Macquarie Income Opportunities Fund

Monthly report – 31 August 2023

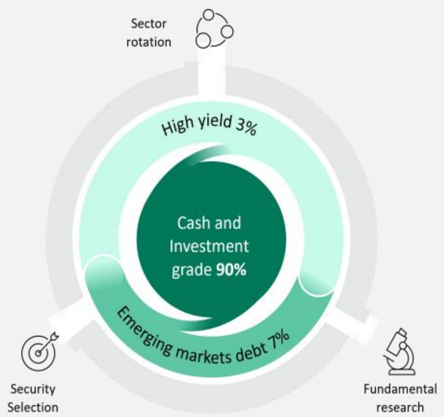
Investment objective

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	$3,086.0m
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 August 2023

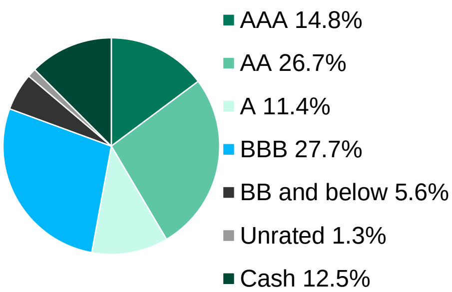
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.40	0.36	0.37	-0.01
3 months (%)	0.78	0.66	1.04	-0.38
1 year (%)	4.05	3.54	3.37	0.17
3 years (% pa)	0.86	0.37	1.25	-0.88
5 years (% pa)	1.70	1.20	1.24	-0.04
10 years (% pa)	2.69	2.19	1.72	0.47
Since 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.

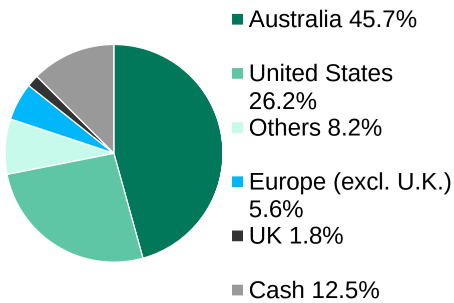
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

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^	47.3
Investment grade government	0.3
Asset-backed securities	30.3
High yield corporates^	2.4
Emerging market corporate	4.5
Emerging market government^	2.7
Cash and equivalents	12.5

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

^Fund holds (12.2%) in investment grade, (1.0%) in high yield and (0.6%) in emerging markets credit hedges as synthetic cash (reduction in percentage of physical cash exposure).

Fund statistics

Credit spread duration	2.5 years
Interest rate duration	2.8 years
Standard deviation^	2.1% pa
Yield to maturity*	5.0% pa
Cash	12.5%
Cash exposure through credit hedges⁺	13.8%

^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 modestly over August, on a gross of fee basis. Duration positioning was a positive contributor, despite significant volatility and weakness in rates markets, with curve and country positioning the key benefit. Credit positioning was a flat contributor, with positive contributions from investment grade offset by emerging markets. Within credit sectors, investment grade credit was a positive contributor, with Australian banks, insurance issuers and selected offshore names (such as Amgen) key positive contributors. Australian mortgage-backed securities were also a positive contributor, with very stable running yield the driver in this sector. Emerging markets detracted, reflecting underperformance of small holdings of African sovereign issuers. Within duration positioning, the Fund's exposure to Australian duration was a positive contributor, bucking the broader volatility in rates, and in the US, modest overall underperformance was offset by curve positioning.

The Fund made small changes to credit exposure over the month, favouring additions to Agency mortgage securities as historically wide spreads due to volatile rates markets, remain attractive. The Fund trimmed exposure to selected higher beta issuers that had performed strongly (such as International Consolidated Airlines) and added to mid-curve Australian corporates and selected new issuance, where we see specific opportunities. The Fund also participated in new Australian Residential Mortgage-Backed Securities (RMBS) issuance during the month, viewing spreads there as an attractive long-term source of carry. 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. In duration, the Fund trimmed approximately half of its Japan government bond short position, after the Bank of Japan relaxed their yield curve control policy somewhat and yields rose.

Market overview

August marks the holiday season in the Northern Hemisphere but it was no holiday for financial markets, which were taken on a wild roller-coaster ride. US 10-year yields spiked from 3.96% to 4.34% during the month, before closing at 4.09%. This was despite a benign inflation print and a weaker than expected employment reports. The much stronger than expected retail sales report was a key driver of the bond market sell-off. This combined with ongoing tough talk from US Federal Reserve (Fed) Governors, which translated into the market (again) debating a rate hike at the September meeting but more importantly revising back expectations for rate cuts in 2024.

The market narrative with regard to the economic outlook has evolved toward a belief that a soft landing can be achieved, and this has been fuelled by surging GDP. The estimate for Q3 growth, provided by the Atlanta Fed, moved from 3.9% to 5.9% (annualised quarterly growth). While stronger growth is theoretically good news for equities and credit, both risk markets came under (modest) pressure in the month, largely reflecting concerns about the Fed's interest rate hiking cycle. Like rates, credit spreads retreated from higher levels into month end, where high yield (HY) notably outperformed in the month.

The picture globally is more mixed, where China remains a key area of concern. Here, policy efforts to drip stimulus into the economy are being met with scepticism as the consumer has hunkered down, the export sector is struggling with slowing global demand and the property sector remains a key structural concern. Inflation is likely to pressure more rate hikes in Europe and the UK, despite clearly softening economic growth. Meanwhile the Australian central bank is edging towards neutral with a new Governor at the helm and an economy that is slowing but with inflation sticky in its decline.

Risk markets were modestly weaker in August, which was impacted by continued rates volatility as markets tried to determine whether central bank tightening has come to an end or whether a softer than expected landing may see more work to be done.

US Credit markets finished marginally wider over the month, reversing the rally in the final days of July. The strongest negative influences to performance were the continued volatility in underlying government bond markets, with negative total returns contributing to consistent weeks of investment grade (IG) outflows for the first time this year. A lack of supply in the second half of the month helped to stabilise spreads, with new issuance markets essentially closed for the end of the Northern Hemisphere Summer. IG spreads finished +6bps overall, with HY outperforming, +5bps – with the longer duration of IG increasing its exposure to rate volatility. Amongst sectors, performance was mostly consistent, with cyclicals such as automotive, metals and mining the underperformers. The primary market is expected to open significantly in the beginning of September, providing some pricing clarity and potentially testing the supply-demand balance.

European IG underperformed global peers closing 8bps wider. Supply for the month came to €31.4bn, issuance was concentrated towards month end with almost 75% of the monthly issuance coming in the past week. IG failed to keep up with the macro bounce in the latter part of the month especially as concessions in new deals have begun to increase, high quality utilities such as Engie paid at least 15bps in mid-long end. Key underperforming sectors include auto's +14bps as US names led the widening on potential strikes, cyclical sectors such as metals & mining were also notably weak +18bps led by Glencore. The primary market has been the main focus for European credit over recent sessions and is likely to be the maintain attention over the coming weeks especially as issuance transitions to higher beta names.

Australian credit performed solidly again with Index option-adjusted spread tightening 8bps in August, though this was largely driven by narrowing of swap spreads. The outperformance was broad-based across sectors with utilities and higher beta transportation continuing to grind tighter. REITs performed broadly in line with the general credit beta, though industrial REITs outperformed while some of the longer dated bonds with greater office exposures lagged. In financials, major bank senior paper ended the month 1-3bps tighter with 3-5year part of the curve flattening 2bps despite a deluge off senior primary issuance from major banks as 13bn for the 19bp issuance in IG primary market was accounted for by supply from 3 major banks in August. Major bank subordinated bonds finished broadly unchanged in August, though this masked the intra-month volatility which saw spreads widen during the month as some switching activity followed Lloyds Banking Group's 10NC5 T2 issuance as well as Mizuho's 6NC5 TLAC deal. In the structured space, RMBS spreads were marked tighter again in August given the strong demand and oversubscription for primary deals. There was circa 19bn of IG primary issuance in the Aussie credit market with majority of the supply coming from financial institutions.

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Outlook

Globally inflation has peaked and in retreat, the debate now is, can this move lower be sustained? The narrative on growth has been more volatile, with a once high conviction on a recession coming under attack in recent months as economic data continued to surprise on the upside.

While attention continues to be on central banks and “will they / won’t they” hike rates again, we continue to point to fiscal policy being the big surprise in 2023. In fact, the fiscal impulse from the US through 2023 to date has also been behind the “US exceptionalism” narrative. In Q1, fiscal provided a boost via large cost of living adjustments and military spending. In Q2, the debt ceiling process threatened to reverse this thrust, but the battle was ultimately won by the Democrats and fiscal spigots remained firmly open, including through Q3. Our analysis suggest that this fiscal action has worked to underpin growth or temper the slowdown that was underway, rather than kick start to higher growth. On the other side, this action has made the job for central bankers harder, which is why their rhetoric implies that monetary policy will err on over-tightening.

Our Strategic Forum is set for mid-September, where we comprehensively review the drivers of the outlook and re-assess each of the asset classes. Our base case outlook for a recession will be hotly debated in the context of the changing policy mix that has been experienced. If the US new year fiscal process (starts 1 October) stalls or reverses, the recession/soft landing debate is likely to swing again, especially with monetary policy being pushed into even greater over-tightening mode. The debate is keeping interest rate markets and duration as the source of volatility across portfolios, with risk markets remaining remarkably resilient. This balance could shift decisively in the coming months if recession fears elevate again, with potential further cracks in the employment market tipping that balance.

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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