Macquarie Investment Management

Macquarie Income Opportunities Fund

Monthly report – 30 June 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	$3,288.3m
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.

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

Fund statistics

Credit spread duration	3.0 years
Interest rate duration	1.0 years
Standard deviation[1]	1.8% pa
Yield to maturity[2]	1.4% pa
Cash	14.5%
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 performance to 30 June 2021

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	0.29	0.25	0.00	0.25
3 months (%)	0.85	0.73	0.01	0.72
1 year (%)	3.63	3.13	0.06	3.07
3 years (% pa)	3.06	2.55	0.96	1.59
5 years (% pa)	3.44	2.93	1.29	1.64
10 years (% pa)	4.08	3.57	2.19	1.38
Since inception (% pa)	5.13	4.62	3.68	0.94

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.

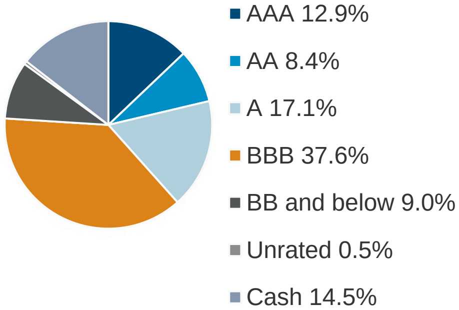
Asset allocation

Sector	Market value %
Investment grade corporates^	53.0
Investment grade government*	2.2
Asset-backed securities	21.5
High yield corporates^	3.7
Emerging markets corporates	1.8
Emerging markets government^	3.3
Cash and equivalents	14.5

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, (5.4%) in high yield and (0.1%) in emerging markets credit hedges as synthetic cash (reduction in percentage of physical cash exposure).

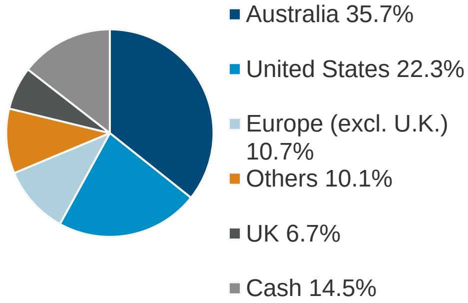
Credit profile breakdown



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 highlights

The Fund outperformed the benchmark in June. The Fund's credit exposures and interest rate duration both contributed evenly to performance, with investors' desire for yield continuing to support a small rally in credit spreads and government bond yields during the month. Spread compression (higher-beta/lower-rated credit outperforming higher-rated) continued to be the key theme in June, which benefited the Fund's positions in BBB-rated credit in particular. Amongst the strongest contributors in the credit allocation were corporate hybrids (for example, holdings of Ampol and European toll road operator Abertis), higher-beta US utilities names, and some travel exposures. These allocations held in well overall despite some late month weakness, as concerns built around the 'delta' variant of the virus and the pick-up in cases in a number of regions.

The Fund reduced some holdings in longer-dated AUD-denominated credit during the month, continuing with the theme of reducing longer-dated exposures that either offer low spreads or have performed very strongly, reflecting our view that these allocations offer reduced upside and higher downside in the case of credit market weakness. For example, we reduced exposures to selected longer-dated industrial REITs and other industrial names that had performed strongly. Excess cash continues to be re-deployed in short-maturity credit where some spread can be found, including subordinated banks globally and BBB non-financial corporates. Overall, the risk setting of the Fund remain in place, favouring a 'barbell' of higher-beta credit (BBB, and selected high yield and emerging markets credit), while maintaining short-dated holdings and significant liquidity to take advantage of any opportunities. The interest rate duration exposures were maintained, which provided some additional carry in the most attractive parts of the AUD and USD curves and should offer some modest offset to the risk holdings.

Market review

The key event in June was the decision of the US Federal Reserve (Fed), which surprised markets by shifting its tone and forecasts for the outlook of rate hikes. Despite the Fed continuing to emphasise that the recent rise of inflation is transitory, markets viewed the upward shift in rate expectations as validation of their speculation. This caused shorter-term yields to push higher. Longer-dated bond yields went the other way, with a flatter yield curve the result. The debate amongst market participants was not only interpreting the Fed's signal, but also why the bond market rallied. There is merit in the view that earlier-than-expected Fed tightening could put a lid on the recovery and hence cap inflation, but there were also more subtle technical forces at play, which combined to squeeze many 'short' positions that further fuelled the rally in Treasury yields.

While these events were unique to the US, the impact rippled across countries, and curve flattening was a common theme and magnified in Australia and New Zealand, where recovery has already returned to pre-pandemic levels. Risk markets proved resilient, with credit spreads grinding tighter and high yield bonds outperforming. Emerging markets debt underperformed as the US dollar reversed its downward trend, but also because the pandemic is having a differentiated but significant impact on many countries.

US credit spreads rallied in June, though at a slower pace. Investment grade (IG) credit tightened 4bps to 80bps. In particular, lower-rated credit performed most strongly. Supply-demand technicals remained a key support as investors continue to move down the quality spectrum to search for yield, while corporate fundamentals continued to improve. In Europe, IG credit tightened 2bps and, within IG, high-beta names in sectors such as REITs and sub-insurance outperformed. Australian IG credit also grinded tighter, with spreads in COVID-impacted and higher-beta sectors, such as industrials and financial subordinated paper, compressing further.

Outlook

The pandemic continues to exert an influence on the shape of recovery as countries are at different stages, while new variants remind that vaccination may quell the hospitalisation risk but the virus will likely be with us for some time to come. There are still many unanswered questions on the future, such as: when will normal activity resume; when will international travel resume; what will the post-virus workplace look like?

As we move into the second half of 2021, attention is on the shape of recovery as economies re-open and whether the current inflation pulse will prove transitory as expected by policy makers or persistent. A key feature of the pandemic was massive government support to workers and businesses, but this is nearing its end, with many states in the US deciding to withdraw the Federal support early in the hope that this encourages people back to work. How quickly these furloughed/unemployed workers return will be key in determining the shape of the recovery. Businesses trying to re-open have reported difficulty in hiring and many have offered financial incentives, including higher wages, which has fuelled concerns that inflation will become persistent. Yet the data has shown that the majority of government transfer support to these workers during the pandemic was saved, suggesting that persistent uncertainty will hold back consumption. While supply disruption is likely to continue to pressure inflation, in our opinion, the evolution of consumer income and demand will prove the decisive determinant of inflation longer term.

These vital but unanswered questions, combined with low bond yields and tight valuations, guide to a cautious approach to investment. However, we also recognise the ferocious insatiable need for yield. We balance these forces by maintaining discipline and 'doing the work' to determine the best risk-adjusted positioning for portfolios.

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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