Investment Management

Macquarie Income Opportunities Fund

Monthly Report – March 2017

Investment objective

The Fund 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.

Fund performance to 31 March 2017

	Total gross fund returns	Total net fund returns*	Benchmark returns **	Total net excess returns
1 month (%)	0.47	0.43	0.15	0.28
3 months (%)	1.53	1.41	0.44	0.97
1 year (%)	5.94	5.42	1.94	3.48
2 years (% pa)	3.48	2.97	2.09	0.88
3 years (% pa)	3.63	3.13	2.30	0.83
5 years (% pa)	4.83	4.32	2.65	1.67
Since inception (% pa)***	5.79	5.27	4.47	0.80

Past performance is no indication of future performance.
*Total net returns are quoted after the deduction of all fees and expenses. Total returns are calculated based on changes in net asset values and assumes the reinvestment of distributions. Due to individual investor circumstances, your net returns may differ
** The benchmark is the Bloomberg AusBond Bank Bill Index.
*** Inception date is 19/09/2003

Fund highlights

The Fund outperformed the benchmark in March, despite performance in global credit markets slightly diverging during the month. Excess returns were driven by the Fund's holdings in the Australian credit market, as spreads for Australian bank debt and mortgaged-backed securities both outperformed. However, volatility in the US credit market increased which driven by a midmonth fall in oil prices and the failure of President Trump to pass the healthcare bill. The Fund reduced its high yield position during the month, as valuations for the sector have become less attractive.

US issuance volumes increased, with Verizon Communications the largest issuer at $11bn and Siemen AG issued $7.5bn of debt. In financials, both HSBC Holdings and UBS Group issued. The Fund participated in the new issues by HSBC Holdings and Siemen AG.

Issuance volumes in Australia were moderate in March, and the Fund participated in a new bond issue from AMP and a credit card ABS issued by Latitude Financial Services.

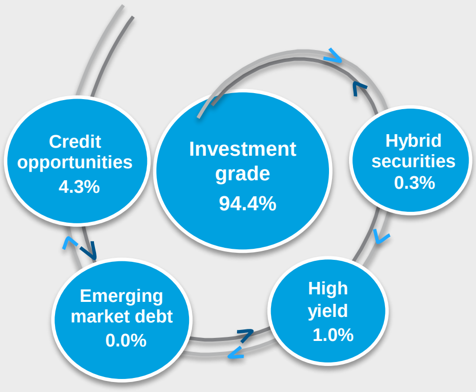
Markets finished March on a mixed note overall. Risk markets that had rallied strongly for the last 12 months took a small backward step. The volatility proved to be modest and short-lived, and by the end of the month, much of the spread widening had been reversed. There were a number of drivers of the initial weakness, including weakness in oil prices, an earlier than expected US Federal Reserve (Fed) hike, and a setback to Trump's reform agenda in the US. By the end of March, though, a 'chase for yield' mentality began to return to markets, and both credit and government bond markets attracted buyers.

The Fed hiked the federal funds rate in March for the third time since the financial crisis. The move was exceptional, as only three weeks earlier markets had priced only a 30% chance of a rate move. While the move may have unsettled markets, the Federal Open Market Committee statement and Fed Chairperson Yellen's post-meeting press conference underlined a gradual approach to raising rates, calming market uncertainty.

Oil prices weakened over the month, breaking back down through $US50/barrel as US supply continued to grow and OPEC's production cuts looked less rigidly applied than had been hoped. The price moves were only moderate however, it was enough to be a strong contributor to a widening of 50bps in global high yield credit spreads. With valuations in high yield credit generally unattractive, any reason to not hold the asset class has understandably been met with significant outflows from the sector, and this was reflected in investor withdrawals from high yield credit picking up in March.

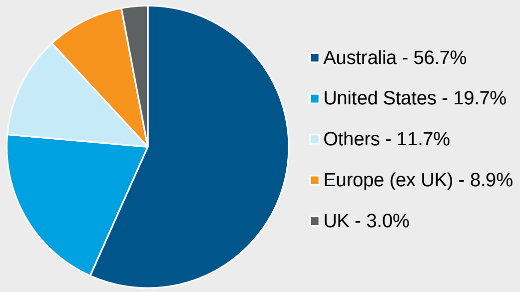
The Trump administration stumbled at its first significant legislative hurdle during March, with the Republican Party's amendments to the Affordable Care Act failing to find enough

Sector breakdown

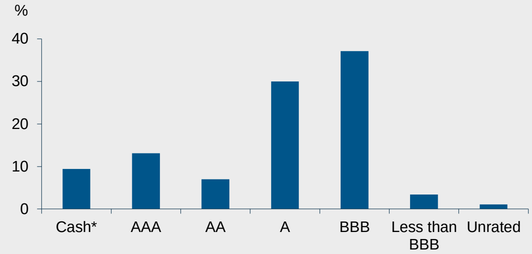


Sector limits (%)	(min/max)
Investment grade	20/100
Hybrid securities	0/10
High yield	0/15
Emerging market debt	0/15
Credit opportunities	0/20

Region breakdown



Credit profile breakdown



* Cash consists of physical cash and cash exposure through credit hedges

Average credit rating: A-

'Less than BBB' includes 1.2% of residual exposure to issuers held via our global Investment Grade allocation support within their own party. While the failure has limited direct economic consequence, it may point to difficulties for the new President in getting his broader, more economically important agenda through a much divided legislature.

Australian credit markets actually traded very strongly over the month, ignoring the modest volatility coming out of the US. Corporate issuance in the local market continues to be quite limited, but increasingly weighted to the long end of the maturity spectrum. 10 year corporate issuance, which has not ever been a significant feature in Australian markets, has been a major portion of recent supply.

Global investment grade credit likewise traded in a stable range over the month, though overall did underperform the Australian market. Issuance volumes remained very healthy, with $US135bn in new US investment grade bonds, though this was down from previous March records.

Market review

Economic data maintained its recent positive momentum. US nonfarm payrolls recorded another beat while Australian gross domestic product (GDP) rebounded strongly. China's Purchasing Managers' Index (PMI) numbers climbed higher and industrial production (IP) increased in the euro area.

US

US economic data for March continued to beat expectations. US nonfarm payrolls increased by 235k (versus 200k expected) and the Institute for Supply Management Manufacturing Index increased to 57.7. Consumer confidence also beat expectations.

Australia

Australian economic data was mixed. The month began on a positive note, with GDP increasing 1.1% in the final quarter of the year. The strong quarter was enough to bring the annual growth rate up 0.6% to 2.4%. However, the unemployment rate unexpectedly rose to 5.9% as the number of jobs declined 6.4k (versus an increase of 16.0k expected).

Asia

Chinese data presented mixed results in March. The manufacturing PMI hit a 5 year high at 51.8, while the non-manufacturing PMI increased to 55.1. However, inflation weakened to 0.8% YoY. Economic data in Japan was also mixed. Core inflation rose for a second consecutive month. However, household spending continued to deteriorate, falling 3.8% in March.

Europe

The level of economic activity in Europe continued to trend positively. Euro area IP rose 0.9% MoM in January, with December also revised upwards. Euro area consumer confidence also rose sharply in March (+1.2 points to -5.0) while the Ifo Business Climate Index for Germany increased to 112.3, its highest level since July 2011.

Outlook

Market sentiment remains positive, despite modest volatility and some setbacks to the bull case this month. In the absence of meaningful reform, we believe markets are likely to revert to a 'chase for yield', as the underlying structural issues that weigh on developed markets have not meaningfully changed. That means that high quality credit should remain well supported, as well as bonds, which provide steady income and some downside protection. Given the strong performance of markets over the last 12 months, some portions of the credit market offer less value compared to the risk they bring. As such, we have adjusted positioning in some segments accordingly, reducing weights to the highest beta sectors while remaining invested in investment grade credit.

Top 5 asset allocation by industry	(%)
Banks	26.7
Residential mortgage	12.8
Transportation	5.9
REITs	5.6
Electric	4.5

Fund statistics	
Credit spread duration	3.8 years
Interest rate duration	1.1 years
Standard deviation[1]	1.7% pa
Yield to maturity[2]	3.1% pa
Physical cash	7.8%
Cash exposure through credit hedges[3]	1.5%

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

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

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

Unit prices	
Application price	$1.0302
Redemption price	$1.0272
NAV price	$1.0287

Distribution details (Cents per Unit)	
Current month	0.15
Financial YTD	1.75

Fund details	
APIR Code	MAQ0277AU
Inception date	19 September 2003
Fund size	$2,566.0m
Distribution frequency	Monthly
Management fee	0.492% pa
Buy/Sell spread	+0.15% / -0.15%
Minimum investment (Direct)	$20,000

Available platforms include:

- AMP Flexible Super
- AMP North
- Asgard
- BT Wrap
- Colonial FirstChoice
- Colonial FirstWrap
- IOOF
- Macquarie Wrap
- MLC Wrap
- Navigator
- Netwealth
- Oasis
- OnePath PortfolioOne
- Perpetual WealthFocus
- PortfolioCare
- WealthView

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