The 100-year storm: Every cloud has a silver lining

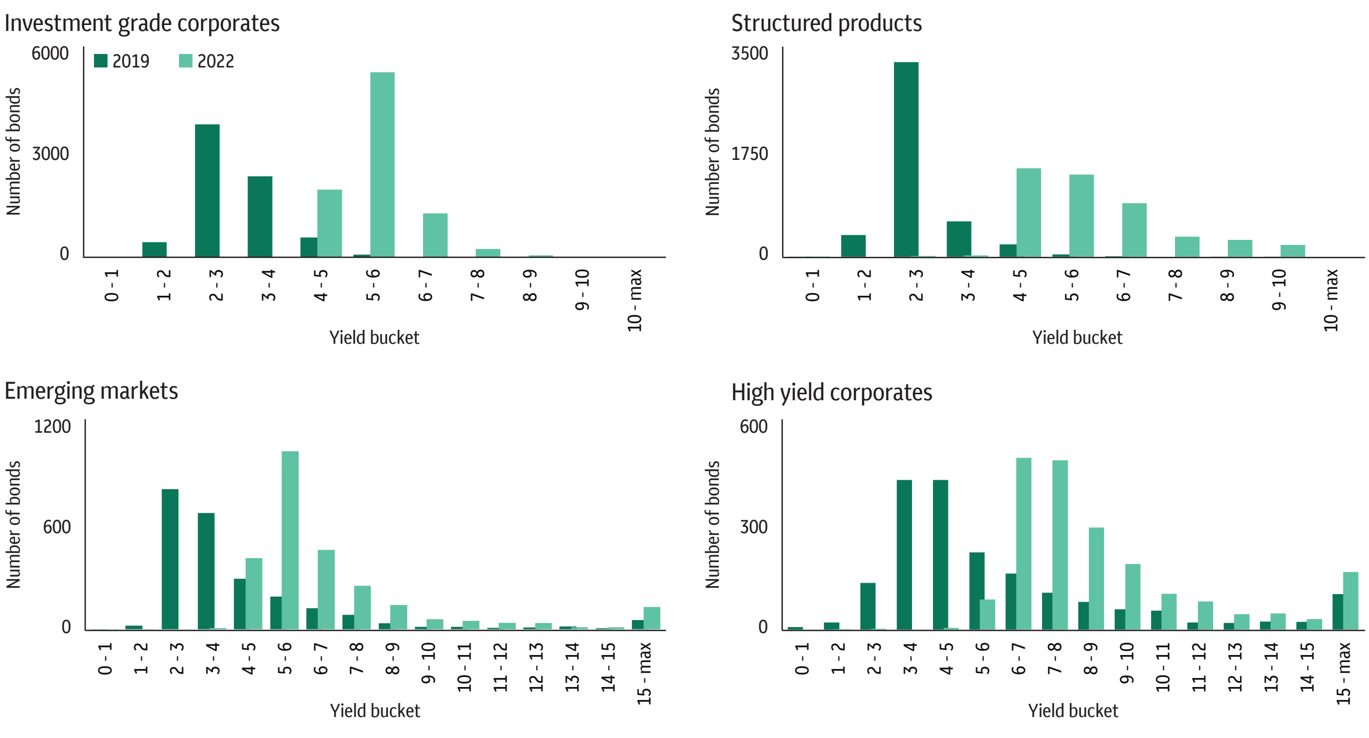
The case for Delaware Diversified Income Fund at higher yields

The basic principle of yield as applied to a single bond is easily understood by most clients. In bond-speak, "yield" means your expected return if a bond is held to maturity and does not default, and it includes any income reinvested at the same yield. Although buying a mutual fund is different from buying an individual bond, the features of cash flows generated are comparable since the source of income is the underlying bonds in the fund.

As we reflect on 2022, we are confronted with the worst year-to-date performance for bonds in modern history. A scary moment, no doubt, but to make informed decisions, it is important to recognize where we stand. In the past 12 months, we've seen an incredible 202% relative move in yields – the equivalent of a 7+ shift in standard deviation.[1]

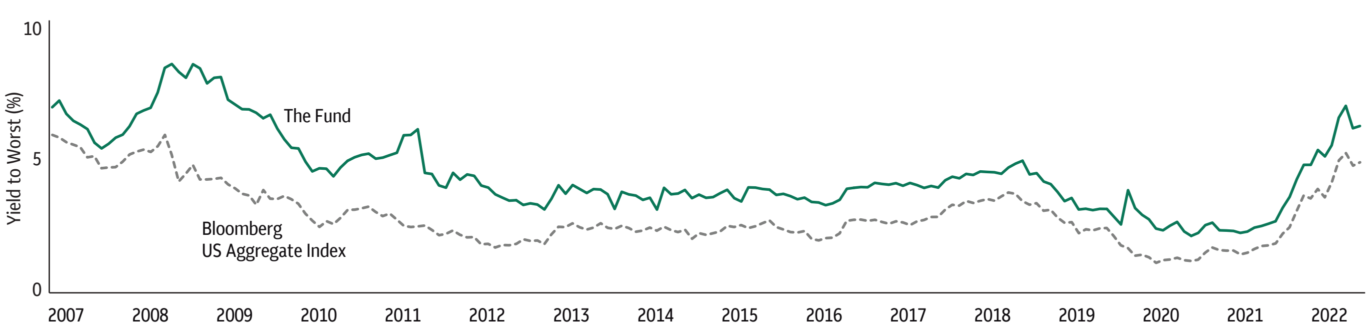
Just as rising tides lift all boats, rising yields have created opportunity in every corner of the multitrillion-dollar bond market. One no longer needs to desperately wander into minuscule, obscure, and risky corners of the market. **Figure 1** shows the dramatic shifts in yields across asset classes in 2022 compared with 2019. These levels recall a pre-global financial crisis (GFC) era in which retirees could have nearly all their retirement assets in bonds, collecting sufficient income. **Figure 2** shows 15 years of yield history for Delaware Diversified Income Fund (the Fund) versus its benchmark, the Bloomberg US Aggregate Index. Leveraging Macquarie Asset Management Fixed Income's robust research process and risk framework, the Fund has consistently outyielded its benchmark through time.

Figure 1. Dramatic shifts in yield across the fixed income market have made it possible to build well-diversified, higher-yielding portfolios
2022 yields vs. 2019 yields



Source: Bloomberg US Universal Index.

Figure 2. Delaware Diversified Income Fund outyields benchmark since the global financial crisis
Yield to worst



Sources: Macquarie Asset Management, Bloomberg.

1. Bloomberg US Aggregate Index since 1977.

Why put so much weight in starting yields?

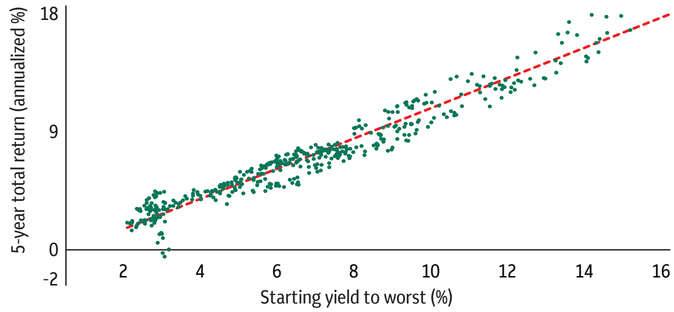
First, higher yields provide an income buffer in fixed income portfolios. One of the reasons 2022 was so difficult for the fixed income investors, is that when the Fed started raising rates in March, yields were at historic lows. At the beginning of 2022, the yield on the Bloomberg US Aggregate Index was 1.75% – offering very little income cushion. **Since March 16, the Fed has raised rates 4.25 percentage points, and since this timeframe, the total return on the index has been -7.9%.** Contrast this to 1980, when, over a five-month period, **Paul Volcker and the Fed raised rates 10.5 percentage points, and the total return impact was just -3.35%.** Why? Starting yields were above 10% during the Volcker era, and the income safety net helped provide a cushion. We believe that if rates continue to increase in 2023, medium-term (5-year) returns would be higher than if the Fed were to pivot and rates were to drop precipitously.

Second, we believe starting yields are an excellent predictor of medium-term returns. **Figure 3** plots the starting yield of the Bloomberg US Aggregate Index versus 5-year forward total returns (annualized). Using data going back to January 1980, we demonstrate a strong relationship between the two. Put differently, in the same way that holding an individual bond to maturity could result in earning its starting yield as the annualized return, holding a diversified portfolio of bonds for a medium duration could result in a similarly high degree of return predictability.

We can extend this analysis to the Fund. Using 10 years of monthly data, **Figure 4** demonstrates that about 60% of the time, the Fund's 5-year annualized total return was within 1 percentage point of its starting yield to worst. When returns did end up outside of that range, they were primarily to the upside, highlighting the potential value of Macquarie Asset Management Fixed Income's active approach. In **Figure 5**, we demonstrate that despite periods in which the Fund's 5-year total return "underperformed" its starting yield, in virtually every measurement period, it still significantly outperformed the benchmark.

Figure 3. A strong relationship between starting yields and forward total returns

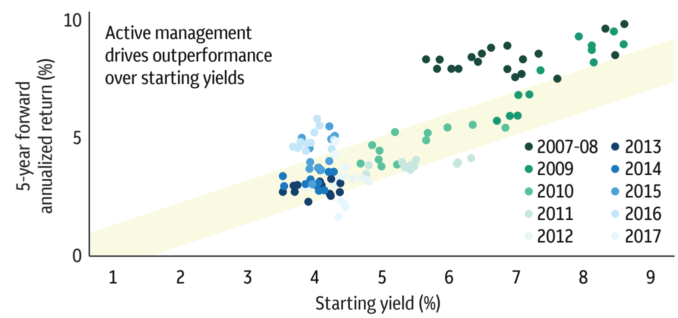
Bloomberg US Aggregate Index 5-year forward annualized returns vs. starting yield to worst*



*measured monthly, since January 1980
Source: Bloomberg.

Figure 4. Delaware Diversified Income Fund performance has been closely tied to starting yields

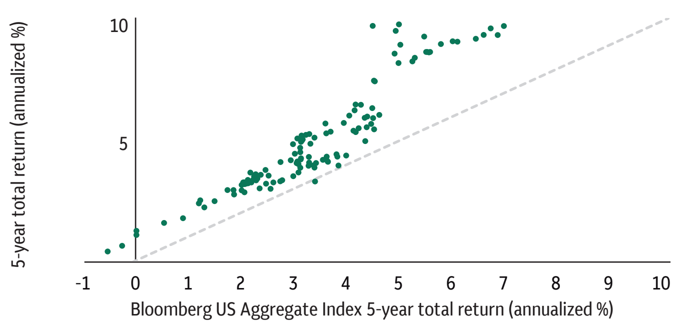
Delaware Diversified Income Fund 5-year forward annualized returns vs. starting yields*



*measured monthly, over last 10 years
Source: Macquarie Asset Management.

Figure 5. Delaware Diversified Income Fund consistent 5-year outperformance

Delaware Diversified Income Fund vs. Bloomberg US Aggregate Index*



*measured monthly, over last 10 years
Sources: Macquarie Asset Management, Bloomberg.

Great storms may afford great opportunity

What 2008 was for credit risk, 2022 will be for interest rate risk – both extreme events, gut-wrenching and perplexing. As we reflect on the actions of 2008 and the performance of the subsequent five-year period, we think the most compelling action would have been to overcome the fear and harvest for our clients the value that was created. We believe 2022 will be much the same. In our view, taking advantage of the Fund's compelling starting yields in 2023 and relying on the reassuring evidence of bond math offers the potential for solid longer-term returns with lower volatility than equities. Bonds are back, and we believe they can once again do what they were intended to do: provide the clockwork reliability of income.

For more information,
call us at 877 693-3546 or visit our website at delawarefunds.com.

Investing involves risk, including the possible loss of principal.

Past performance does not guarantee future results.

Carefully consider the funds' investment objectives, risk factors, charges, and expenses before investing. This and other information can be found in the funds' prospectuses and their summary prospectuses. Obtain a prospectus and summary prospectus by visiting delawarefunds.com/literature or calling 800 800 523-1918. Investors should read the prospectus and the summary prospectus carefully before investing.

The views expressed represent the investment team's assessment as of the date indicated and should not be considered a recommendation to buy, hold, or sell any security, and should not be relied on as research or investment advice.

The **Bloomberg US Aggregate Index** is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

Yield to worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting.

Macquarie Asset Management (MAM) is the asset management division of Macquarie Group. MAM is a full-service asset manager offering a diverse range of products across public and private markets including fixed income, equities, multi-asset solutions, private credit, infrastructure, renewables, natural assets, real estate, and asset finance. The Public Investments business is a part of MAM which includes investment products and advisory services distributed and offered by and referred through affiliates which include **Delaware Distributors, L.P.,** a registered broker/dealer and member of the Financial Industry Regulatory Authority (FINRA), and Macquarie Investment Management Business Trust (MIMBT), a Securities and Exchange Commission (SEC)-registered investment advisor. Investment advisory services are provided by a series of MIMBT. Macquarie Group refers to Macquarie Group Limited and its subsidiaries and affiliates worldwide. Delaware Funds by Macquarie refers to certain investment solutions that MAM Public Investments distributes, offers, refers, or advises.

Other than Macquarie Bank Limited ABN 46 008 583 542 ("Macquarie Bank"), any Macquarie Group entity noted in this document is not an authorized deposit-taking institution for the purposes of the Banking Act 1959 (Commonwealth of Australia). The obligations of these other Macquarie Group entities do not represent deposits or other liabilities of Macquarie Bank. Macquarie Bank does not guarantee or otherwise provide assurance in respect of the obligations of these other Macquarie Group entities. In addition, if this document relates to an investment, (a) the investor is subject to investment risk including possible delays in repayment and loss of income and principal invested and (b) none of Macquarie Bank or any other Macquarie Group entity guarantees any particular rate of return on or the performance of the investment, nor do they guarantee repayment of capital in respect of the investment.