Macquarie Investment Management

Macquarie Income Opportunities Fund

Monthly report – 31 March 2021

Investment objective

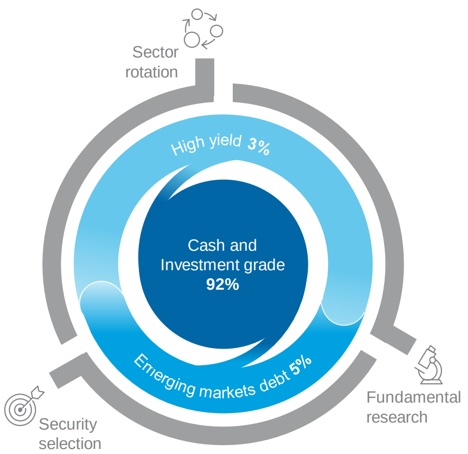
Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles.

Key information

Fund details	
APIR code	MAQ0277AU
Inception date	18 September 2003
Fund size	$3,317.7m
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.

Current sector breakdown



Sector limits	(min/max)
Investment grade	0/100
High yield	0/20
Emerging markets debt	0/15
Cash	0/100

Fund performance to 31 March 2021

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.14	0.10	0.00	0.10
3 months (%)	-0.38	-0.50	0.00	-0.50
1 year (%)	5.19	4.68	0.11	4.57
3 years (% pa)	2.79	2.29	1.12	1.17
5 years (% pa)	3.61	3.10	1.40	1.70
10 years (% pa)	4.14	3.63	2.31	1.32
Since inception (% pa)	5.16	4.64	3.73	0.91

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.

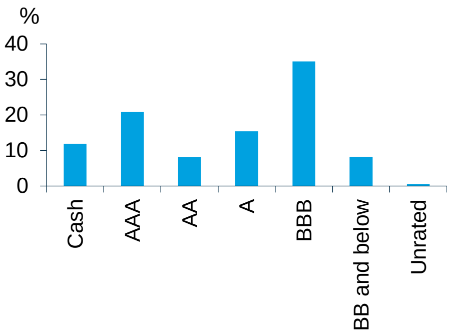
Asset allocation

	Fund (%)
Investment grade corporate^	49.4
Investment grade government	10.5
Asset-backed securities	19.9
High yield corporates^	3.1
Emerging markets corporate	1.7
Emerging markets government^	3.5
Cash	11.9

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

^Fund holds 0.0% in investment grade, 5.3% in high yield and 0.2% in emerging markets credit hedges as synthetic cash (reduction in percentage of physical cash exposure).

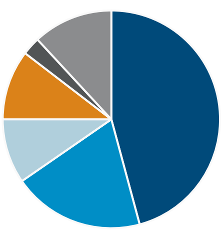
Credit profile breakdown



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



Fund statistics

Credit spread duration	3.1 years
Interest rate duration	1.5 years
Standard deviation[1]	1.8% pa
Yield to maturity[2]	1.5% pa
Cash	11.9%
Cash exposure through credit hedges[3]	5.5%

[1] Statistical measure of variance of Fund's post-fee monthly returns from average post-fee return since inception, used as gauge of volatility.

[2] Pre-fee returns Fund would earn over next year based on current market conditions if there were no changes to interest rates or holdings. It is not an actual or estimated return.

[3] Credit hedges swap the return for underlying credit index for cash.

Fund highlights

The theme of 'divergence' has been observed over the past months, with uneven impacts of the pandemic across countries and sectors as well as varied fiscal responses by different governments. Adding to the divergence has been the vaccination rollouts. Amongst developed countries, the UK and US have led the way on vaccine administration, which are enabling the gradual re-opening of their economies. In contrast, Europe has laboured and is now dealing with a third wave of coronavirus and a re-tightening of restrictions. The combined result has caused US rates to shoot higher, led by the 10-year bond yields, and yield curves to steepen sharply. European yields, on the other hand, actually fell by a few basis points. So, for fixed income investors, country selection and positioning were key drivers of performance in the month of March.

That said, there should be no allusions to the challenges facing fixed income in 2021, as the volatility across interest rate markets experienced during the first quarter is likely to continue as investors cope with the uncertainties still surrounding the virus, the challenges of the vaccination process and the expected volatility in the month-to-month economic data. Still, supportive policies and a gradual re-opening of economies are combining to underpin risk markets, where credit spreads have remained resilient and close to historic tights.

The Fund outperformed the benchmark during March. Duration was a key contributor, with a retracement in global bond yields from last month and rolldown in the targeted yield curve positioning contributing to performance. Credit markets finished the month generally unchanged, and the Fund's risk positioning contributed positively to returns. Subordinated Australian mortgage-backed securities were a key contributor, with limited issuance and strong demand for yield in this space, along with continued improvements in fundamentals for mortgages especially rising house prices, driving spreads tighter. Other sectors, including investment grade (IG) corporate credit and emerging markets debt, also added modestly to returns. Overall, March was characterised by improving growth expectations as a result of the global vaccination progress, against residual market uncertainties about the impacts of higher yields. So far, the push higher in growth expectations has been leading the tone in credit markets.

The Fund maintains a preference for higher beta credit, viewing the remaining upside in generic credit spreads as limited and opportunities as more driven by spread compression in wider trading names and sectors, rather than further performance from names that are already trading tight. We have further reduced some exposure to lower beta IG credit that offer limited upside, while continuing to maintain healthy liquidity levels in the Fund. This month's positioning changes were mostly focused on new issuance opportunities. The heavy issuance volumes in both the US and Europe offered some value to participate. There were also some attractive new names in the Australian market despite issuance volumes remaining low. New additions included US technology company Oracle Corporation, which was downgraded just before the new bond was offered and repriced significantly wider, offering attractive spread levels; and Australian toll road operator WestConnex, which has stable and escalating toll revenue, a long-dated concession expiry and manageable construction and traffic risk.

Market review

Global and Australian credit markets

USD-denominated credit markets finished March generally unchanged, though intra-month volatility was higher. IG spreads hit a wide of 100bps, driven by the volatility in underlying treasury markets, higher new issue concessions and heavy new issue supply. As bond volatility subsided somewhat into month end and offshore investor demand improved, spreads rebounded to recapture almost all of their weakness. European IG spreads finished the month 2bps wider at 90bps.

Outlook

In the coming quarter, the recovery outlook for the US is poised to lead the way, while Europe is expected to continue struggling. The US will benefit from the upcoming substantial fiscal package, which includes large direct stimulus payments. As the services sector gradually re-open, the benefit should manifest in both spending and employment. These all point to a likely robust rebound in growth in the coming quarter, which will be accompanied by the surge in oil prices and base effects to push headline inflation rates higher. Interestingly though, central banks have been consistently citing the transitory nature of these inflation factors, expecting the large structural dampeners on inflation to contain the longer-term risks. Thus, a gap has opened between the markets' outlook for inflation and that of central banks. This suggests that bond market volatility is likely to persist until one side shifts their view.

Certainly, the rise in US rates has been larger and quicker than we had expected, but elsewhere the move in rates has been more gradual. Thus, the scene is set for a lot of noise in fixed income markets, where managing duration risk is in focus. We are also alert to any shift by policy makers. We expect central banks to maintain their easy policy stance, which leaves fiscal as the likely factor for surprise. On one hand, as economies re-open the huge fiscal support measures are expected to roll off. The risk here is that there is an 'activity gap' particularly in terms of employment. On the other hand, there is scope for fiscal policy to shift from 'support' to 'direct' stimulus. The US is again leading the way, with President Biden outlining an ambitious infrastructure package. This could help lift the current low level of productivity, as it tilts policy toward investment into the supply side of the economy. While there is still a long way to go for the passing of the package, theoretically the US fiscal policy is supportive of growth going forward. But as it is supply-driven, the inflation risk should be contained. A side effect to consider is that this fiscal initiative could widen the gap of growth further between the US and regions such as Europe.

We therefore expect a challenging investment climate to persist, where our intention is to maintain discipline and recognise that opportunities will present themselves.

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For more information speak to your financial adviser, call us on 1800 814 523, email mim.clientservice@macquarie.com or visit macquarie.com