

Macquarie Income Opportunities Fund

Monthly report – 31 December 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 \$3,401.9m

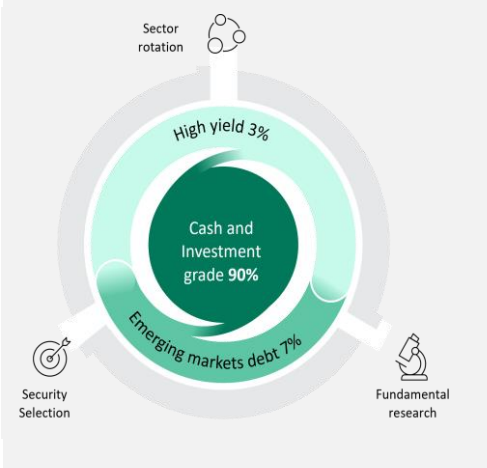
Distribution frequency Monthly

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 December 2022

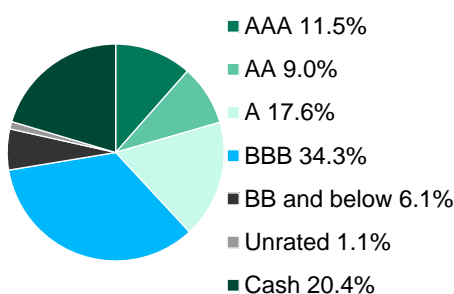
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-0.11	-0.15	0.25	-0.40
3 months (%)	2.17	2.04	0.74	1.30
1 year (%)	-3.36	-3.83	1.25	-5.08
3 years (% pa)	-0.05	-0.54	0.55	-1.09
5 years (% pa)	1.27	0.78	1.01	-0.23
10 years (% pa)	2.78	2.28	1.67	0.61
Since inception (% pa)	4.56	4.04	3.45	0.59

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.

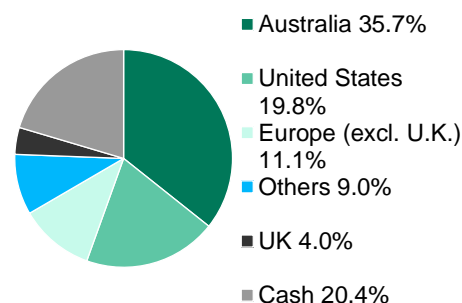
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

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 [^]	50.6
Investment grade government [*]	0.3
Asset-backed securities	18.9
High yield corporates [^]	2.8
Emerging market corporate	4.4
Emerging market government [^]	2.6
Cash and equivalents	20.4

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

[^]Fund holds (6.0%) 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	2.1 years
Standard deviation [^]	2.0% pa
Yield to maturity [*]	5.3% pa
Cash	20.4%
Cash exposure through credit hedges ⁺	6.9%

[^]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.

Macquarie Income Opportunities Fund

Monthly report – 31 December 2022

Fund highlights

The Fund underperformed the benchmark over the month, with detractor from duration positioning offsetting positive credit contributions. Fixed income markets finished the year mixed: high quality credit spreads were modestly tighter, but government bond yields were higher in the final weeks of the year after the Bank of Japan (BoJ) adjusted their yield curve control settings, against an illiquid market backdrop. The Fund's overweight position in AUD duration detracted, though this was offset by a short position in Japanese bonds, intended to offset the impact of this kind of unexpected adjustment from the BoJ. Credit positioning added value: investment grade credit benefitted from tighter spreads and increases in allocations made over the last several months, and emerging markets were also positive. The largest industry sector contributions were from financials, transportation, and capital goods.

Key individual names contributing to the credit result again included major financial issuers, such as bonds issued by US banks Morgan Stanley, as well as subordinated debt from Australian major banks. Fundamentally strong issuers (such as Holcim and Honeywell) denominated in EUR also added to the result, as that market continued to move back from the extreme wids reached in mid-October. Underperformers included Aroundtown, a European REIT, and Warner Bros Discovery: hit by continued elevated integration costs as the issuer moves to get the costs of its streaming content down to an appropriate level.

The Fund generally maintained its credit positioning over the month, adding small exposures in shorter dated bonds offering attractive yields, but less exposed to credit spread and bond market volatility. The Fund's duration position was trimmed during the month after a rally in yields, mostly in the US. We continue to view the moves in bond markets as offering opportunities to add to both credit and duration positions over time - but at higher yield levels, particularly in credit, where spreads are now only at long term averages despite the more difficult economic outlook. 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. We think that best reflects the environment looking ahead and look forward to opportunities to add to higher beta sectors.

Market overview

The event calendar through December was dominated by numerous central bank meetings. As expected, further rate hikes were delivered. However, it was the messaging from central banks that really caught attention where each reiterated a laser focus on returning current high inflation back to target. The signal from the European Central Bank was perhaps the strongest guidance and this caused a significant repricing of sovereign bond yields across the yield curve. And yet it was the BoJ that pulled out the biggest surprise of all, where they delivered an unexpected shift in their ultra-dovish Yield Curve Control policy that has anchored the Japanese bond market in recent years. The shockwaves from this position change, just before the festive holidays, caused bond yields to slump and the Yen to spike.

So, what did asset markets make of this deluge of central bank change? Sovereign bond yields, which had been grinding lower, quickly reversed and surged higher causing yield curves to steepen in the process. Perhaps more interesting was the reaction of forward expectations: in the US they actually fell, signalling the markets belief that the US Federal Reserve (Fed) hiking cycling is almost done and that rate cuts will be in focus by late 2023; in Europe, expectations for total hikes in this cycle rose by around 50 bps; in the UK forwards remained steady, discounting multiple further hikes; while in Japan bond yields all moved positive for the first time since November 2015. Equities markets embraced the change and repriced lower, expecting weaker earnings to dominate in 2023. However, credit markets, somewhat surprisingly remained very resilient, with spreads closing tighter in the month for investment grade and emerging markets, with high yield spreads modest wider.

Risk markets were more cautious as 2022 concluded with central banks signaling the need to remain hawkish. Equities and US high yield (HY) were mostly weaker for the month, though higher quality investment grade (IG) outperformed to finish the month tighter, with rates responding to the continued hawkish tone and drifted higher.

US credit markets finished the year mixed over the month. At an index level, benchmark IG spreads ended at 129 bps, -3bps over the month, but US HY spreads were somewhat wider, +21bps to 469bps. Sector dispersion was modest, with European financials outperforming, and short-maturity bonds under 3 years underperforming. Lack of liquidity into the end of the year was a key factor in relative performance. Technicals have remained supportive for IG with very low issuance, lighter dealer inventories, and continued inflows providing support for pricing. Macro indicators were mixed in the US with the US Consumer Price Index (CPI) again coming in below expectations, but the Fed painted a hawkish outlook with their meeting and 'Dot Plots', which showed continued hikes and a lower growth outlook.

New issuance came in well below expectations, with only \$US3bn in HY and a total of \$US8bn in IG, including deals from pipeline operator Energy Transfer, and utility Duke. January is expected to be much more active as investors and issuers both return to markets.

Outlook

The past year has been dominated by escalating supply tensions emanating from the war in Ukraine which pushed inflation much higher and for longer than anyone was expecting. The ramped-up response by central banks, in retrospect, should have been widely expected.

Looking into 2023 we feel that asset markets will have to work through the consequences of the above events of 2022. First, we must recognise that geopolitical tensions are likely to remain elevated and also assume that these tensions could take an unexpected turn at any time. Be warned and be prepared to adapt. Secondly, we can observe that many supply problems have dissipated and while there is no return to the pre-Covid norm, the economic impact from supply is likely to be much less in 2023. Third, we are expecting the year ahead

Macquarie Income Opportunities Fund

Monthly report – 31 December 2022

to be the report card on demand destruction wreaked by the most aggressive monetary policy tightening cycle since the 1980s. And finally, we recognise that prevailing conditions for households and corporates have been robust compared to past tightening cycles, however the signalling from central banks is they intend to cause stress for both groups.

Again, we will thoroughly review our portfolio management strategy from the bottom up via the Strategic Forum during January. Our base case call has been for a recession in 2023 and that inflation will continue to fall through the year. We believe this combination will prove to be good news for sovereign bond yields. However, demand destruction is bad news for consumer spending and corporate earnings. This implies that credit spreads are vulnerable to widening from current levels.

Thus, sovereign bond yields can 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.

Macquarie Income Opportunities Fund

Monthly report – 31 December 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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