MACQUARIE ASSET MANAGEMENT

MACQUARIE

Macquarie Income Opportunities Fund

Monthly report – 30 November 2022

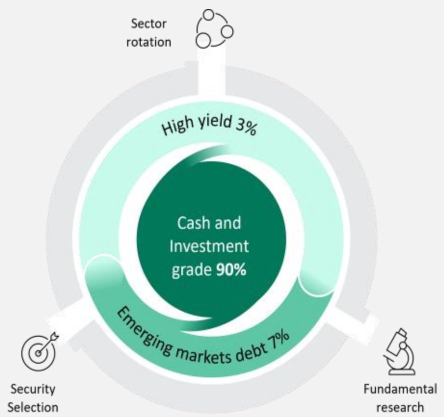
Investment objective

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	$3,591.8m
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 30 November 2022

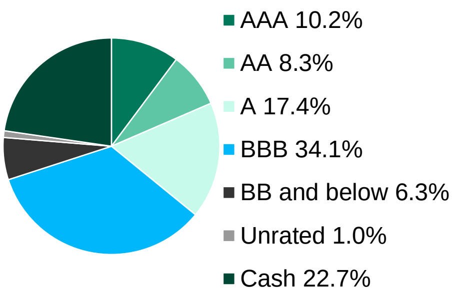
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	1.92	1.88	0.25	1.63
3 months (%)	0.86	0.73	0.64	0.09
1 year (%)	-2.88	-3.36	1.01	-4.37
3 years (% pa)	0.10	-0.39	0.49	-0.88
5 years (% pa)	1.36	0.87	0.99	-0.12
10 years (% pa)	2.88	2.38	1.68	0.70
Since inception (% pa)	4.58	4.07	3.46	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.

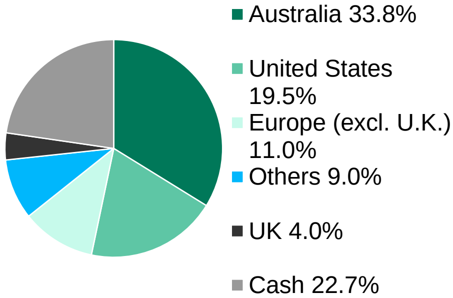
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

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^	49.8
Investment grade government*	0.3
Asset-backed securities	17.4
High yield corporates^	2.8
Emerging market corporate	4.5
Emerging market government^	2.5
Cash and equivalents	22.7

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

^Fund holds (5.7%) 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*	5.1% pa
Cash	22.7%
Cash exposure through credit hedges⁺	6.6%

^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 over the month, with positive contributions from both duration and credit positioning. A better than expected US consumer price index print was a trigger for significant repricing across markets, which benefited positioning. Amongst credit sectors, emerging markets and investment grade credit were the strongest contributors: investment grade credit spreads were the best (volatility-adjusted) sector across global markets, and are the largest weight in the Fund – a position that has been added to over previous quarters. Duration positioning also added value, with global developed market bond markets rallying sharply. Holdings of AUD and USD interest rate duration strongly contributed to the month's result.

Key individual names contributing to the credit result included senior bonds issued by US banks Morgan Stanley, Bank of America, and JP Morgan, which had widened consistently all year and had been gradually added to the Fund, reflecting our view that fundamentals in this sector were very strong, and the spread widening was more technical in nature. Recent additions in Euro also strongly contributed: the focus had been adding names less impacted by Europe's slowing economy, but that had been dragged wider by the broader market. Additions in Euro-denominated bonds issued by PPG (US-based industrial coatings) and Allianz (insurance), are two examples. Underperformers included a small number of high yield holdings, such as Occidental Petroleum – the high yield market rebounded early, but had a much more mixed November. The high yield sector is only a small allocation, given our view that spreads here do not compensate for the uncertain environment.

The Fund made small further additions to investment grade credit in the first half of the month but paused buying and moved to small position trims into the end of the month, reflecting tighter spreads and lower new issuance concessions. No material changes were made to duration positions over the month. The Fund remains positioned with significant liquidity to take advantage of opportunities – we believe markets will continue to be volatile as we navigate the challenges of bringing inflation down, while trying to avoid a material growth slowdown. The Fund's credit exposures overall are heavily weighted to investment grade, with small emerging markets and very modest high yield holdings. This positioning reflects our outlook for the environment ahead.

Market overview

Asset markets had a very strong month in terms of absolute returns. Bond yields fell, credit spreads narrowed, the dollar weakened, and equities rallied. Enjoy the ride or "eye of the storm"? Central banks continue to deliver the most aggressive rate hiking cycle since the 1980s even if there is recognition that smaller moves are more likely going forward. Bond yields have been pulled higher in 2022 by both rising inflation but also by central banks tightening monetary policy. However, bond markets provide a feedback loop to policy makers via the yield curve (that is, the spread between short- and long-dated maturities). During November both, the European and United Kingdom yield curves inverted, while the United States, Canadian, and New Zealand curve inversions deepened. Inverted yield curves imply economic fragility and are a reliable historic indicator for recession in 12 months' time. So, it seems that the rally in financial markets is reflecting the prospect that the elusive 'soft economic' landing in 2023 materialises. Our base case for 2023 is recession.

Against this background it was notable that the oil price slid by circa 9% in the past month, likely reflecting the slowing global demand environment. While this is good news for inflation, it could be yet another signal of tougher economic times ahead.

November saw risk assets perform well on the back of the US consumer price index print that saw the market embrace the notion that inflation has likely peaked and will allow the central banks to slow their aggressive tightening.

United States High quality (investment grade) credit spreads tightened 25 basis points over the month, marking the sharpest move tighter in spreads since the early rebound from the Covid crisis, in May 2020. Lower quality credit (high yield) also tightened overall, but performance was much more mixed, with the index tightening 16 basis points but many issuers widening over the month. The strongest performers in investment grade were financials, with US bank issuers regaining a portion of their year-to-date underperformance. UK banks in US dollar also performed particularly strongly, rebounding from very weak performance after UK market turmoil in September. Other sector performance was generally broad-based, with most major sectors tightening 20-25 basis points. Earnings season in the US wrapped up, with generally positive results: approximately 60% of issuers beat expectations on sales and earnings, generally in line with past periods. Some sectors showed signs of weakness, with retail and tech hardware mixed, and earnings from big tech and media generally poorly received. But financials were strong, reflecting loan growth and sharply higher interest margins, and most industrial companies continue to effectively navigate the challenging environment.

New issuance continued at a solid pace, with just over $US100 billion for the month well ahead of projections of $US75 billion, though still down over 17% versus this point last year. Large issuers included Amazon (with $US8.25 billion across 5 tranches) and GE Healthcare. Concessions continue to be modest (low single-digits for most new bonds), reflecting strong demand. Flows continued to be mixed, with sharp outflows from investment grade credit, in contrast to high yield which has enjoyed a turnaround, now with 5 weeks of consecutive inflows.

Outlook

In trays are beginning to fill up with 2023 outlook papers. Long term experience and the huge uncertainties thrown up by two supply shocks in the past two years suggest that one should have a base case but be alert for unexpected surprises. There is a strong consensus that inflation can fall significantly during 2023, a view we agree with, resulting from as a combination of base effects, on-going supply improvement and the prospect of a demand shift as recessions unfold. However, the bigger question is: where will inflation settle? Central banks understand the uncertainties and the policy lags involved, yet they are speaking with a consistent voice that their greater fear is for under-tightening than overtightening, as the consequence could leave inflation stubbornly above target. This suggests that central banks could continue to hike further than is expected – take note that the Reserve Bank of New Zealand, an early adopter of tighter policy, actually increased the size of its rate hike at the meeting in November. In addition, central banks could hold onto tighter policy for much longer than expected, to ensure that inflation does return sustainably to target.

For this reason, our base case outlook for 2023 also assumes that demand destruction can become a dominate theme. If demand falls into recession, as we expect, and supply continues to adjust this should ensure lower inflation through the coming year. This is good news for sovereign bond yields, which should be in the process of peaking. However, demand destruction is bad news for consumer spending and corporate earnings. This implies that credit spreads are vulnerable to widening from current levels.

We therefore expect sovereign bond yields to offer attractive value for investors during 2023, with the added attraction of offering portfolio protection against risky assets. We are cautious on corporate credit, preferring highly rated investment grade issuers that are not exposed to the cycle. Our approach to higher yield corporates and emerging market debt is more cautious, preferring selective opportunities.

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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