

Macquarie Income Opportunities Fund

Monthly report – 31 July 2023

Investment objective

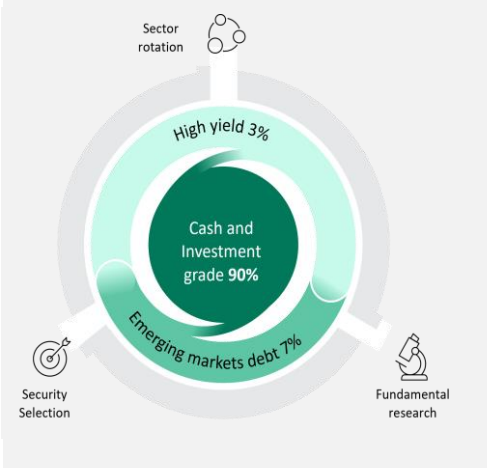
Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles.

Key information

Fund details

APIR code	MAQ0277AU
Inception date	18 September 2003
Fund size	\$3,118.0m
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 July 2023

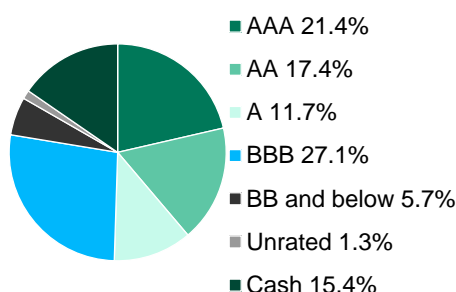
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.89	0.84	0.37	0.47
3 months (%)	-0.07	-0.19	0.97	-1.16
1 year (%)	3.16	2.65	3.15	-0.50
3 years (% pa)	0.77	0.27	1.13	-0.86
5 years (% pa)	1.68	1.18	1.20	-0.02
10 years (% pa)	2.70	2.19	1.71	0.48
Since inception (% pa)	4.57	4.06	3.46	0.60

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.

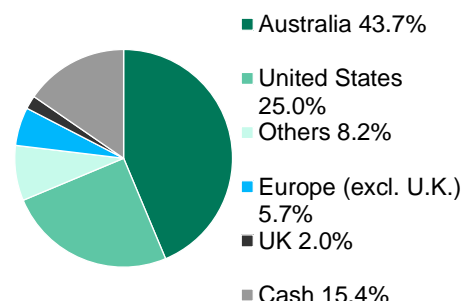
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

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 [^]	46.7
Investment grade government	0.1
Asset-backed securities	28.3
High yield corporates [^]	2.5
Emerging market corporate	4.4
Emerging market government [^]	2.6
Cash and equivalents	15.4

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

[^]Fund holds (11.6%) in investment grade, (1.0%) in high yield and (0.5%) 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*	5.2% pa
Cash	15.4%
Cash exposure through credit hedges ⁺	13.0%

[^]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 over July, with credit positioning continuing its recent positive performance contributions. The Fund's duration positioning also added value, with the Fund's short positioning in Japan, as well as shorter end curve positioning globally (particularly short end AUD bonds), performing well despite overall benchmark global yields finishing the month higher. Amongst credit sectors, investment grade was a key contributor, as were emerging markets holdings, due to tighter spreads in all risk markets. Amongst individual issuers, Australian and global financials were amongst the largest contributors (Morgan Stanley, Westpac and NAB, amongst others), as the global banking sector rebounded strongly after lagging for several months. Amongst underperformers, AT&T modestly detracted, as reports of lead sheathing on some of the company's legacy wireline network added uncertainty to the picture – we remain very comfortable with the long-term fundamentals of the issuer.

The Fund made small changes to credit exposure over the month, trimming emerging markets exposure and some specific credits as spreads approached 1-year tights. Additionally, the Fund added to shorter-dated global financials amidst new issuance and specific opportunities to maintain yield in an ongoing uncertain environment. The Fund also added credit downside protection via options, which we believe provides low-cost and positive-asymmetric protection for the portfolio, in the case of a meaningful sell-off in the coming months. The Fund also added to Agency MBS securities, with spreads on these sectors remaining at the upper end of historical ranges, which continue to offer attractive yields with very strong fundamental credit quality. We continue to expect opportunities to add to credit positions over time - but at higher spread levels, given the likelihood of economic weakness in the medium term.

Market overview

The market narrative with regard to the economic outlook has evolved toward a belief that a soft landing for the economy can be achieved, while inflation gradually eases back toward target. Risk markets have embraced this narrative, with equities surging, led by the US (S&P500 +3% in July and +10% since end May), and credit spreads tightening (Investment Grade -16bp in EUR and -10bp in USD, High Yield -23bp and Emerging Markets -35bp). The inflation data is clearly slowing, again led by the US, as supply pressures continue to dissipate, and slower demand gradually quells pricing power. The economic data is more mixed, but where the broader resilience of the service sector stands in stark contrast to the manufacturing sector which is in recession in most countries. Perhaps the biggest surprise has been the resilience of the labour market, where the slowdown has slowed hiring but not leading to large job losses.

Central banks, on the other hand have yet to be convinced of this 'goldilocks' outcome on growth and inflation. Certainly, policy rates have been tightened faster and more significantly than any time since the 1970s, yet many central banks continue to push rates higher. Hopes (from markets) for a 'pause' are ever present but this belief was put to the sword several times already in this cycle. Part of the problem is that governments have been reluctant to wind back spending despite the passing of the pandemic crisis. Thus, monetary policy is carrying more weight to slow growth and pull inflation back to target. For bond markets, lower inflation should be good news for lower yields but the upward pressure on short term yields from central bank tightening has created a negative carry environment that is proving difficult to fight.

Positive sentiment in risk assets continued in July as markets were stronger with a combination of earnings and supportive technicals being key to the moves.

US investment grade (IG) credit tightened by 11bps to 112bps, a new year-to-date tight, and high yield tightened by 23bps at an index level. US Q2 earnings season kicked off, and by month-end about 60% of companies had reported: starting with Financials and continuing overall, the general theme was of beats against low expectations. Approximately 80% of companies beat earnings expectations, in line with historical averages; but that masks the fact that aggregate earnings were down over 7% YoY. Positive technicals were also supportive of spreads, with higher yields attracting buyers and lower issuance volumes: \$90bn in new bonds, a lower than average result reflecting the Northern hemisphere summer, and earnings blackouts. Banks and Financials were the strongest performing major sectors after better than expected earnings were reported. Subsequently the month saw the first new issuance from a regional bank – Fifth Third, who issued a new bond that was strongly over-subscribed and performed very strongly.

European credit outperformed peers this month with IG closing 16bps tighter to an option-adjusted spread of 147bps. Financials and REITs outperformed as both continue to make back underperformance from earlier in the year. Supply as expected was muted at only €20bn, this helped the technical backdrop for the asset class in conjunction with overall inflows. We have experienced some single name underperformance following weaker Q2 results especially in paper/packaging as well as chemicals, however this has not impacted the overall asset class. High Yield (HY) underperformed IG closing 20bps tighter on the month, single name issues mainly the Altice complex and a lower financial weighting resulted in HY underperformance. The technical backdrop for the asset class remains firm in the short term but with spreads approaching YTD tights and a weakening European macro environment, an increase in spread volatility is plausible.

Australian credit had another strong month in July with Index option-adjusted spread tightening 6bps. The positive momentum was broad-based across sectors. In the financial space, domestic regional banks and European issuers significantly outperformed the major banks, though even the on-the-run 5-year major bank senior bonds ended the month more than 2bps tighter below 90bps. Financial subordinated paper crunched in post Westpac T2 issuance in June as spread tightened 28bps to 189bps with the lack of supply, light street inventory and attractive all-in yield contributing to the rally over the month. The recent outperformance in subordinated bonds meant that the spread ratio to senior bonds has tightened to 2.1x, which is at the tighter end of the historical range, compared to 2.4x at the end of June. There was also a reasonable spread performance in the corporate sector, particularly the recently issued bonds in the utility sector as well as some of the previously unloved REIT and high beta names that have underperformed the broader credit market over the past few months. Primary issuance market was lighter in July with 3.7bn of benchmark eligible bonds printed, mostly in shorter tenors from banks.

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Outlook

The battle lines of debate have been drawn, are you in the recession camp or the no recession camp. Consensus for a long time has been convinced recession would be inevitable, sustained yield curve inversion never gets it wrong? Yet long and variable lags are difficult to live through even if the inevitable ends up becoming true.

The big surprise in 2023 has been fiscal spending, which has remained more persistent than expected, underpinned by large increases to benefits and salaries and support for the Ukraine war effort. As fiscal spending feeds directly into the economy it has underpinned the jobs market, household incomes and therefore spending. The impact of monetary tightening is gradual and importantly felt differently between countries depending on lending practices. That said, higher rates are a drag on growth but for households and business there can be winners (e.g. savers) and losers (e.g. borrowers). Key for the economy is when this is accompanied by a tightening of lending conditions, which is taking place, the combination of monetary over-tightening and excessive tightening of credit conditions has resulted in recession every time in the past.

Our base case outlook remains for a cyclical recession, similar to 2001, acknowledging that hard landing risks have reduced in recent months. Our highest conviction view this year has been for inflation to fall, highlighting the possibility of a dip into deflation, remains on track. This is key for our position to add duration into each back up in the bond market. Risk markets remain very tightly priced, and therefore vulnerable to weaker growth emerging through the second half of this year. In addition, the environment of monetary over-tightening and tightening credit conditions also signals risk for potential financial dislocation, such as experienced with US Regional Banks earlier in the year. History guides that risky assets do not tend to react significantly until evidence of a downturn or financial risk become clearly evident. We therefore maintain a strategically constructive view 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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