MACQUARIE

Macquarie Income Opportunities Fund

Monthly report – 31 August 2022

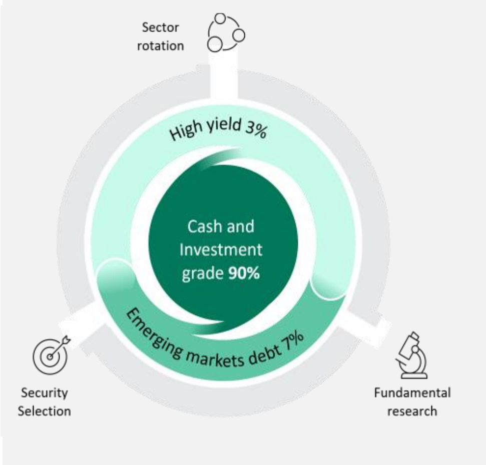
Investment objective

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	$3,600.4m
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 August 2022

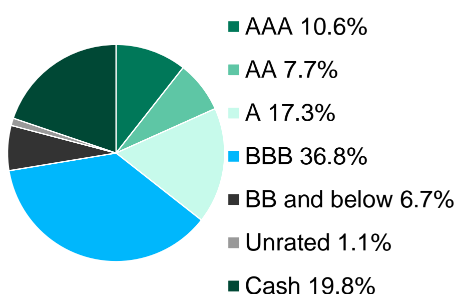
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-0.46	-0.50	0.15	-0.65
3 months (%)	-0.60	-0.73	0.33	-1.06
1 year (%)	-4.33	-4.80	0.37	-5.17
3 years (% pa)	0.01	-0.48	0.36	-0.84
5 years (% pa)	1.43	0.93	0.95	-0.02
10 years (% pa)	3.03	2.52	1.70	0.82
Since inception (% pa)	4.59	4.08	3.47	0.61

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.

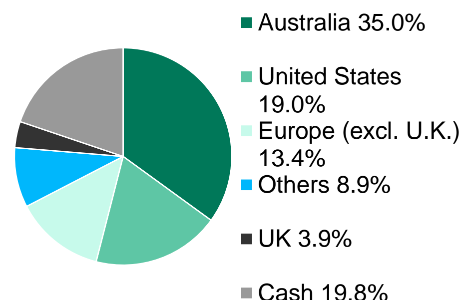
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

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^	51.2
Investment grade government*	0.2
Asset-backed securities	18.7
High yield corporates^	3.3
Emerging market corporate	4.6
Emerging market government^	2.2
Cash and equivalents	19.8

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, (0.8%) in high yield and (0.0%) in emerging markets credit hedges as synthetic cash (reduction in percentage of physical cash exposure).

Fund statistics

Credit spread duration	2.4 years
Interest rate duration	2.5 years
Standard deviation^	2.0%
Yield to maturity*	5.2% pa
Cash	19.8%
Cash exposure through credit hedges+	0.8%

^Statistical measure of variance of Fund's post-fee monthly returns from its average post-fee return since inception used as gauge of volatility.

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

+Credit hedges swap the return for underlying credit index for cash.

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Monthly report – 31 August 2022

Fund highlights

The Fund underperformed the benchmark for August, with positive contributions from credit offset by weakness in interest rate duration. Amongst credit sectors, emerging markets staged a meaningful recovery after lagging the rebound in July and were joined by global investment grade credit as key positive contributors to the overall result. On the duration side, the detractors were in Australian and US denominated interest rate positions, as bond yields again accelerated into the end of the month. Among individual performers, the recent NAB and ANZ subordinated bonds were strong contributors, as well as rebounds in small allocations to corporate hybrids, such as US utility Southern Co. This was offset by spread widening in US banks such as Bank of America and JP Morgan as new issuance and general volatility in that market put some pressure on these names, despite the fundamental credit quality remaining high.

The Fund's positioning remains with significant liquidity, with cash and short-dated investment grade totalling over 40% of holdings, offering meaningful possibilities to begin to look at opportunities in a sharply higher yield environment. During the month, the Fund trimmed a small number of higher beta credit exposures, after strong recovery into the middle of August – we view the outlook for markets as remaining volatile and have previously added higher quality investment grade credit during periods of spread weakness.

Market overview

An energy crisis ignited by the Russia-Ukraine conflict has pushed inflation rates to new highs and forced central banks to talk (even) tougher about the path for target rates. Financial markets have been thinking that rate hikes in 2022 would flip into rate cuts in 2023 and this belief was fueling a rally in risk assets. While only the Bank of England, Reserve Banks of Australia and New Zealand delivered rate hikes in August the tough talk from both the US Federal Reserve (Fed) and European Central Bank had a dramatic impact on medium term rate expectations. While this pulled bond yields higher, yield curves continue to flatten with the UK the latest country to join the inverting trend between 2 and 10 year yields. Consumer and business sentiment remain weak. Hard economic data is showing signs of softening, not enough to distract central banks from inflation. This combination has elevated recession fears for 2023. Housing data is often the first mover to tightening of financial conditions and all the data is pointing to slower activity in the sector. Personal income and spending data also disappointed as consumers battle the combined headwinds of higher energy costs and higher rates.

August started positively for risk assets but that faded as the optimism about 'peak inflation' gave way as central bankers pivoted in a hawkish direction, this was exacerbated with Europe's energy woes continued to mount.

US credit markets were mixed for August: the investment grade (IG) index finished slightly tighter on spread, and high yield slightly wider. Modest month-on-month moves obscured more volatility during the month, with a sharp sell-off in the second half undoing earlier strong performance. New issuance volumes were healthy in the first half of August, with significant issuance from both US and non-US financials and industrials, before quieting for the second half of the month. Overall volumes of >100bn in IG was strong for August, in contrast, high yield issuance remains very constrained. Amongst rating quality, BB issuers underperformed in August after a very strong rebound in July, while BBB issuers relatively outperformed the broader market – driven by a slowing of issuance in the second half of the month, which had kept pressure on investment grade in earlier weeks. The tone was weak in European risk, with IG spreads widening and underperforming peers. The weakness was broad based and higher quality credit actually underperformed on a relative basis due to supply being focused in IG and the move higher in rates limiting the move in high yield spreads. Inflation remains a material concern in European with several regions in the double digits due to energy pricing, but core consumer price index is also strong moving to a 4.3% YoY rate, European Central Bank rate hike expectations have moved to 75bps for the September meeting.

Australian credit marginally outperformed its global peers in August with the credit index option-adjusted spread tightening a further 5bps despite the widening of swap spreads. With little issuance in the corporate sector, spreads tightened across the curve with the belly of the curve slightly outperforming. In the financial space, senior paper performed strongly with spreads close to 10bps narrower over the month. Though, subordinated bonds were the standout with the fixed tranche of the newly issued major bank 10NC5 subordinated debt a further 38bps tighter, while the floating-rate note lines were roughly 25bps lower in spread. This is despite another jumbo major bank subordinated 10NC5 deal from ANZ. It was a busy month in the IG primary market with the majority of the issuance concentrated in financials which printed $A14.8bn out of the total $A15bn new issues in August.

Outlook

Stagflation continues to be the entrenched macroeconomic environment. Evidence is increasing that supply problems are easing, but this is a gradual process and still a long way to go. Demand is greater than supply, however, this is not driven by excess demand rather compromised supply. Central banks are being explicit in their desire to lower demand to ease the inflation pressure. They hope for a soft landing but with the energy crisis pushing inflation rates even higher the risk for a hard landing for the economy are increasing. The coming months and quarters will see a battle between slowing demand and improving supply and who wins will ultimately determine the outlook for both growth and inflation. It's a high stakes game and asset markets are at the table so expect volatility to persist.

For most countries growth has rebounded from the pandemic lows, but it has struggled to return to the pre-pandemic trend. Remember that this pre-pandemic trend was a long but uninspiring period of growth that underpinned the previous lower-for-longer interest rate environment. Against this fragile macroeconomic backdrop central banks are hiking rates rapidly. Meanwhile, fiscal stimulus of 2020-21 has given way to fiscal drag (that is, lower spending compared to the previous year) which is typical following a crisis spike in government spending. This combined policy tightening is rare and the risks for growth are firmly to the downside. Stagflation has been a bad environment for asset markets, but recession would be worse. This suggests that the upside risk for rates (ie duration) should be limited and the current higher yields offer a hedge to the downside risks facing risk markets should a recession become a reality.

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Monthly report – 31 August 2022

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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