

Macquarie Income Opportunities Fund

Monthly report – 31 March 2022

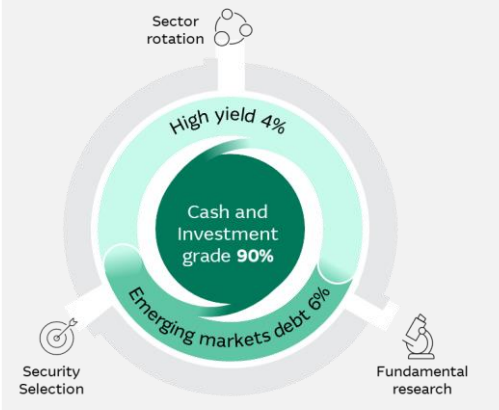
Investment objective

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	\$3,656.1m
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.



Fund performance to 31 March 2022

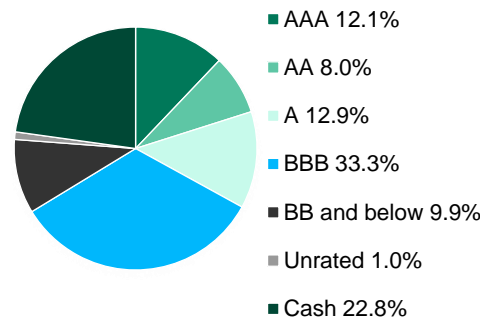
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-0.80	-0.84	0.00	-0.84
3 months (%)	-2.13	-2.25	0.01	-2.26
1 year (%)	-0.99	-1.48	0.04	-1.52
3 years (% pa)	1.44	0.94	0.46	0.48
5 years (% pa)	2.22	1.72	1.02	0.70
10 years (% pa)	3.52	3.01	1.83	1.18
Since inception (% pa)	4.81	4.30	3.53	0.77

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.

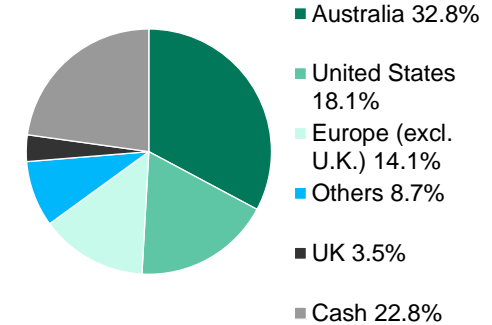
Credit profile breakdown



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



Asset allocation

Sector	Market value %
Investment grade corporates [^]	44.2
Investment grade government*	0.2
Asset-backed securities	22.5
High yield corporates [^]	3.9
Emerging markets corporates	3.5
Emerging markets government [^]	2.9
Cash and equivalents	22.8

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

[^]Fund holds (0.0%) in investment grade, (0.7%) in high yield and (0.1%) in emerging markets credit hedges as synthetic cash (reduction in percentage of physical cash exposure)

Fund statistics

Credit spread duration	2.6 years
Interest rate duration	1.7 years
Standard deviation ¹	1.9% pa
Yield to maturity ²	3.3% pa
Cash	22.8%
Cash exposure through credit hedges ³	0.8%

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.

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Fund highlights

The Fund underperformed the benchmark for the month. The moves were principally driven by interest rate duration positioning as government bond markets continued to reprice sharply, with the start of 2022 being the worst first-quarter performance for global government bonds in decades. The Fund's credit positioning added value, with an appropriate overall credit risk stance and significant liquid holdings allowing the Fund to add to holdings at attractive levels during the significant mid-month volatility. Holdings of high yield and emerging markets credits were the key contributors to performance, as these sectors bounced back the strongest in the latter half of the month. There were several key drivers of market moves – most significantly the continued war in Ukraine and its impact (beyond the direct humanitarian implications) on growth and inflation, alongside renewed hawkish tones from most key global central banks; offset by relatively healthy underlying economic data and expectations for corporate earnings. By the end of the month, government bond yields had increased by 70bps across the curve (for example, the Australian 2- and 10-year yields). The US 2-year 10-year Treasury yield spread inverted for the first time since 2019 – the spread has historically been a reliable indicator of recessionary risk if the inversion persists, though the timing is highly variable. Credit spreads widened sharply into mid-March, with US investment grade credit spread at one point nearing levels from the late 2018 Federal Reserve tightening-induced stress, though spreads rapidly repriced tighter in the second half of the month to remarkably finish overall lower in spread.

We maintain a 'barbell' approach to positioning the Fund: we continue to hold significant liquidity (with cash and short-dated investment grade credit totalling over 40% of the holdings), paired with allocations to higher-beta sectors including high yield credit and emerging markets debt. This remains appropriate, as evidenced by the ability in March to add to positions amongst market weakness. The Fund started accumulating exposure selectively in a couple of areas. These include BB-rated issuers in the US that are fundamentally solid, including cable operator Charter and business services firm Iron Mountain with bonds from both issuers around 10bps off their 2021 highs; and investment grade issuers where bonds have sharply repriced, including Boston Scientific, a US medical devices issuer that issued in EUR; and Discovery, a US media company with long bonds that were over 15bps lower. Additions were also made in higher-risk sectors, but with an opportunistic mindset and focused on capturing a degree of market dislocation. For instance, the Fund added a position in the European high yield credit default swap index in the days following the outbreak of the Ukraine-Russia conflict, judging the repricing too extreme as spreads surpassed 2018 peaks, and we took profit on this after significant spread tightening.

Market overview

Fixed income market performance in March was primarily driven by the significant upward move in bond yields, as central banks signalled a more aggressive response to the rising trend of inflation. The Ukraine-Russia conflict has ignited another supply shock to the global economy. Both hard and soft commodity prices increased sharply in response. This shock hit just as expectations and early evidence were suggesting that the impact from the pandemic supply shock were beginning to dissipate. Expectations had been that inflation would begin to fall during coming months and quarters. Instead, inflation has risen and there is uncertainty as to how its path will evolve in coming months and quarters. Central banks, aware of the medium term risks to growth but cognisant of the current economy resilience, have been pushed into a more aggressive stance on monetary policy.

Shorter-term bond yields have risen more than longer-dated bond yields. This price action has reflected the expectation of more aggressive central bank actions but at the same time reflects a market belief that the impact on economic growth will be significant. The US yield curve is close to inverting (that is, a negative spread between short- and longer-dated bond yields) and such a move, if sustained, has historically been a reliable long-term indicator of recession risk. Indeed, risk markets did sell off but, either encouraged by underlying corporate fundamentals; recent economic data; or the hope for a near term end to the war, risk markets have rallied – with equities finishing the month higher and credit spreads sharply tighter from their inter-month wides.

US investment grade (IG) spreads were 6bps tighter with long-end bonds leading the move tighter, and high yield spreads were 30bps tighter – but still both well wide of the start of the year. New buying was evident from domestic US investors, such as pension plans and insurance companies, with higher total yields providing support, hence the strong performance in long-end credit. New issuance volumes were very strong, and strong new issuance concessions was a key to underperformance in the first half of the month. By month end, strong demand and waning supply had driven concessions flat to negative in some cases. Key new issuance included \$US30bn from the new Discovery-AT&T combined media group, the largest single bond deal in several years, amongst many others. European IG closed the month 15bps tighter to a spread of 129bps, 31bps off the wides. Volatility was clearly high in the market, with the Russian-Ukraine tension weighing on the market. In addition, European Central Bank moved notably hawkish as inflation continues to move higher. Higher yields acted as a catalyst for insurance demand for long duration credit especially in higher quality names. Australian credit spreads widened further. After outperforming its global peers over the past couple of months, Australian credit significantly underperformed in March relative to offshore markets. After several months of curve steepening, the credit curve in Australia bear-flattened in March as recent major bank senior issuance, particularly the Westpac 3-year deal, remarked yields higher in the shorter-maturity part of the credit curve.

Outlook

We had already modified our outlook for 2022 to reflect the impact from the war in Ukraine, to one where short-term inflation would remain more elevated than we previously expected, and at the same time we assessed that the medium term risks to growth have increased. That said, the aggressive signalling from the US Federal Reserve (Fed) was a surprise but not in the context of increased pressures on inflation in recent weeks. The challenge now is for the Fed to drive inflation back towards target without inflicting too much damage on growth. From our perspective, tighter monetary policy will in time slow aggregate demand. Current high inflation, however, is largely being driven by supply problems. This is a classic tool and target mismatch, which implies that the task in front of the Fed is difficult and, for markets, suggests that further volatility should be expected as the Fed navigates this path.

Rate markets globally have repriced sharply. The overhang of negative yields is quickly evaporating, evidenced by 2-year German yields moving into positive territory for the first time since 2014. None of this makes bonds an obvious buy, particularly as the Fed and other central

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banks are in aggressive hiking mode, but for investors, yields are indeed starting to look attractive outright and as a hedge against risk assets.

While inflation is now a problem, for risk assets the path of growth through 2022 should prove critical. This second supply shock has increased the risk of recession in the 12-18 months ahead. How central banks navigate the delivery of tighter monetary policy likely holds the key to whether recession becomes a reality, or we experience a 'soft landing' for the economy. Our investment approach has been cautious, and our outlook implies that fixed income markets will experience further volatility in the months ahead but one where value is beginning to re-emerge.

For more information speak to your financial adviser, call us on 1800 814 523, email mim.clientservice@macquarie.com or visit macquarieim.com

Important information

Macquarie Investment Management Australia Limited ABN 55 092 552 611 AFS 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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