

Macquarie Income Opportunities Fund

Monthly report – 31 October 2022

Investment objective

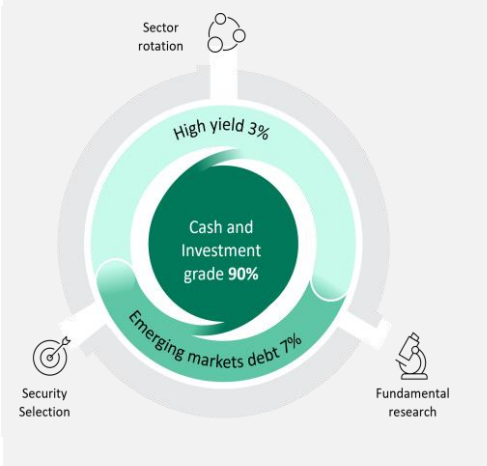
Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles.

Key information

Fund details

APIR code	MAQ0277AU
Inception date	18 September 2003
Fund size	\$3,563.6m
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 October 2022

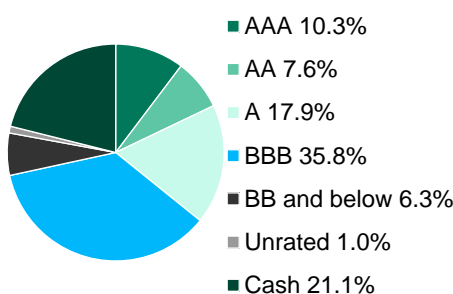
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.35	0.31	0.24	0.07
3 months (%)	-1.50	-1.62	0.54	-2.16
1 year (%)	-4.52	-4.99	0.76	-5.75
3 years (% pa)	-0.53	-1.02	0.43	-1.45
5 years (% pa)	1.02	0.52	0.97	-0.45
10 years (% pa)	2.74	2.24	1.68	0.56
Since inception (% pa)	4.50	3.99	3.46	0.53

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.

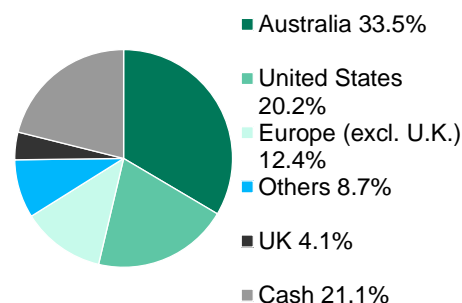
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

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*	0.3
Asset-backed securities	17.9
High yield corporates [^]	2.9
Emerging market corporate	4.3
Emerging market government [^]	2.3
Cash and equivalents	21.1

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

[^]Fund holds (6.1%) in investment grade, (0.9%) 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% pa
Yield to maturity*	5.8% pa
Cash	21.1%
Cash exposure through credit hedges ⁺	7.0%

[^]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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Fund highlights

The Fund outperformed the benchmark for October, with positive contribution from credit allocations being the key driver. Duration positioning was a modest positive contributor to the result, despite overall higher global yields. All credit sectors contributed to the result, including the Fund's small allocation to high yield, which outperformed broader credit markets. On interest rate positioning, allocations to Australian rates contributed positively to performance, significantly outperforming global yields (which overall ended the month weaker). Amongst individual issuers, holdings of US banks, European tollroads (including a holding receiving an upgrade from high yield to investment grade), and oil refiner Valero were contributors.

The Fund's positioning remains with significant liquidity (with cash and short-dated investment grade totalling over 40% of holdings), offering meaningful opportunities to begin to look at opportunities in a sharply higher yield environment. During the month, the Fund added to European credit, particularly in new issuance, taking advantage of attractive spreads in non-European or companies less exposed to the European economic cycle in that market: for example, adding Morgan Stanley and US industrial conglomerate Honeywell. The Fund also added modestly to Australian duration positioning at attractive levels, viewing the expectations for Reserve Bank of Australia (RBA) pricing as too optimistic, and viewing duration as an effective offset to credit risk now that yields are materially higher.

Market overview

Cries of 'Pivot!' were on everyone's lips as central banks around the world enacted their rate hiking cycles, though with more cautious outlooks, reflecting the competing forces of persistent inflation and deteriorating economic activity. The term 'pivot' can be defined in a number of ways – decelerated pace of tightening, declining implied terminal funds rate, increased implied pace of normalisation after terminal rate is achieved – and whilst there was no reversal in the direction of monetary policy, markets bounced around on the prospect of a 'soft' versus 'hard' landing. The RBA, Bank of Canada (BoC) and European Central Bank (ECB) all delivered dovish hikes, either slowing the pace of tightening or suggesting that they were nearing the peak in the tightening cycle.

Markets remain wary of the growing prospect the unintended consequence of central banks efforts to bring inflation under control could be recession, and a general risk-off sentiment was evident with weaker equity markets and wider credit spreads. There was mixed data and even more mixed fiscal policy announcements, as consumer and business sentiment remained weak and personal income and spending data have deteriorated. The improving LNG gas price situation in Europe will be a relief for households and policymakers as storage facilities have filled up significantly, however markets will want to wait until after winter before assessing the long-term situation. The Japanese Yen meanwhile continues to depreciate, despite efforts by the Bank of Japan to stem the tide.

October saw most risk markets perform well despite elevated inflation keeping pressure on bond yields. The market appeared to take some support in the idea that the Fed would begin to scale back the pace of tightening in the coming months.

United States credit markets were mixed for the month, with small moves at the overall investment grade index level (-1 basis points over the month, to 158 basis points) masking more significant deviation amongst sectors. High yield (HY) credit meaningfully outperformed investment grade (IG), with HY attracting inflows for only the second time this year: IG accelerated outflows. Amongst industry sectors, financials performed worst, pricing 10 basis points wider on average – dragged down by continued weakness in European banks. In contrast, most US banks performed well, and industrial sectors generally traded tighter over the month. Supports for the overall performance included limited new issuance (approximately US\$80 billion of new IG credit, remaining below longer term averages for this time of year), and earnings. The portion of earnings season that had completed by month-end was mostly benign – apart from large cap tech, which is not heavily represented in the credit market – with some indicators of slowing economic momentum but no material negative acceleration. Valuations remain attractive by any historic measure – with spreads in their top historic quartile and total yields at the highest level since 2009. Also spreads can clearly trade wider in a recession, which remains at the front of market mind (the US 3 months-10 year curve inverted during the month marking a further yield curve inversion, a broadly watched indicator of growth slowdowns).

Outlook

Over the past two years our analysis has determined that the economic environment was being largely defined by first the pandemic shock and then later by the energy price shock resulting from the war in Ukraine. However, at our September Strategic Forum our analysis pointed to the outlook being increasingly defined by the aggressive stance by central banks to tame inflation.

Measures of the supply side point to continued gradual recovery, despite various setbacks, although there is still a lot of repair to get back to pre-pandemic levels and the energy outlook is more uncertain due to geopolitics. The demand side is slowing, but the picture is varied across countries, with Europe/UK the hardest hit and the US proving relatively resilient. The hiking cycle underway will impact demand, and we expect central bank overtightening to mean that demand destruction will become the dominant driver of the economic outlook in coming quarters. Unfortunately, inflation is not providing central banks with any reason to hold back, despite the hopes of asset markets for a reprieve and despite the knowledge that demand will be hit. Recession is increasingly becoming the consensus expectation for 2023.

Current stagflation and the prospect of recession in 2023 implies that high volatility will persist across asset markets. Inflation has pulled bond yields higher than expected but we see value returning and offering an attractive entry point and strong protection levels for multi asset strategies. Credit fundamentals have softened in Q3 but remain at robust levels. The outlook suggests these will come under pressure, particularly if a hard landing manifests.

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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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