Macquarie Investment Management

Macquarie Income Opportunities Fund

Monthly report – 31 December 2020

Investment objective

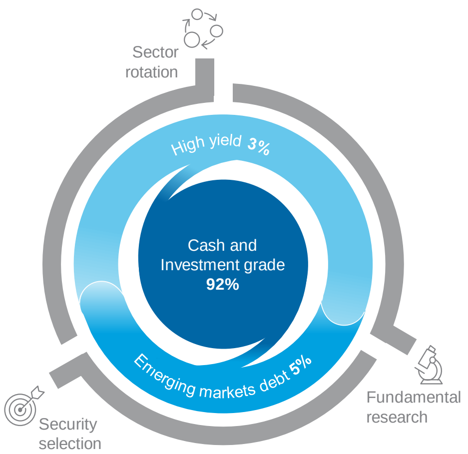
Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles.

Key information

Fund details	
APIR code	MAQ0277AU
Inception date	18 September 2003
Fund size	$3,317.2m
Distribution frequency	Monthly
Management fee*	0.492% 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.

Current sector breakdown



Sector limits	(min/max)
Investment grade	0/100
High yield	0/20
Emerging markets debt	0/15
Cash	0/100

Fund performance to 31 December 2020

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.41	0.36	0.00	0.36
3 months (%)	1.85	1.72	0.02	1.70
1 year (%)	2.52	2.02	0.37	1.65
3 years (% pa)	3.03	2.53	1.26	1.27
5 years (% pa)	3.73	3.22	1.52	1.70
10 years (% pa)	4.46	3.95	2.44	1.51
Since inception (% pa)	5.25	4.74	3.78	0.96

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.

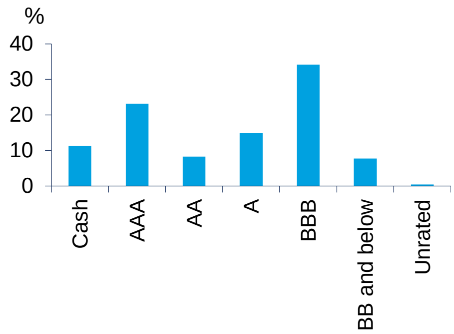
Asset allocation

	Fund (%)
Investment grade corporate^	48.4
Investment grade government	12.8
Asset-backed securities	19.6
High yield corporates^	3.3
Emerging markets corporate	1.7
Emerging markets government^	2.9
Cash	11.3

Asset-backed securities include but are not limited to residential mortgage backed securities, bank loans and other credit related securities.

^Fund holds 1.2% in investment grade, 0.9% in high yield and 0.1% in emerging markets credit hedges as synthetic cash (reduction in percentage of physical cash exposure).

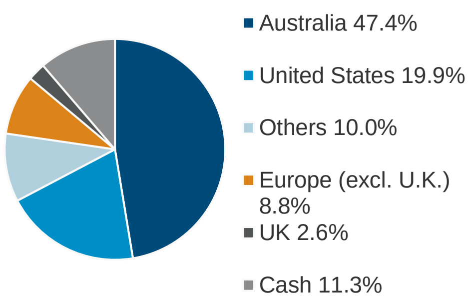
Credit profile breakdown



Average credit rating: A

BB and below include direct holdings and residual exposure to issuers held through our investment grade and emerging markets allocation.

Region breakdown



Fund statistics

Credit spread duration	3.3 years
Interest rate duration	0.9 years
Standard deviation[1]	1.8% pa
Yield to maturity[2]	1.3% pa
Cash	11.3%
Cash exposure through credit hedges[3]	2.2%

[1] Statistical measure of variance of Fund's post-fee monthly returns from average post-fee return since inception, used as gauge of volatility.

[2] Pre-fee returns Fund would earn over next year based on current market conditions if there were no changes to interest rates or holdings. It is not an actual or estimated return.

[3] Credit hedges swap the return for underlying credit index for cash.

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 in December, with continued vaccine positivity boosting the recovery and compression trades globally. Investment grade (IG) credit was again the largest contributor to performance. High yield (HY) and emerging markets (EM) debt were also strong contributors despite the smaller allocations, as these markets outperformed in the spread compression environment. Amongst individual issuers, infrastructure names such as airports and European toll roads issuers, as well as hybrids from utility provider AusNet, were top performers during the month. The duration exposure in the Fund was a modest negative contributor to performance in the month, as duration positions have been pared back significantly since earlier in 2020.

The Fund mostly maintained its overall risk exposure levels, with an allocation to global IG, some holdings of EM debt and HY, and significant levels of liquidity to take advantage of any market volatility. The allocation to global IG was trimmed early in the month, with much less spread tightening potential going forward from ‘generic’ IG credit (that is, not heavily virus-impacted) meaning that there are better risk-adjusted opportunities. Overall, the Fund maintained its barbell approach of maintaining strong portfolio liquidity and holding allocations to higher beta sectors and selected ‘recovery’ trades. We believe this has been appropriate given the backdrop of modest overall spreads, low yields, and the potential for volatility in the short- to medium-term outlook.

Market review

Global and Australian credit markets

The compression in spreads continued to be the theme for global credit markets in December. In the US, HY outperformed IG credit and the lowest rung of HY (CCC-rated) outperformed all other rating bands, tightening by 90bps. Australian credit market also performed strongly despite slightly underperforming global IG markets. It was again the COVID-impacted sectors that led the rally, such as REITs, airports, and other higher beta industrial sectors, which tightened by 30 to 40bps in spreads over the month.

Outlook

What are the themes that will shape 2021? First, 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 with a commitment to do more if necessary. In 2020, fiscal 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.

Second, risk assets have ended the year at levels that seemingly ignored the fundamental shock to the economy. The solving ingredient has been the overwhelming policy support. 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. Thus, 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