from markets requires deep fundamental research — building a top-down understanding of core market drivers alongside an in-depth, bottom-up analysis of individual opportunities.

Research can help understand and address irrational behaviour, identify and counteract vested interests and uncover patterns that help navigate the complexities of financial markets.

"Deep detailed research has always underpinned the way we think — whether it's investing in a company, thinking about the direction of financial markets, central bank decisions, or pivotal global themes like the nature of a pandemic," says Brett Lewthwaite, Chief Investment Officer and Global Head of Fixed Income at Macquarie Asset Management.

"When you do the work, when you have the amount of people that we have looking at the world, you produce evidence — and evidence over time will generally bear out."

In investing, it can be easy to fall into the trap of believing that the work is complete. When market conditions are favourable, there is a tendency to become complacent. However, as circumstances inevitably change, this behaviour can lead to losses or missed opportunities.

By way of example, the Macquarie Asset Management team's deep dive into the COVID pandemic in 2020 identified themes that many in the market were missing: that the pandemic would last longer than most thought, and that its effect would be deeply felt around the world.

"In mid-2020 these findings surprised us all, but history showed what occurs and sure enough that pattern played out — doing the work mattered!" says Lewthwaite.

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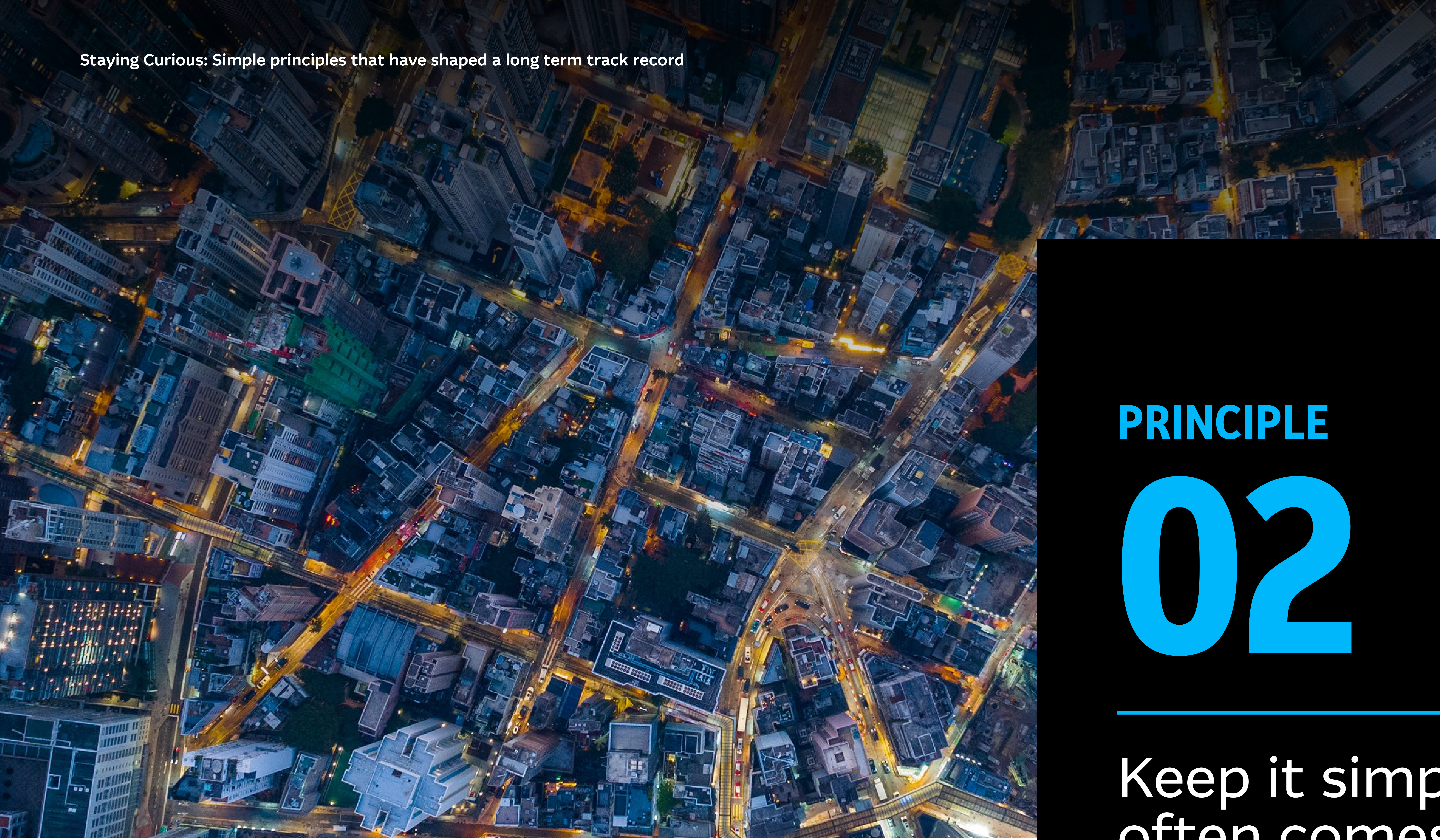

PRINCIPLE 02

Keep it simple: complexity often comes at a cost

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Keep it simple: complexity often comes at a cost

Complex investments that promise high returns with low risk and easy liquidity have consistently proven to be illiquid and unreliable, as witnessed during events like the sub-prime crisis and the speculative hype around assets like digital tokens and NFTs.

But time and time again, investors are drawn to the latest trends, overlooking complexity due to the fear of missing out and hope of high returns. Every cycle has a new wave of investing that people claim is fool proof, but what looks attractive on the surface inevitably gives way to the reality of investing.

“People are naturally drawn to the ‘new, new thing’,” says Lewthwaite.

“Our approach is to try not to get involved in complexity because complexity in financial structures generally means they make money and you bear the risk.”

Key questions remain eternal: do you deeply understand exactly what you are investing in? Are you being rewarded for the risk you’re taking? If you change your mind, can you easily get your money back at a price that you can see on a screen?

“Instead of trying to do the cool, new, new thing or get outsized returns, we keep it simple yet effective — it’s about investing in things you understand, focusing on returns that are achievable year in, year out, and getting a far more consistent outcome of ongoing growth.”

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PRINCIPLE 03

Understand the true nature of liquidity

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Liquidity appears simple: it's the ability to buy or sell in a timely fashion without significantly impacting price.

But what many miss is that liquidity comes and goes. Historically, portfolios with assets that are harder to sell tend to do worse when it's difficult to trade and can face even bigger losses when the market is stressed.

"In its worst form, you can be stuck with investing positions that you cannot sell at all," says Lewthwaite.

"That's why the key lesson for us is that you must always have liquidity on hand, understand the true nature of liquidity and ensure that you're being rewarded for it."

The textbook liquidity study is the GFC, when markets from structured credit to mortgage funds locked up. But liquidity events occur in all market cycles — during the pandemic, sovereign bond markets faced liquidity problems; post-pandemic, liquidity squeezes saw the collapse of multiple US banks.

"In any situation where there's market stress, it is liquidity that is always at the heart of these problems. It is people mismanaging liquidity risk or not anticipating how much they'll need when markets get into distress."

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PRINCIPLE 04

Reputations are earned in bear markets

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There's an adage in investing that bull markets take the stairs and bear markets take the elevator.

But experience shows it's not that simple — falling markets are not simply the faster mirror image of rising markets, but instead are characterised by a disorienting cycle of sudden drops, temporary recoveries, and then returns to decline.

Falling markets are highly volatile and the complacency bred in a rising market is quickly replaced by an escalating contagion and a confidence-sapping rollercoaster ride of anguish and fear.

"There are false dawns, bear market rallies where everyone thinks the worst is over before markets fall sharply again. It's very difficult to trade," says Lewthwaite.

JP Morgan's rescue of Bear Sterns in March 2008 prompted a 15 per cent market rally over two months, leaving markets within reach of previous highs. But less than a year later, markets had fallen a staggering 60 per cent.

The lesson? Keep a level head, do the research, keep it simple, and be careful with liquidity. Too many investors get out too late before rushing back in too early.

"Navigate through markets in a sensible fashion so that you come out the other side in a position to go again."

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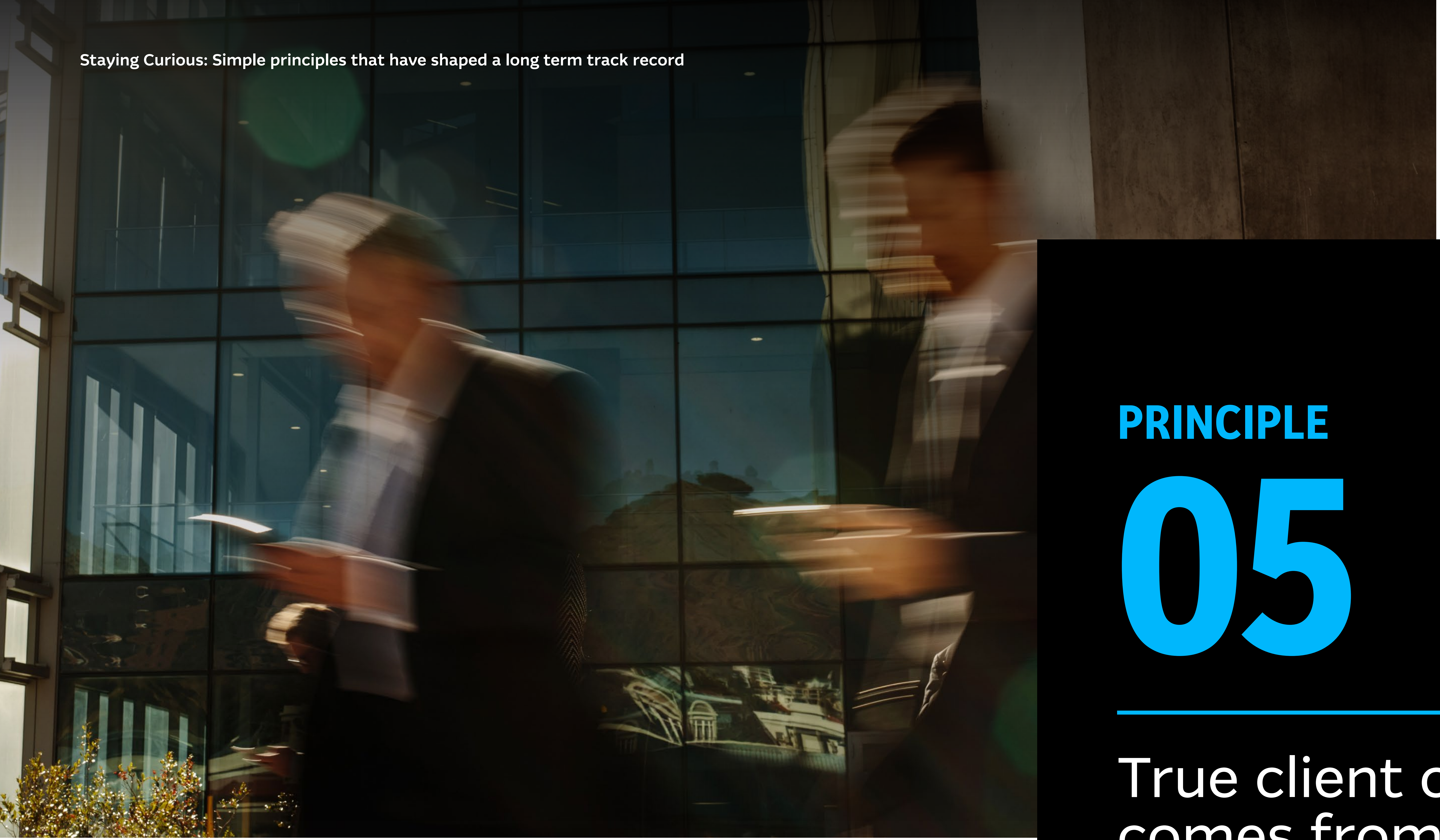
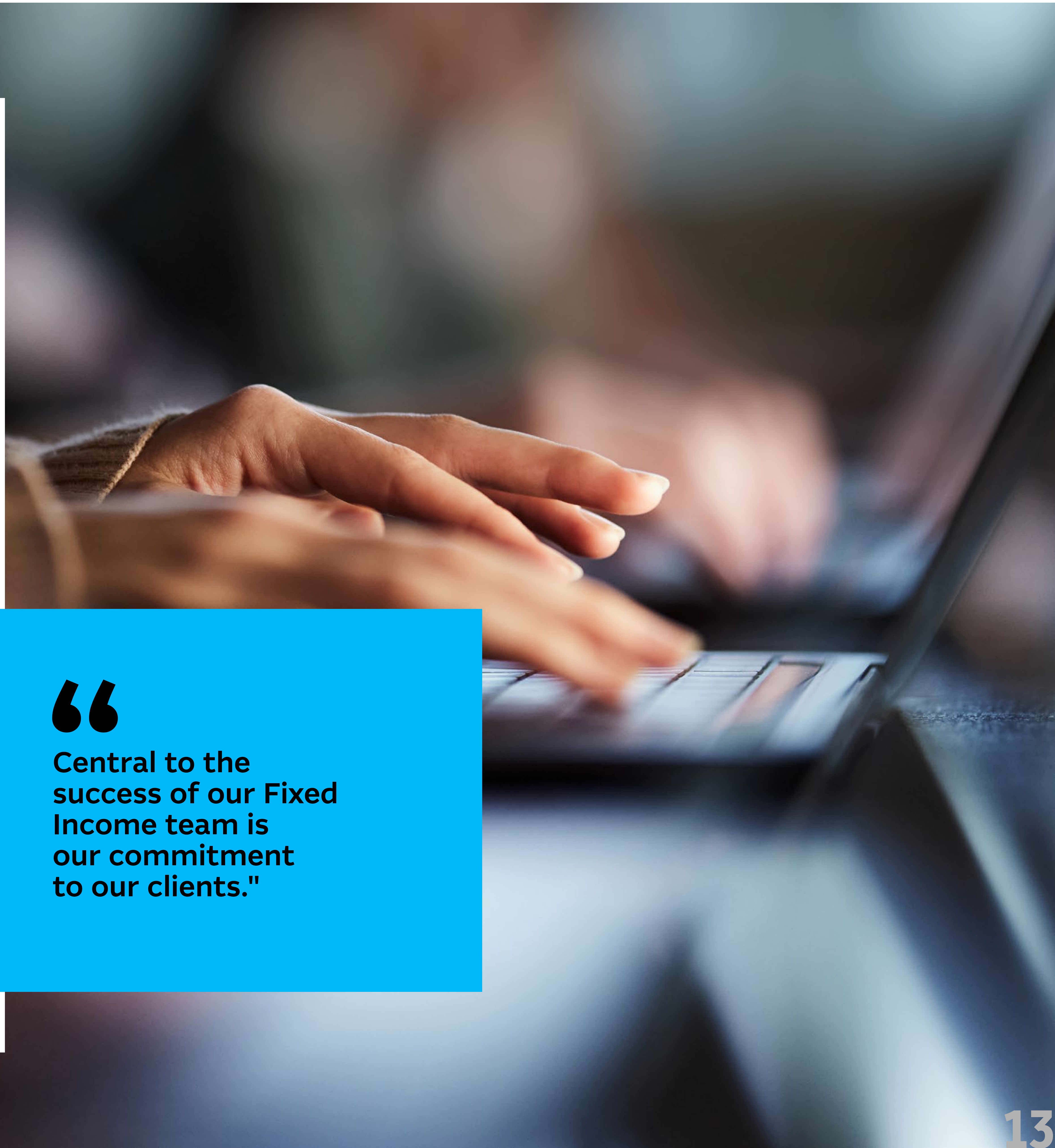


PRINCIPLE

05

True client connection comes from investing in your clients, not simply for them



PRINCIPLE 05

True client connection comes from investing in your clients, not simply for them

Financial markets can at times incite stress, fear, and panic. Understanding clients and maintaining constant, open, and frank communication, no matter how irrational markets may become, is essential.

“While we would all like to distance ourselves from the madding crowd, no one operates in a vacuum,” says Lewthwaite. “We navigated the GFC really well — we had a lot of liquidity; we didn’t experience the kind of losses that others did. But that didn’t stop some of our clients from selling — they made their own decisions for their own reasons.

“We know we must be prepared for this — even if you’re doing things right, even if you’re navigating things well.

“Central to the success of our Fixed Income team is our commitment to our clients.

“We firmly believe that clients not only judge us on our performance but also on our openness and engagement with them. We have developed long term and trustworthy partnerships and have been fortunate enough to have maintained some client relationships for over 20 years.”

> **“Central to the success of our Fixed Income team is our commitment to our clients."**

Knowing where we are going starts with remembering where we have been

1980
Macquarie launches Australia's first **Cash Management Trust**

1983
Australian Dollar is floated

1990
Macquarie launches flagship **Macquarie Treasury Fund**

1991
The recession 'Australia had to have'

1995
Launch of Macquarie's flagship **Australian fixed interest capability**

1997
'Investing in credit-based securities'— Underscores our philosophical belief that in fixed income management, it is more important to focus on managing the downside, rather than chasing yield

2001
DotCom Crash

2003
Launched the flagship **Macquarie Income Opportunities Fund**

'The value of liquidity'— Our research conducted in 2003 (and updated in 2014) demonstrated that liquidity risk is by nature, even more skewed than credit risk

2005
'Assessing risk in Residential Mortgage Backed Securities'— Publication detailing our Safety Factor Model, the only live database at the time of every Australian RMBS

2006
Macquarie's Fixed Income capability turns global, expanding footprint into the United Kingdom

2008
Global Financial Crisis

2010
'Inflation Series'— Launched to demonstrate the case that quantitative easing and money supply does not cause inflation

Macquarie's Fixed Income capability continues to expand globally, establishing operations in the United States

2011
'An Investigation into duration'— Demonstrated the team's duration process which has been founded on in-depth research conducted over many years

2013
'Crisis management—Managing investments through a crisis'. A proprietary tool to forecast market crises

2016
'Low, Lower, Negative'— Investigated the impact of once unthinkable negative policy rates, explaining why negatives rates would not solve the low growth problem

2017
A strategy redesign is undertaken, culminating in the launch of the award winning **Macquarie Dynamic Bond Fund**

2018
Emerging Market Debt capability enhancement

2020
COVID-19 Global pandemic

2023
Macquarie Fixed Income surpasses **A$300bn in assets under management** for clients globally

Macquarie Income Opportunities Fund 20 year anniversary

Launch of Active ETFs in Australia for the **Macquarie Income Opportunities Fund** and the **Macquarie Dynamic Bond Fund**

Conclusion

In drawing these lessons together, we arrive at an important insight: enduring success in investment management is not coincidental but rather the result of rigorous work, unwavering principles, and a deep commitment to clients.

Our legacy is built on a dedication to understanding and navigating the complexity and volatility of financial markets. It is the wisdom gained from this 40-year journey that shapes our ongoing approach.

The coming four decades will undoubtedly present investors with all new challenges — but the Macquarie Asset Management team's collective experience and proven approach should provide confidence in the continued delivery of consistent results for clients.

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