Fund Research

Metrics Master Income Trust (ASX: MXT)

Overview

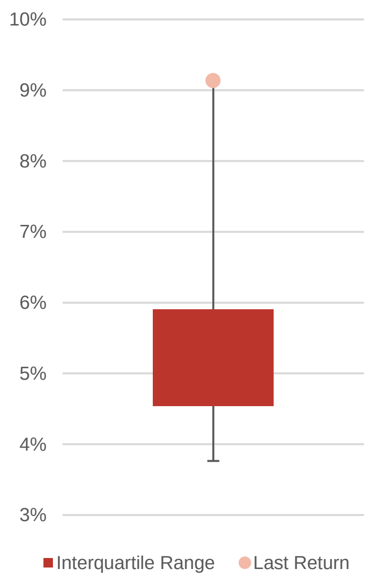
The Metrics Master Income Trust (the “Trust”; “MXT”; or the “Fund”) is a listed investment trust designed to provide retail investors with ready access to the Australian corporate loan market. As at 31 March 2023 the market capitalisation of the Fund was $1.71 billion.

Private credit is an important part of the Australian corporate debt market that has previously been limited to major banks and institutional investors. For this reason, MXT offers retail investors a unique exposure to a debt sub-asset class that is not easily directly accessible to them.

The Trust’s investment objective is to provide stable capital value and an attractive income stream with a target return of the **RBA cash rate plus 3.25% p.a.** (currently 7.35% p.a.) **after fees**, payable monthly.

MXT invests in the Metrics Credit Partners Pty Ltd (MCP, Metrics) Wholesale Investment Trust (WIT), which, in turn, invests in Metrics wholesale institutional investor funds that participate across the credit risk spectrum and are managed by Metrics.

Figure 1. Monthly Net Returns Box Plot



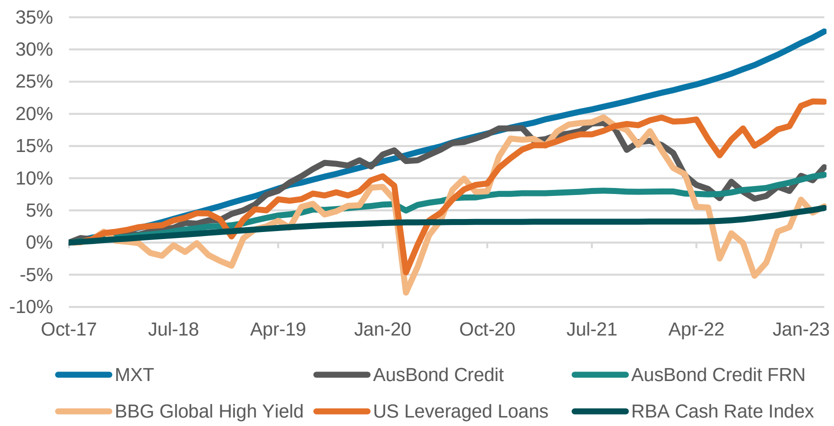
Source: BondAdviser, Metrics. Annualised monthly returns, after fees since inception.

Figure 2. Monthly Net Returns* (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2023	0.71	0.64	0.73										**2.08**
2022	0.36	0.32	0.37	0.35	0.42	0.44	0.47	0.54	0.52	0.63	0.63	0.68	**5.74**
2021	0.33	0.33	0.43	0.31	0.36	0.32	0.31	0.34	0.34	0.34	0.37	0.38	**4.14**
2020	0.45	0.41	0.43	0.43	0.39	0.40	0.50	0.44	0.38	0.38	0.40	0.40	**5.03**
2019	0.48	0.47	0.54	0.54	0.52	0.33	0.43	0.43	0.38	0.42	0.42	0.43	**5.41**
2018	0.38	0.32	0.43	0.38	0.38	0.45	0.50	0.49	0.45	0.49	0.47	0.52	**5.27**
2017										0.46	0.35	0.41	**1.23**

Source: BondAdviser, Metrics. As at 31 March 2023.
** Return is monthly net total return based on NTA plus dividends.*

Figure 3. Relative Cumulative Performance



Source: BondAdviser, Metrics, Bloomberg. As at 31 March 2023. Calculated from cumulative net monthly returns of the Underlying Fund. Returns on NAV, not traded unit price, see Figure 12 for unit price variance.

Product Assessment

Highly Recommended

The Fund has continued to outperform its net target return over the past year and since inception while NAV has been predictably stable.

The Metrics Master Income Trust (ASX: MXT) offers investors exposure to three Metrics wholesale unlisted funds, which in turn provide diversified exposure to commercial loans. The majority (~60%) of the portfolio is invested in Metrics Credit Partners Diversified Australian Senior Loan Fund (DASLF), with ~20% allocated to the MCP Secured Private Debt Fund II (SPDF II) and ~20% to the MCP Real Estate Debt Fund (REDF).

MXT suits investors seeking an attractive, monthly income stream that are comfortable with exposure to an actively managed diversified portfolio of private loans weighted toward the real estate sector. The product exhibits low long-term correlation to traditional asset classes, so it can provide diversification benefits for investment portfolios, which tend to be weighed towards equities and fixed interest.

Following the recent retraction of traditional lenders, Metrics have a wider and more higher credit quality opportunity set to redeploy funds into.

NAV has been predictably stable, however investors need to understand that as a listed fund, MXT is exposed to market volatility, unlike Metrics' unlisted funds. Such market exposure can result in the unit price trading at a discount to the NAV in periods of heightened volatility. These situations can present an opportunity to buy at a discount for investors that retain confidence in the resilience of MXT's underlying investment portfolio. On the flipside, being listed may provide greater liquidity than an unlisted fund. After a ~14 month-period of the MXT unit price trading beneath the Fund's NAV, the price has been above net asset value for 36 out of 39 trading days since 28 August 2023 to now be at a 0.5% premium (20 October 2023 close). The Fund has continued to outperform its net return target over the past year and since inception. On a rolling 12-month basis to 31 March 2023, MXT generated a net return of 6.97% (assuming reinvestment of distributions), which was 147bps above the target. Since inception (October 2017) the annualised net return was 5.39% or 103bps above the target.

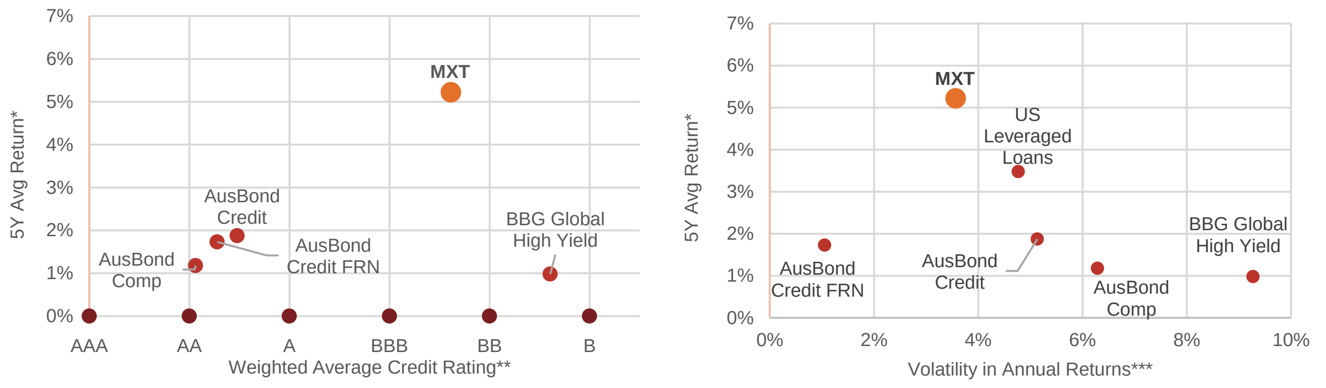
Credit risks are clearly on the rise for all lenders given the rapid rise in interest rates and inflationary environment. At this point of the credit cycle, we are particularly wary about the circa 54% exposure to real estate (on a commitment basis) of the underlying portfolio – noting that almost 20% is exposed to real estate development. That said, it is positive that ~97% of the real estate loans are senior secured ranked as at 31 March 2023, which protects against first losses that are worn by subordinated/equity tranches in the borrower's capital structure. Furthermore, we note that Metrics has established a commendable track record of originating, structuring, and managing commercial real estate credit investments. It is important to note it does not lend to building contractors.

As a function of the turning credit cycle, the manager is finding a growing opportunity set as the banks tighten their lending policies. This is resulting in borrowers that were previously of high enough quality for bank funding being forced to look elsewhere for capital. Metrics now has a greater pipeline than at other points in the cycle and is able to be increasingly selective in capital allocation to the best risk-adjusted return opportunities.

Although there are the occasional payments made a few days late, as is commonly experienced by most private credit portfolios, there remains a complete absence of loans in arrears exceeding 30 days. This underscores the quality of Metrics' portfolio. Considering the substantial range of counterparties Metrics extends loans to, we interpret this outcome as a result of meticulous screening procedures aimed at ensuring confidence prior to the precise allocation of funds. Overall, we remain confident that Metrics has robust systems and processes to originate and structure loans, and diligently monitor performance to mitigate credit risk at the individual loan and portfolio level. At the loan level, risk is lessened with around 91% of the underlying portfolio (excluding cash) invested in senior secured loans, which improves the potential recovery following a loan default event. At the portfolio level, risk is reduced by the diversification benefits of having a number of unique loan counterparties that totaled 306 as at 31 March 2023.

We maintain our anticipation that MXT will excel in terms of risk-reward dynamics, and we uphold the Fund's rarely achieved assessment of being **Highly Recommended**.

Figure 4. Estimated Risk-Adjusted Return Comparison



** All returns for indices calculated using annualised monthly returns for the past five years. Average return for MXT calculated since inception in October 2017.*
*** Credit Ratings based on BondAdviser estimates. *** Calculated based on annualised monthly returns data for past five years for indices and since inception for MXT. Source: BondAdviser Estimates, Metrics, Bloomberg. As at 31 March 2023.*

Construction and Investment Process

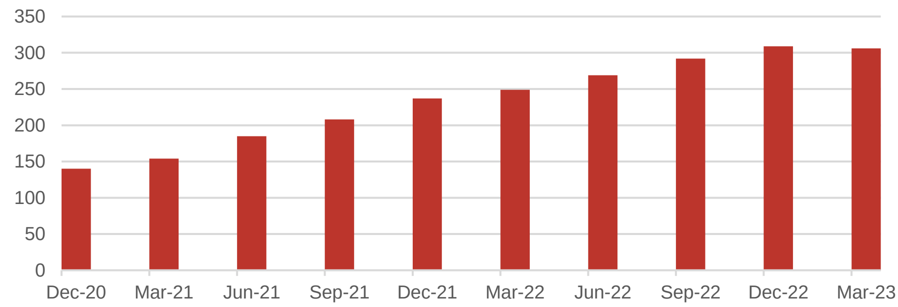
There have been **no material changes** to MXT's construction and investment process.

Portfolio Risk Management

The risk profile of the underlying portfolio (excluding cash, on a commitment basis) deteriorated moderately over the March 2023 quarter. The allocation to investment grade credit reduced from 50.1% as at 31 December 2022 to 48.9% and is mildly negative. Compared to a year ago, it is 3.5 percentage points lower, which is notable at this point of the credit cycle.

Concentration risk is a key risk for a credit fund and in this regard, we positively note the large number of counterparties in the portfolio as a feature of the Fund from a portfolio credit perspective. Over the quarter, counterparty risk was broadly stable - the number of unique borrowers decreased slightly from 309 to 306, while the average loan exposure rose 1 basis point to 22bps and the largest single loan exposure fell from 1.94% to 1.87%.

Figure 5. Unique Borrower Exposure Over Time

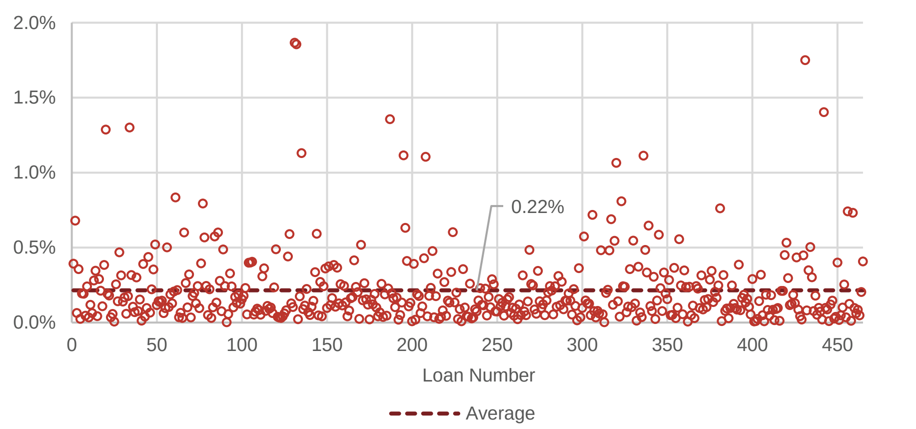


Source: BondAdviser, Metrics. As at 31 March 2023. Based on Metrics' underlying portfolio (WIT) not MXT.

Of some concern is the uptick in portion of the book that is maturing in less than a year from 31.9% at 31-Dec-22 to 38.2% at 31-Mar-23. Two years ago, this portion was just 25.7% of the portfolio. This heightened roll-off places significant pressure on the investment team's ability to originate new loans in order to prevent cash stockpiling and dragging on returns. Such an effect would stand out in this high yielding environment, placing even more pressure on redeployment. While cash drag is bad, rushed investment into weaker credits at this point in the cycle would be far worse. Positively, we are yet to see a material weakening in the portfolio's seniority composition. Additionally, Metrics have proven their ability to successfully and efficiently recycle capital over a number of years, avoiding impact to the portfolio's credit profile or returns. Despite the larger than typical refinancing task ahead, we expect Metrics' record in this regard to continue given there is no shortage of corporate lending opportunities currently.

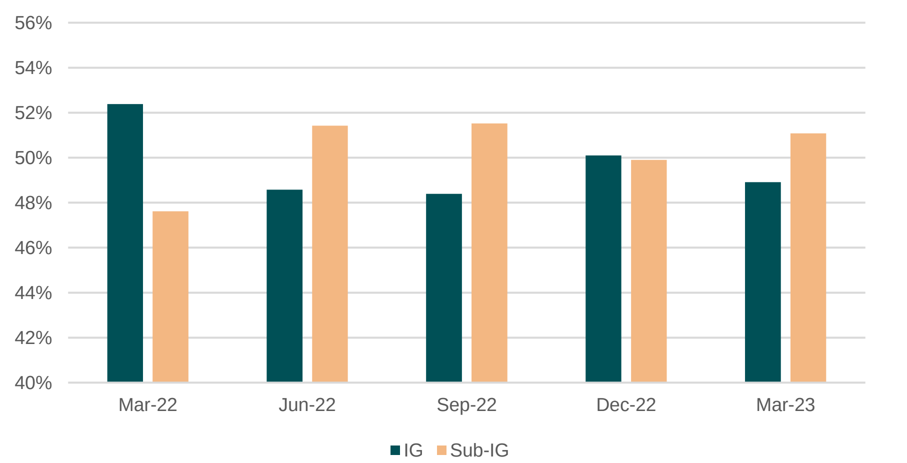
Furthermore, of additional concern is the increasing exposure (excluding cash on a commitment basis) to real estate over the past six months to 54.3% at Mar-23 from 50.0% at Sep-22. About a third of this is exposed to real estate developments with the balance in REITs. This is not a major deterioration, however, is of note as asset cross-correlations are a vital aspect of credit portfolios.

Figure 6. Individual Loan Exposure*



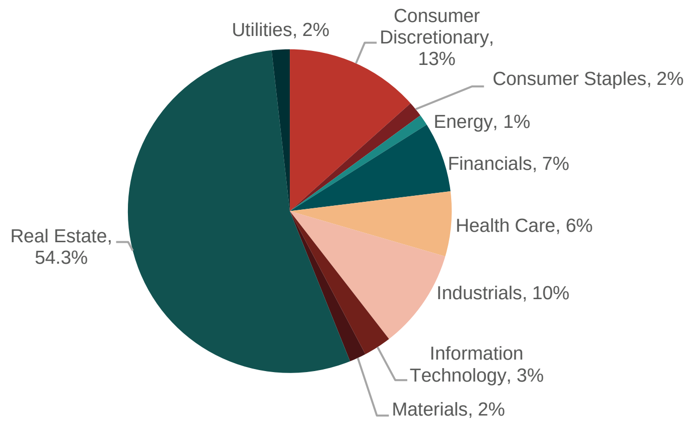
*Source: BondAdviser, Metrics. As at 31 March 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Figure 7. Portfolio Credit Rating Mix*



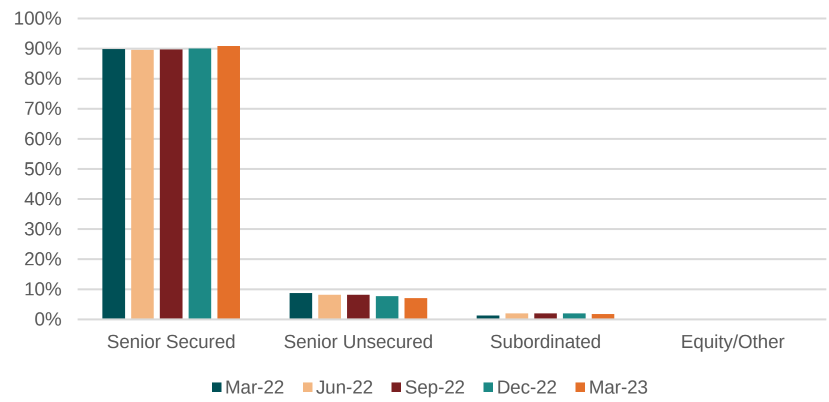
*Source: BondAdviser, Metrics. As at 31 March 2023. * Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Figure 8. Portfolio Exposure by S&P Sector*



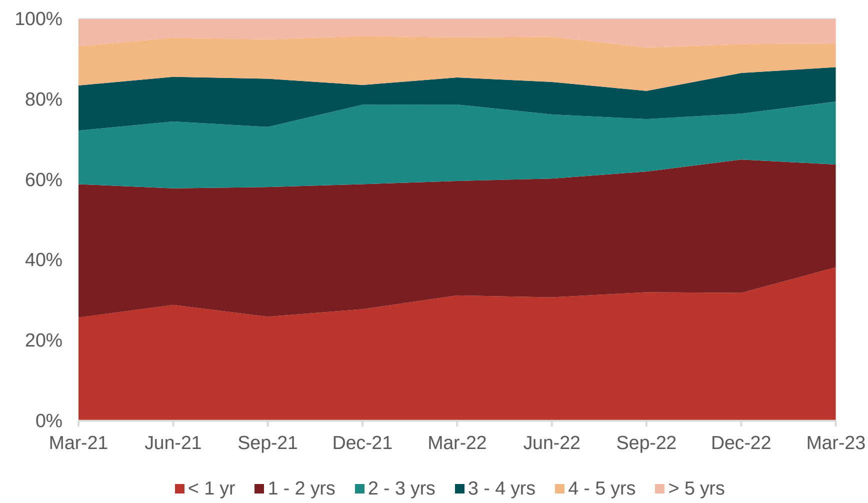
*Source: BondAdviser, Metrics. As at 31 March 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Figure 9. Portfolio Seniority Mix*



*Source: BondAdviser, Metrics. As at 31 March 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Figure 10. Portfolio Loan Tenor Mix*

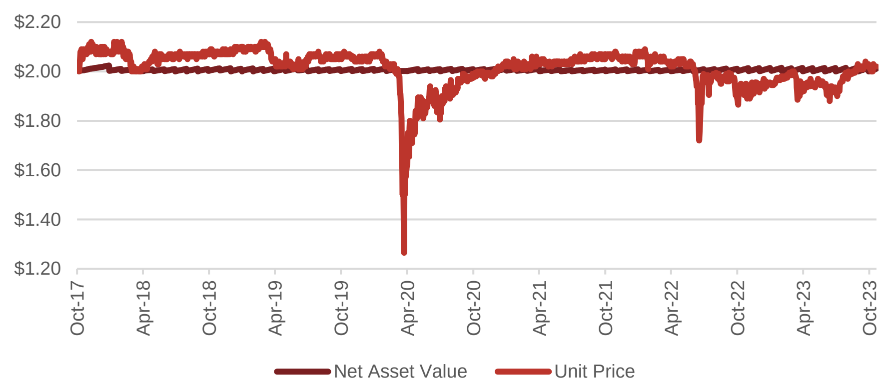


*Source: BondAdviser, Metrics. As at 31 March 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Fund Governance

There have been **no material changes** to MXT's fund governance.

Figure 11. Net Asset Value Against Unit Price



Source: BondAdviser, Metrics, Bloomberg. As at 20 October 2023.

The structure of the Trust has not changed and is outlined in prior reports (see page 4 of MXT Update Report – 21 April 2021).

The price to NAV discount that reached as a high as 14.2% during the market disruption around June 2022, retraced to under 1% by February 2023. However, renewed market turmoil in March 2023 following the failure of three US banks (Silicon Valley Bank, Silvergate Bank, and Signature Bank) and the collapse of Credit Suisse saw MXT's unit price to NAV discount widen to over 6%, despite daily updates showing that NAV remain stable. However there has again been positive unit price movement following the market shock and MXT units were trading at a 0.5% premium to NAV as at 20 October 2023. MXT has closed 36 of the last 39 trading days at a premium to NAV after having consistently been at a discount for 14 months to 29 August 2023.

We continue to view unit price discounts as presenting opportunities for investors with high conviction in MXT to potentially benefit from any unit price appreciation as it approaches NAV. It is worth noting that the Metrics Direct Income Fund (MDIF) has the ability also take advantage of such price to NAV gaps in MXT - which provides a form of backstop to the long-term share price of MXT.

Quantitative Analysis

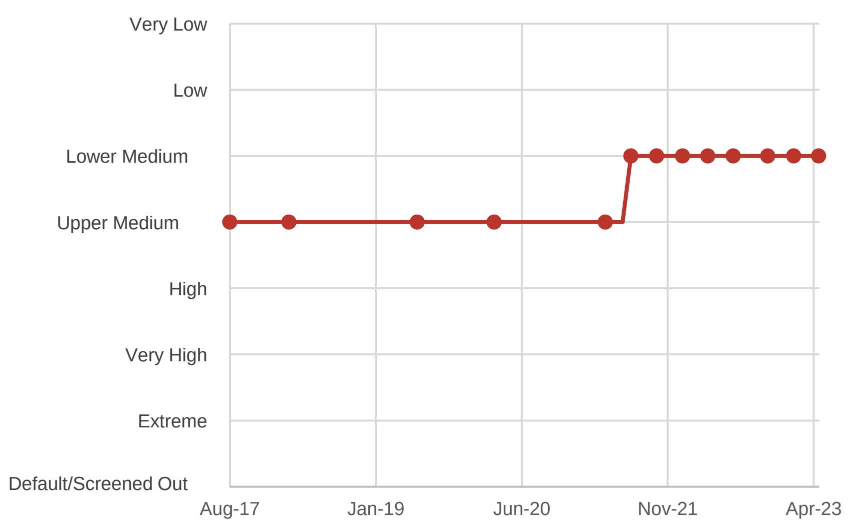
Once again off the back of rising swap rates, the expected outcomes both at a distressed and neutral simulation level have improved versus the previous experience (as at 31 December 2022). Our modelling continues to screen the portfolio as demonstrating impressive downside protection in distressed scenarios along with robust risk-adjusted returns. The high level of returns predictability is especially pertinent in the GFC-like scenario. The lack of deviation in modelled outcomes is driven by the high level of diversification in the portfolio.

In credit portfolios, the largest downside risk is counterparty concentration and conversely, the largest capital protector is diversification. Next in terms of capital protection is seniority. Over the last 18 months there have been targeted improvements at both levels. The number of individual borrowing counterparties in the portfolio has risen from 208 to 306 and the portion of senior secured exposures ex cash has risen from 87% to 91%. Both of these features drive lower losses given default, and subsequently better expected performance in the downside scenario.

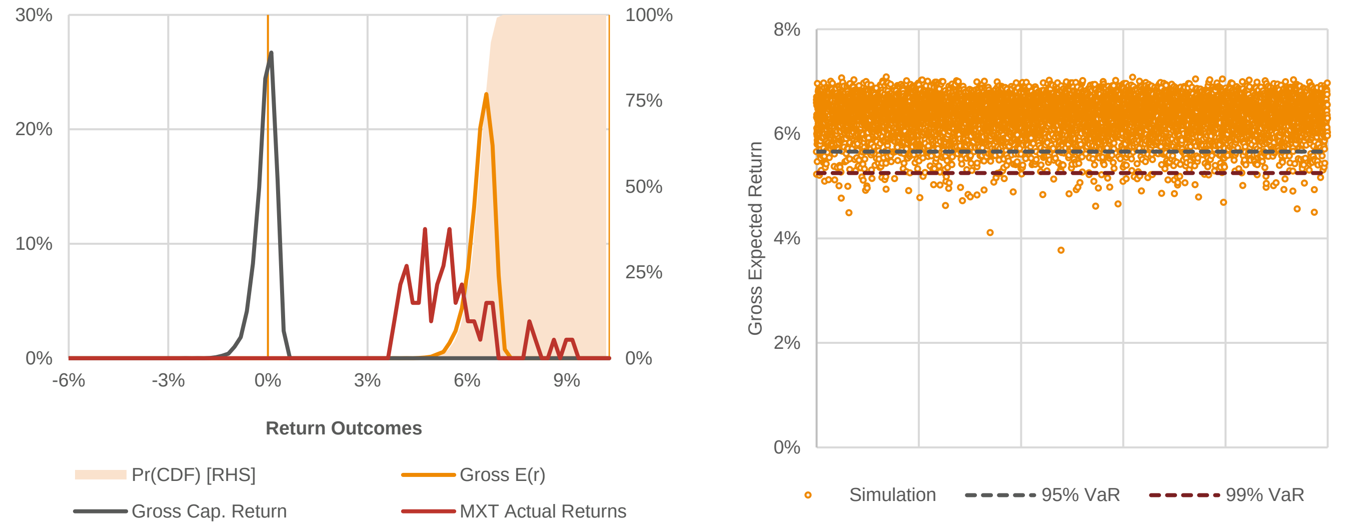
On the other hand, the Fund's cash holdings from Sep-21 of 10.0% have been reduced to 0.1% at Mar-23 and with nearly all of these funds deployed into sub-investment grade loans. Over this 18-month period, the exposure to sub-IG has increased from 42.2% to 51.0% while IG holdings excluding cash are relatively unchanged. Although this is credit negative, diversification and seniority benefits have more than offset this detraction.

Since the start of 2022, simulated portfolio returns in our baseline scenario have continually improved each quarter as a result of reference rates resetting higher, benefitting the portfolio given its high proportion (97.9%) of floating-rate holdings. This has driven noticeably stronger performance under the baseline scenario while the benefits of diversification have added to the rising rate tailwind in the GFC-like environment. The 99% VaR for the baseline and distressed environments has improved to 5.25% and 1.76%, respectively. This is substantially improved on 12 months' prior at 2.64% and 0.87%. Our risk score is reiterated as being "**Lower Medium**" or "A", a credit rating band above the weighted average credit profile, which is a function of the supreme level of counterparty diversification.

Figure 12. Risk Score

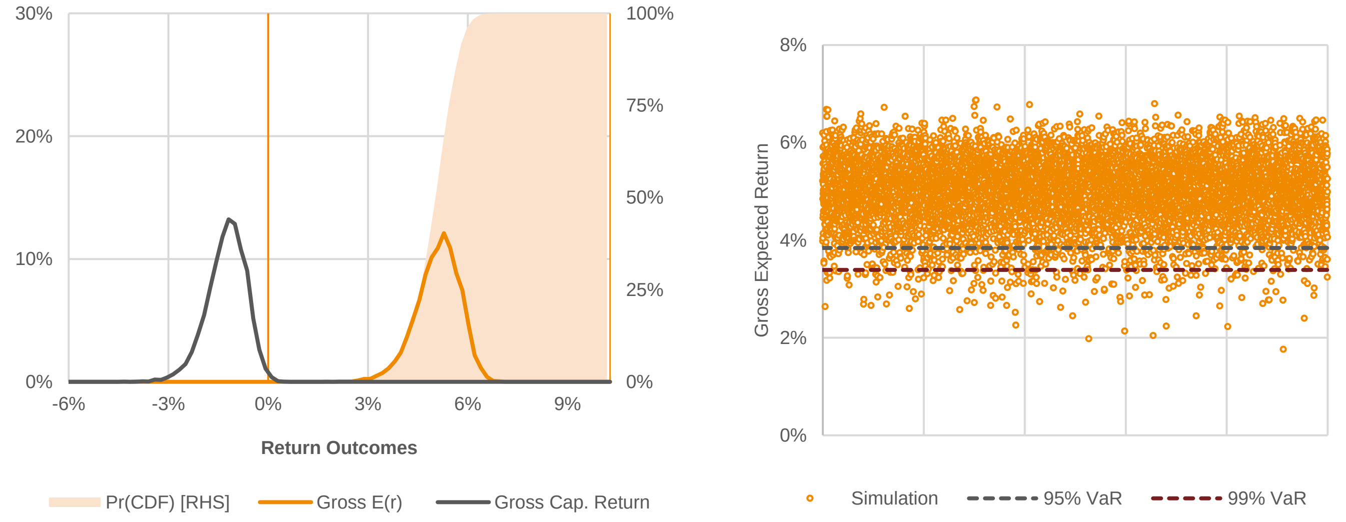


Scenario 1. Baseline Asset Assessment



Source: BondAdviser Estimates as of 31 March 2023 portfolio. Excludes impact of management and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is not simulated. For a more detailed explanation of the methodology, please contact BondAdviser.

Scenario 2. Stressed Asset Assessment



Source: BondAdviser Estimates as of 31 March 2023 portfolio. Excludes impact of management and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is not simulated.

Reporting History

MXT Update Report – 7 July 2023

MXT Update Report – 7 December 2022

MXT Update Report – 17 October 2022

MXT Update Report – 26 May 2022

MXT Update Report – 27 April 2022

MXT Update Report – 5 November 2021

MXT Update Report – 21 August 2021

MXT Update Report – 21 April 2021

MXT Update Report – 27 February 2020

MXT Update Report – 8 May 2019

MXT Entitlement Offer Report – 26 February 2018

MXT IPO Report – 1 August 2017

Alternative Investment Fund Research Methodology

Click here to view

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Report created on 23 October 2023.