

Macquarie Income Opportunities Fund

Monthly report – 31 May 2023

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 \$3,281.5m

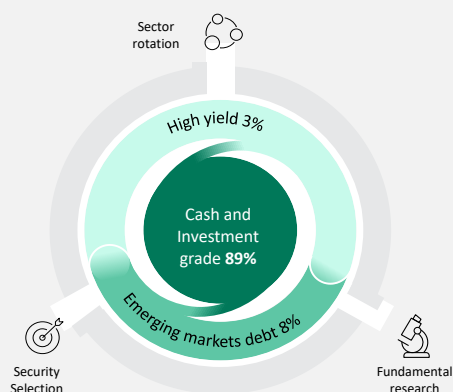
Distribution frequency Monthly

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 May 2023

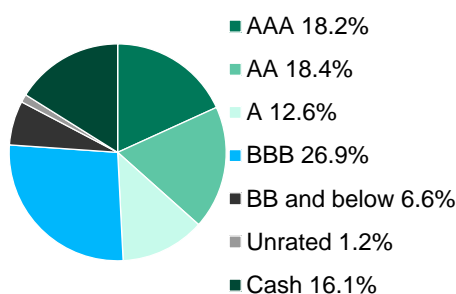
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-0.45	-0.49	0.29	-0.78
3 months (%)	1.45	1.33	0.89	0.44
1 year (%)	2.61	2.11	2.64	-0.53
3 years (% pa)	1.25	0.75	0.91	-0.16
5 years (% pa)	1.68	1.18	1.14	0.04
10 years (% pa)	2.69	2.19	1.69	0.50
Since inception (% pa)	4.59	4.08	3.45	0.63

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.

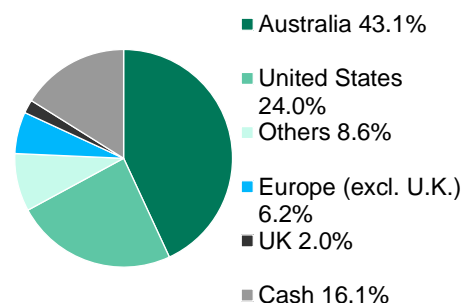
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

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 [^]	47.8
Investment grade government [*]	0.1
Asset-backed securities	25.4
High yield corporates [^]	2.9
Emerging market corporate	4.7
Emerging market government [^]	3.0
Cash and equivalents	16.1

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

[^]Fund holds (11.4%) in investment grade, (1.0%) 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	2.2 years
Standard deviation [^]	2.1% pa
Yield to maturity [*]	4.8% pa
Cash	16.1%
Cash exposure through credit hedges ⁺	12.4%

[^]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 underperformed the benchmark in May, driven by duration positioning. Credit positioning added value, even as credit spreads widened modestly. The Fund maintained an approximately 3-year duration position over the month, weighted to US denominated rates. Bond yields globally sold off with lingering inflation, continued healing in financial markets after the turbulence in March, and some specific concerns around the US debt ceiling. Overall, 10-year Treasury yields rose by over 20bps for the month, and Australian 10-year bonds performed worse, rising by over 25bps. Credit positioning added value chiefly through protective option positions – these were removed mid-month amidst a weak market backdrop, locking in gains. Security selection within investment grade (IG) corporates and Emerging Markets also contributed positively.

The Fund made small changes to credit exposures during the month, adding exposure in European and Australian new issuance, with elevated overall spreads and some deals offering attractive concessions. The Fund added Australian utility Ausnet Services, and European insurer Allianz – all high-quality issuers with new bonds sold during the month. The Fund removed some high yield (HY) credit hedges in the first weeks of the month, with spreads at year-to-date wides (excluding the brief spell of volatility during March), banking profits as those positions were put in place at much tighter spreads in February. The Fund also further added to the US Agency Residential Mortgage-Backed Securities (which had begun from an initially zero base in late April): an asset class that had performed very poorly through 2022 and early 2023, and that now offers historically wide spreads. We continue to expect opportunities to add to credit positions over time - but at higher spread levels, given the likelihood of economic weakness or recession later this year. The Fund added modestly to duration mid-month, reflecting higher yields and our ongoing belief that bond yields at these levels reflect strong long-term value.

Market overview

The noise surrounding the US debt ceiling negotiations were very distracting, but asset markets mainly focused on the facts they understood, namely that inflation was falling only slowly, labour markets remained resilient and while the US Federal Reserve may prefer to hold policy, the data may yet force another rate hike. The above combination enabled risk markets to largely end the month flat or in positive territory, while bond yields pushed higher led by the front end of yield curves as expectations for further rate hikes increased in the month.

The US debt ceiling was a major talking point because of the skew of risk to the downside. While fear of a default was probably overplayed the greater risks lay in the prospect of the Republicans forcing significant spending cuts to agree a lift of the debt ceiling. Memories of 2011 haunted financial markets, where President Obama's was forced to agree to the Budget Control Act and Sequester that prematurely ended his planned fiscal expansion and set the scene for the subsequent period of uninspiring growth. While the current agreement has not yet passed through Congress the details available point to a modest reduction in net spending going forward, essentially neutralising the fiscal risk from a market perspective.

Risk finished May pretty much flat albeit a month that commenced with US regional banks still in the headlines and ended as we got to the pointy end of the US debt ceiling negotiations with a strong close into month end as a resolution became more likely.

US IG closed 2bps wider on the month to 138bps, non-financial sectors also underperformed in the US. Volatility in regional banks remained though as the market focused on issuers with greatest commercial real estate exposure and hold to maturity securities. KRE (regional bank equity index) closed almost 9% lower although credit spreads stabilised in the latter part of the month.

IG fund flows remained positive but both HY and Bank Loans saw outflows. Primary volumes were elevated as the \$31bn, 8-part Pfizer deal gaining much of the market attention with orderbooks more than \$85bn.

European IG spreads closed 9bps wider in May to 171bps, industrials underperformed financials in part due to prior outperformance and an uptick in non-financial supply. The weakest sectors were generally cyclicals such as capital goods, metals & mining and packaging as large new issue concessions impacted secondary curves. HY outperformed closing 4bps tighter on the month with CCC's faring best. Supply for the month totalled €80bn, there has been a material increase in reverse yankee issuance with names such as AT&T, AMT, Honeywell and Booking all issuing multi-tranche deals.

Australian credit marginally outperformed global credit tightening 4bps on an option-adjusted spread basis over the month May, though most of the outperformance came from the narrowing of swap spreads. Financial senior paper finished unchanged for the month while bank subordinated bonds drifted wider as ANZ priced \$A1.15bn of 10NC5 at +235bps which came with a 15bp concession to existing secondary curves. This created some indigestion which caused longer-dated subordinated debt to widen 15bps before retracing most of the weakness in the back half of the month. Recent demand has been heavily skewed towards Floating rate notes leading to a material outperformance relative to the fixed rate bonds. Corporate spread performance was mixed with REITs continuing to lag and telecommunications recording a more broad-based tightening. The primary market saw more than \$A16bn of issuance with most of the transactions coming from banks, though we did have 3 long-dated corporate deals with the most notable being Ausnet's 700mil 10-year deal which garnered more than \$A1.2bn of final orderbook.

Outlook

During May our research and investment teams undertook a deep dive into our views using our triannual Strategic Forum process. The review of the macroeconomic outlook noted that the supply recovery continues on a slow, steady, sustainable path; and while demand has decelerated it has not turned into a destructive force. Importantly, our analysis noted the unexpected positive impulse from US fiscal policy in the early months of the year (from increased defence spending and cost of living adjustments to benefits). This combination has caused inflation to start turning lower, however it remains well above target which has induced central banks to tighten further. Our proprietary

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analysis suggests that US central bank policy is already in over-tightening mode, and historically when this occurs something breaks – the recent US regional bank turmoil is a good example.

A key dilemma for central banks and markets is the fact that monetary policy works with long and variable lags, and this has been the fastest and largest tightening cycle for several decades. In addition, yield curve inversion analysis had been pointing to late 2023 for recession. This highlights a key debate on the outlook- should focus be on leading or lagging indicators? Employment, inflation and wages are all lagging reflections of the economic cycle. Spending data and forward guidance are leading indicators. For the consumer, despite higher nominal wages, spending has remained constrained in real terms as the scars of the supply shocks has increased prices. Thus, with the positive impulse from government cash handouts dissipating and concurrent monetary tightening grinding, the overall impact is we still see recession as our base case outlook for late 2023.

The skew of risks debated at our Strategic forum were biased to expecting a harder landing for the economy. The first risk lay with the debt ceiling and at the time of writing this may have been neutralised. Secondly, is that monetary over-tightening persists, potentially exacerbated by the chance of another hike in June. Thirdly, credit conditions have tightened, already to levels that historically correlate with the near-term onset of recession, yet we expect even more tightening to come. Finally, economic fragility brings financial dislocation. Concerns surround Commercial Real Estate and Private markets for example.

We therefore remain constructive strategically on duration and cautious of risk markets, recognising that the pathway ahead is potholed by a high level of uncertainty.

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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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