

Macquarie Income Opportunities Fund

Monthly report – 30 September 2023

Investment objective

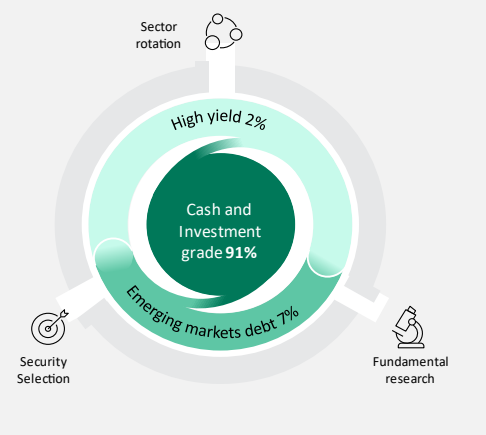
Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles.

Key information

Fund details

APIR code	MAQ0277AU
Inception date	18 September 2003
Fund size	\$3,022.8m
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 September 2023

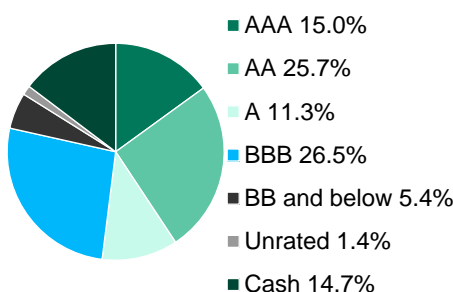
	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	-0.61	-0.65	0.34	-0.99
3 months (%)	0.67	0.55	1.08	-0.53
1 year (%)	4.87	4.35	3.56	0.79
3 years (% pa)	0.60	0.11	1.36	-1.25
5 years (% pa)	1.54	1.04	1.28	-0.24
10 years (% pa)	2.59	2.09	1.73	0.36
Since inception (% pa)	4.52	4.01	3.47	0.54

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.

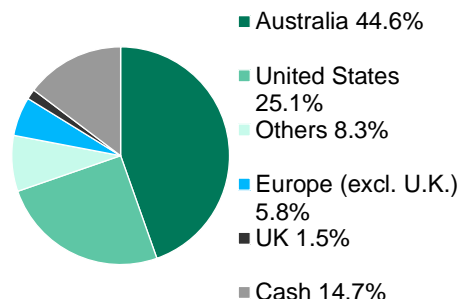
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.

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 [^]	45.1
Investment grade government	0.2
Asset-backed securities	30.5
High yield corporates [^]	2.3
Emerging market corporate	4.6
Emerging market government [^]	2.6
Cash and equivalents	14.7

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

[^]Fund holds (12.4%) 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	2.4 years
Interest rate duration	3.4 years
Standard deviation [^]	2.1% pa
Yield to maturity*	5.5% pa
Cash	14.7%
Cash exposure through credit hedges ⁺	14.1%

[^]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 over September. The key driver was duration positioning as the Fund maintained a position of approximately 3-years of duration, and this detracted from returns as yields rose significantly across the globe. Within the interest rate position, curve and country selection was a positive contributor, offsetting some of the losses. The Fund maintained a strong bias to shorter ends of the yield curve, which performed relatively well amid significant curve steepening, and a weighting toward Australian duration, which likewise performed relatively better. Credit performance was a modest positive, reflecting slightly wider spreads over the month, but defensive positioning and positive security selection in investment grade (IG). Within credit, positive contributors included credit hedges (as volatility began to increase late in the month), and issuers such as Australian banks, US corporates such as Oracle, and selected mortgage-backed securities. This was somewhat offset by renewed weakness in major US bank holdings, which slightly detracted.

The Fund made small changes to credit exposure over the month, reducing some remaining higher beta credits after very strong performance. This included trimming transport-related exposures in Europe, such as Heathrow airport and Abertis, a toll road operator – with spreads fully reflecting the more positive outlook and not compensating for the risk of volatility, in our view. The Fund added shorter dated credit and lower beta sectors such as utilities and healthcare in place of the sales, reflecting our view on credit beta. Within interest rate positioning, the Fund switched further from US duration to Australian duration, without changing the overall level of interest rate exposure, given the ongoing volatility and the fact that the US treasury market recently broke through key technical levels. We continue to expect opportunities to add to credit positions over time – particularly as we see spreads as relatively tight, against a backdrop of high economic uncertainty and increasing volatility in the underlying bond market.

Market overview

Higher bond yields and broadly steeper yield curves dominated September, as credit spreads drifted in range to end the month little changed to slightly wider, though equity markets posted more significant losses, however, September is seasonally the worst month for equity returns. Most major central banks kept policy rates on hold, though the European Central Bank delivered what is being commonly termed as a 'dovish hold'. But it was the US Federal Reserve 'hawkish hold' that dominated price action in rate markets, with the central bank guiding that while policy may not have actually peaked, the stronger message was that rates likely need to stay high for much longer than markets had previously been expecting.

The other major driver of markets in September has been the rise of oil prices, by roughly 10% in the month and by almost 30% through the quarter. With Gas prices and base metal prices giving a more mixed picture, the move in oil prices is more likely driven by production constraints rather than demand. Such a sharp move high in oil prices will impact headline inflation measures, and while this may ultimately prove temporary, there is concern that this re-enforces the "higher for longer" message coming from central banks at present.

Rate volatility drove markets in September with US 10-year yields closing the month neatly 50bps higher. These moves saw risk assets softer on the month as the market embraced a 'higher for longer' narrative.

US credit markets widened slightly over September, with benchmark IG spreads 3bps wider, to 121bps, and high yield (HY) +22bps, to 394bps. Rate volatility was the most notable impact with the moves taking the year-to-date total return for IG credit back to zero, from as much as 5%: this was a factor in the turnaround in flows into the asset class, with clear outflows in the second half of the month after consistent inflows for a sustained period. New issuance was \$130bn in IG and \$24bn in HY, both significant step-ups from quieter northern hemisphere summer months.

Within US IG, the clearest outperformer has been the long end (30-year) maturities, with a lack of supply and strong demand driving long spreads lower, in some cases flat or even below 10-year spreads. Amongst sectors, Banks were the weakest sector, with rates moves weighing on the outlook for both major and regional US banks. Energy was an outperformer, reflecting a strong run-up in the oil price, as were utilities, after under-performing the broader market in recent months.

European IG spreads closed the month 2bps tighter to 153bps, spreads ended the month on a weaker tone having traded down to 147bps mid-month. Issuance totalled €62 which was largely in line with expectations. Auto issuance picked up with VW, BMW and RCI all issuing multi tranche deals, concessions moved considerably higher in the latter part of month generic IG risk requiring approximately 15bps concession to clear. The move higher in bond yields was the main theme in Europe with bunds reaching intraday highs of 2.98% and weakness starting to appear in the periphery as Italian sovereign spreads widened by 30bps.

Australian credit outperformed its global counterparts in September, with the option-adjusted spread tightening a further 6bps. Despite most of the monthly move attributable to narrower swap spreads rather than credit spreads, the broad-based rally over the past six months has the index at 152bps and is the tightest since May 2022 when the Reserve Bank of Australia commenced its hiking cycle. Financials moved modestly wider, driven by the longer-end with 5-year major bank spreads drifting a couple bps in September despite the front-end being well anchored as we passed the first major "cliff" of Term Funding Facility repayments. Tier 2 bonds followed a similar move to senior spreads for the first half of the month and weakened by 10bps, however strong reinvestment flows, and a well-received Suncorp deal ignited a sharp rally over the final two weeks with a near 15bp turnaround to close 3-4bps tighter. Of note in September was APRA's release of a discussion paper on enhancing Australian Additional Tier 1 bonds, although any outcome is likely to take many months. The theme in corporates was more curve than sector based, with the broad-based rates sell-off providing support for longer-dated bonds to modestly tighten over the month. The front-end wasn't so lucky, 5-10bps wider in some sectors as interest rate curves steepened and switching activity into new primary deals became more commonplace. There was around \$12bn of primary issuance in the Australian market in September, financials dominating once again.

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Outlook

During September our global team conducted the third iteration of our Strategic Forum process for 2023. Our macro session concluded with a restatement of 'recession' as our base case outlook, noting that easier US fiscal policy has underpinned the more resilient growth that was expected in recent quarters. This has been in contrast with Europe in particular, where the slowdown has broadened. Thus, with the new fiscal year process in the US (from 1 October) rekindling the difficult political environment and rolling off student loan forbearance, our expectation is for fiscal policy to ease back to a more neutral impact on demand, therefore resulting in the overall policy mix (that is, in combination with monetary policy) to again move tighter. Thus, the growth slowdown should gradually emerge through the coming quarter and into 2024.

Our base case is for a cyclical recession, such as experienced in 2001. However, what happened in 2001 was the 'tech crash' which resulted in a more dramatic impact on asset markets than would have been expected given a mild recession for the economy. For this cycle we note similar risk environment for asset markets even if the economy does experience a mild recession. This risk stems from an environment of prolonged overtightening of monetary policy and tight credit conditions. Here we note that credit conditions are nothing like that of 2008, as here loan demand is already quite weak which offsets the fact that lenders have tightened lending conditions significantly. That said, we are alert to financial risk as a consequence of the current environment.

Managing duration has continued to be difficult with bond yields marching to levels not seen since 2007. Yet history guides that bond yields decline once the rate hike cycle has clearly peaked. Credit spreads have proved resilient despite the fact that earnings have entered a recession due to slowing revenue growth. While most companies entered this slowdown well prepared there has been a steady 'chipping away' at this resilience and the longer the tighter financial conditions persist the risks will continue to grow. Thus, the current pricing across asset markets when combined with our base case outlook is guiding our investment process to remain cautious despite the baying from the narrative that "this time (might) be different".

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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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