Fund Research

Metrics Master Income Trust (ASX: MXT)

www.bondadviser.com.au

BondAdviser

Overview

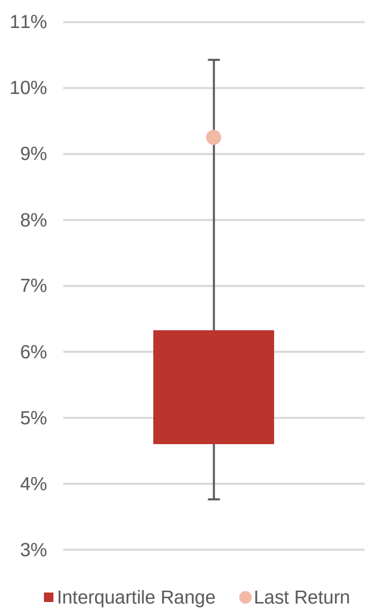
The Metrics Master Income Trust (the "Trust"; "MXT"; or the "Fund") is a listed investment trust designed to provide retail investors with ready access to the Australian corporate loan market. As at 30 September 2023, the market capitalisation of the Fund was $1.78 billion.

Private credit plays a crucial role in the Australian corporate debt market and was previously confined to major banks and institutional investors. MXT offers retail investors an opportunity to gain unique exposure to a debt sub-asset class that is not readily available 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 7.60% p.a.) **after fees**, payable monthly.

MXT invests in the MCP Wholesale Investment Trust (WIT) managed by Metrics Credit Partners Pty Ltd (MCP, Metrics), which subsequently 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



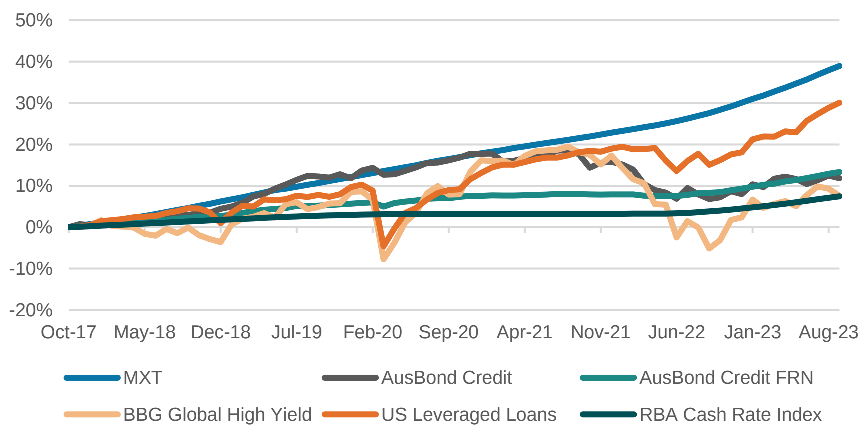
Source: BondAdviser, Metrics. Annualised monthly returns, after fees since inception. As at 30 September 2023.

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	0.69	0.74	0.74	0.83	0.81	0.74				**6.63**
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 30 September 2023.
** Return is monthly net total return based on NTA plus dividends.*

Figure 3. Relative Cumulative Performance



Source: BondAdviser, Metrics, Bloomberg. As at 30 September 2023. Calculated from cumulative net monthly returns of the Underlying Fund. Returns on NAV, not traded unit price, see Figure 16 for unit price variance.

Product Assessment

Highly Recommended

Metrics' track record boasts an absence of defaults, attributed to comprehensive screening protocols and risk management strategies. The Fund has shown the ability to structure loans effectively, minimise credit risk at both individual loan and portfolio levels, and maintain strong diversification with a large number of unique borrowing counterparties.

Investors are able to access three Metrics wholesale unlisted funds through the Metrics Master Income Trust (ASX: MXT), which allows them to gain exposure to a diverse pool of commercial loans. Approximately 60% of the portfolio is invested in the Metrics Credit Partners Diversified Australian Senior Loan Fund (DASLF) and the remaining 40% is allocated at ~20% to the MCP Secured Private Debt Fund II (SPDF II) and ~20% to the MCP Real Estate Debt Fund (REDF).

MXT is a suitable option for investors seeking an actively managed portfolio that generates a consistent and attractive monthly income stream, via exposure to a diversified collection of private loans, primarily focused on the real estate sector. The product has shown a low long-term correlation to traditional asset classes (3% to the AusBond Composite Index and 20% to the ASX 200) since its IPO in June 2017. This characteristic allows MXT to bring diversification benefits to investment portfolios that are typically weighted towards domestic equities and bonds.

The Fund's Net Asset Value (NAV) has demonstrated consistent stability, a crucial factor contributing to MXT's resilience during share market downturns. However, it's important for investors to recognise that, unlike Metrics' unlisted funds, MXT does face market volatility as it is listed on the ASX. This exposure to market dynamics can lead to the unit price trading at a discount to the NAV, especially during periods of heightened volatility.

The Fund has extremely low long-term correlations to traditional asset classes, providing diversification benefits to investment portfolios.

In such circumstances, investors who maintain confidence in the underlying strength of MXT's investment portfolio may find opportunities to enter at a reduced price. The listed Fund has trade-offs that prospective investors should consider, acknowledging that while the Fund may experience higher unit price volatility, being traded on the ASX provides greater liquidity compared to an unlisted fund. After a period of approximately 14 months with the MXT unit price trading below the Fund's NAV, the price surpassed the net asset value on 28 August 2023 and continues to do so. On 29 November 2023, MXT announced a wholesale placement that was completed two days later, raising $196.4 million at a price of $2.00 per unit. As at 29 February 2024, the Fund’s unit price exceeded the NAV of $2.0001 by 2.5%. A Unit Purchase Plan was also announced on 29 November 2023 providing all unit holders with the opportunity to subscribe for up to $30,000 worth of units at NAV. This offer which closed on 30 January 2024 raised a further $76.1 million.

The Fund has consistently outperformed its net return target over the past year, 24 months, and since its inception. On a rolling 24-month basis to 30 September 2023, MXT delivered a net annualised return of 6.94% (assuming reinvestment of distributions), surpassing the target by 155 basis points per annum. Since its inception in October 2017, the annualised net return stands at 5.73%, exceeding the target by 117 basis points. This is a continuation of the trend of outperformance seen at the end of the previous quarter.

Although the underlying portfolio consists largely of floating rate investments, changes in interest rates can still have an effect on the portfolio’s performance. As rates rise the ability for borrowers to meet their repayment obligations can alter. Inherently, this can manifest itself in greater risk as a function of a potential decrease in borrower’s creditworthiness. We exercise particular caution regarding the substantial allocation to real estate exposure, constituting approximately 52% of the underlying portfolio, 5.2 percentage points more than two years’ prior. It is worth noting that nearly all of the real estate loans are senior secured, which provides a high of protection against potential losses or defaults.

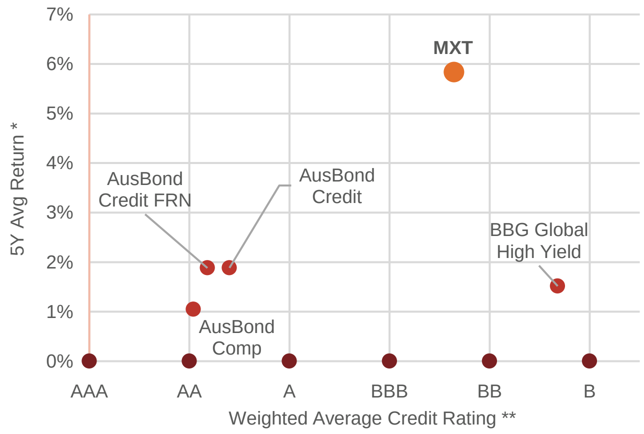
A combination of deteriorating economic conditions and changes in bank regulatory requirements resulting in a higher cost of capital, banks are restructuring capital from certain market segments. Consequently, a broader array of investment opportunities are emerging for Metrics, as borrowers who were formerly able to satisfy their borrowing needs from traditional bank financing are now required to explore alternative sources of capital. This shift in dynamics has empowered private credit fund managers such as Metrics, enabling the replacement of maturing loans in the underlying portfolio with the most favourable risk-adjusted return opportunities.

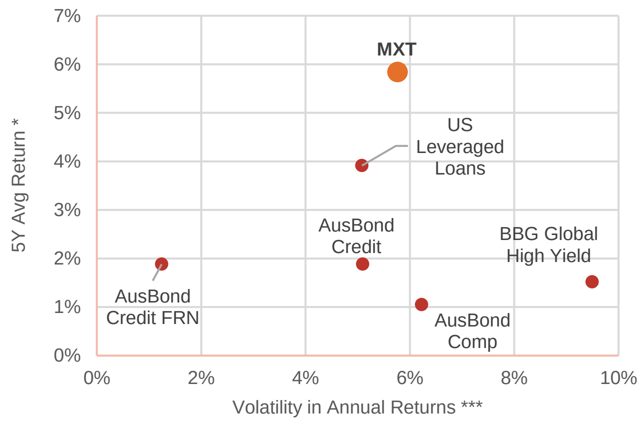
An impressive aspect of Metrics' track record is the absence of defaults. This achievement is particularly noteworthy given the diverse range of counterparties within Metrics' portfolio. We attribute this success to the implementation of comprehensive and rigorous screening protocols, strategically designed to establish trust in a loan's full repayment before any allocation of funds takes place.

Inherently, our confidence in Metrics' ability to sustain effective systems and procedures in minimising credit risk remains strong. The Fund has shown adequate abilities in structuring loans, whilst minimising credit risk from an individual loan and portfolio standpoint. The risk is further reduced as a result of strong diversification, with 303 unique counterparties at a portfolio level. The Fund also has notably high seniority exposure (90% senior secured loans) on a commitment basis, which fortifies the security of the individual investments. Both these factors work hand in hand to help reduce the potential loss to the portfolio in an instance where a counterparty defaults.

On the back of the Fund's continued outperformance on a return basis, demonstrated best-in-class processes and the high level of diversification that serves to minimise downside risk, we continue to view MXT favourably from a risk-return standpoint and reiterate our top-tier product assessment of **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 30 September 2023.*

Construction and Investment Process

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

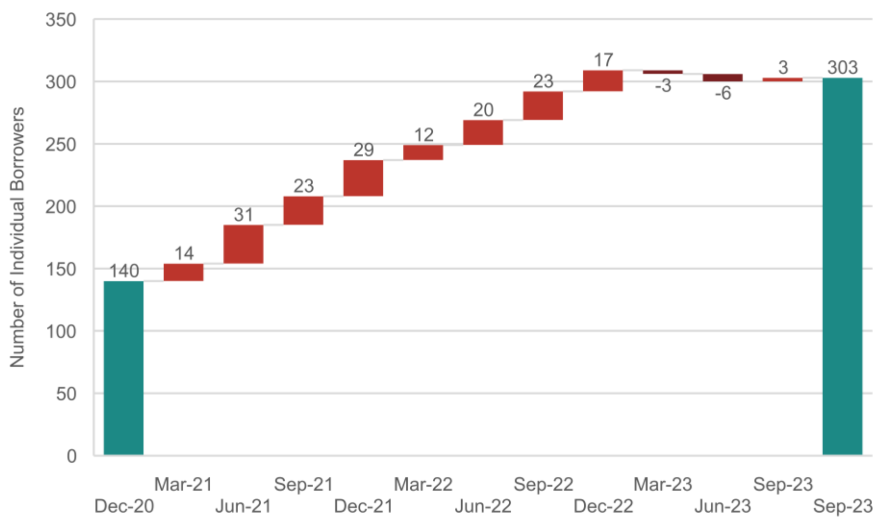
Portfolio Risk Management

The risk level of a private credit portfolio is determined by the expected losses driven by defaults and recovery rates given defaults. Our view on credit portfolio risk has three integral pillars that together derive the expected losses of a portfolio. These pillars are concentration, credit quality, and seniority, all of which a manager can control to set the level of risk within the portfolio.

Diversification is a cornerstone piece in managing portfolio risk management at both a counterparty and an individual investment exposure basis. The more diverse a portfolio is, the less the Fund will be impacted by a single default. Over the last twelve months, short term diversification has slowed as Metrics has improved its investment exposure from 292 to 303 unique counterparties as at 30 September 2023. Over the long term, the Fund has seen significant improvements to diversity, with 95 individual counterparties added to the portfolio over the past 24 months. Average exposure of individual investments has fallen from 0.28% to 0.23% within the same period, indicating diversification improvements.

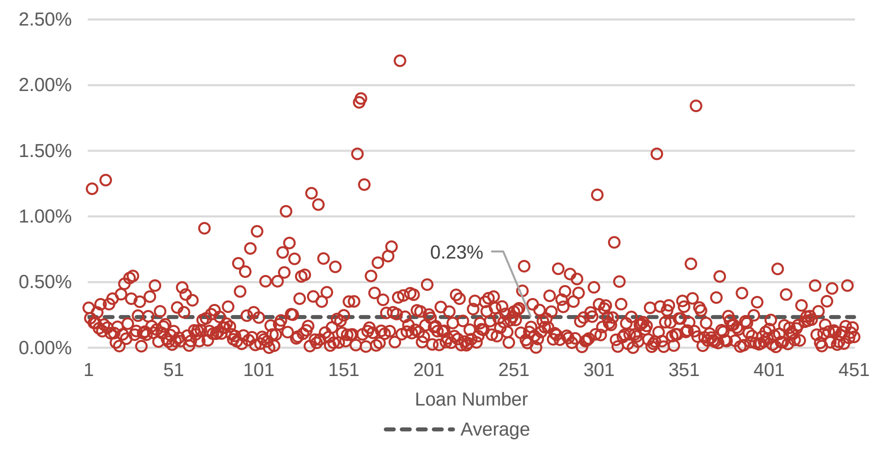
That said, diversification growth more recently has been stunted despite the Manager viewing there being no shortage of deals in the pipeline. Both MXT and MDIF invest in the underlying strategy and since MXT is a closed-ended fund, growth in FUM of the underlying strategy more regularly comes from MDIF's growth. Over the first nine months of 2023, MDIF's FUM grew from $892 million to $1,308 million, meanwhile MXT's FUM was stagnant at $1.76 billion. Additionally, on 1 December 2023, MXT completed a wholesale placement raising $196 million. This capital raise together with the proceeds from the subsequent UPP have cemented MXT's position as the largest ASX-listed credit fund. We expect that these funds will be deployed into new deals in the near future as existing loans mature and for at least some of these new deals to drive increases in portfolio diversification.

Figure 5. Unique Borrower Exposure Over Time



Source: BondAdviser, Metrics. As at 30 September 2023. Based on Metrics' underlying portfolio (WIT) not MXT.

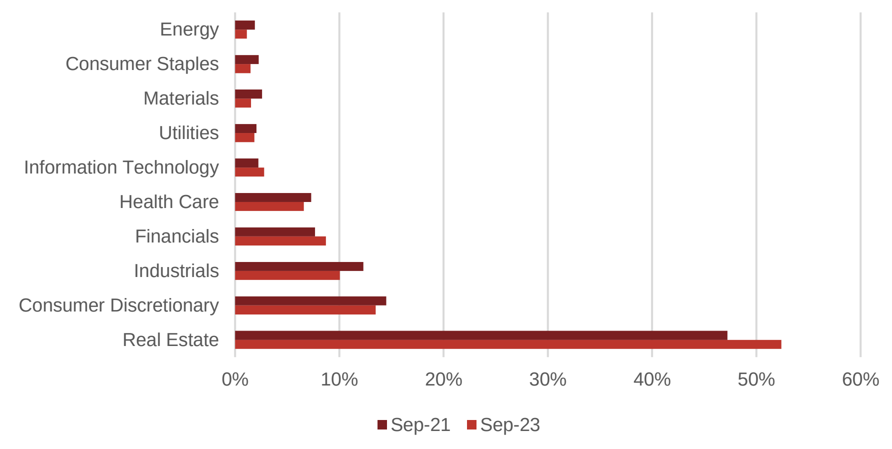
Figure 6. Individual Loan Exposure*



*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

The underlying portfolio's industry diversification has deteriorated, with more than half (52.4%) allocated to real estate. Its second largest exposure is to consumer discretionary at 14.5%. Over the past 24 months, the Fund has increased its exposure in real estate investments by 5.2% as at 30 September 2023. We view this as credit negative and would prefer to see the Fund reduce its significant weight in real estate investments as diversification is a key aspect of credit portfolios.

Figure 7. Portfolio Exposure by S&P Sector*

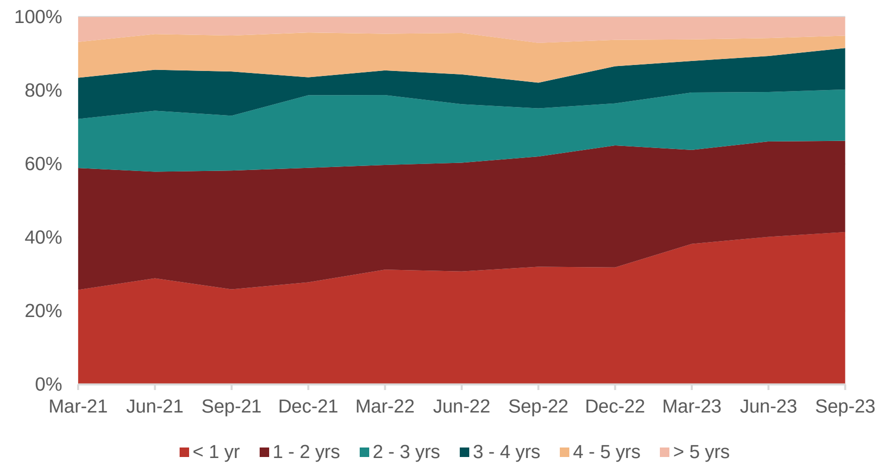


*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Within the past 12 months, there has been a continuous trend in rising allocations to investments maturing in less than a year. Over the 12 months from 30 September 2022 to 30 September 2023, investments maturing in less than a year have risen from 32.0% to 41.5%. The increased roll-off puts pressure on the investment team as an inability to sufficiently write fresh loans would create an accumulation of excess cash that may impede returns.

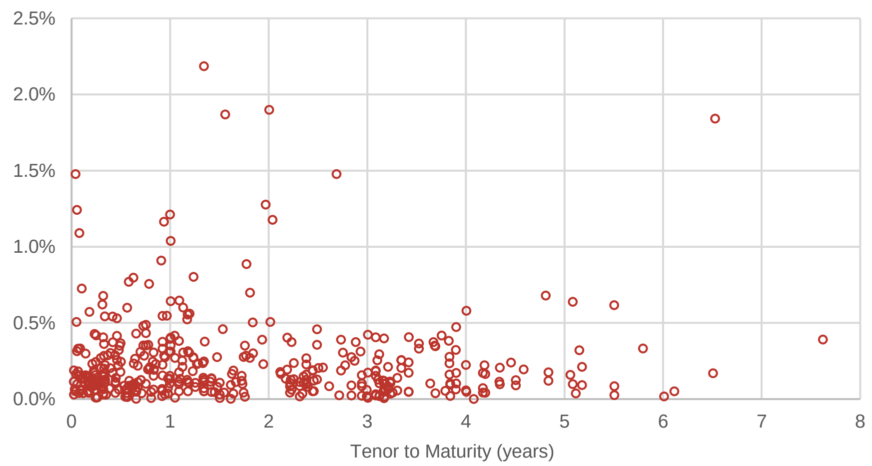
Positively, the manager has proven its ability to effectively recycle capital without any repercussions such as worsening the portfolio's credit quality or returns, and we anticipate that Metrics will continue building on its track record despite the unusually large refinancing challenge.

Figure 8. Portfolio Loan Tenor Mix*



*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Figure 9. Individual Loan Exposure by Tenor to Maturity*



*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

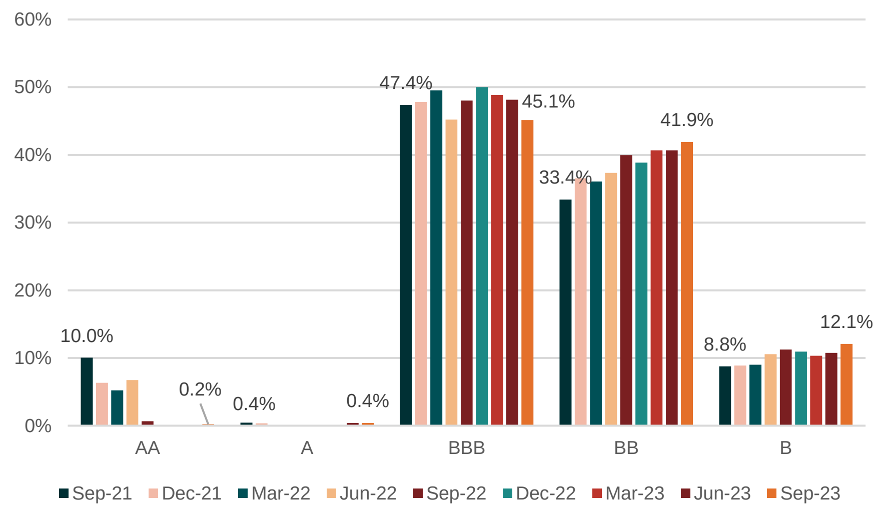
Historically, the seniority of the underlying portfolio has shown an improving trend. However, the previous quarter has seen a very minor decline in the mix of secured investments. From 30 June 2023 to 30 September 2023, the senior secured portion has decreased slightly from 90.9% to 90.3%. Examining the portfolio over a longer period, the substantial emphasis on first lien loans and the counterparty diversification has been a significant net positive in risk reduction versus the portfolio composition 24 months ago (+95 borrowing counterparties, +3.3% in senior secured investments). It is worth noting that the large majority of senior unsecured loans are to strong investment grade borrowers.

Figure 10. Portfolio Seniority Mix*

*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Over the 24 months from 30 September 2021 to 30 September 2023, the underlying portfolio's credit mix has seen a shift into sub-investment grade (IG) loans. Sub-IG loans have increased from 42.2% to 53.2% over this period. Although the weighted average credit rating of the portfolio has shifted into sub-investment grade territory, we don't have any major issues with this, as this is a private credit fund. BBB-rated allocations remain strong at 45.1% as at 30 September 2023, which is a decrease from three months prior of 3.1 percentage points.

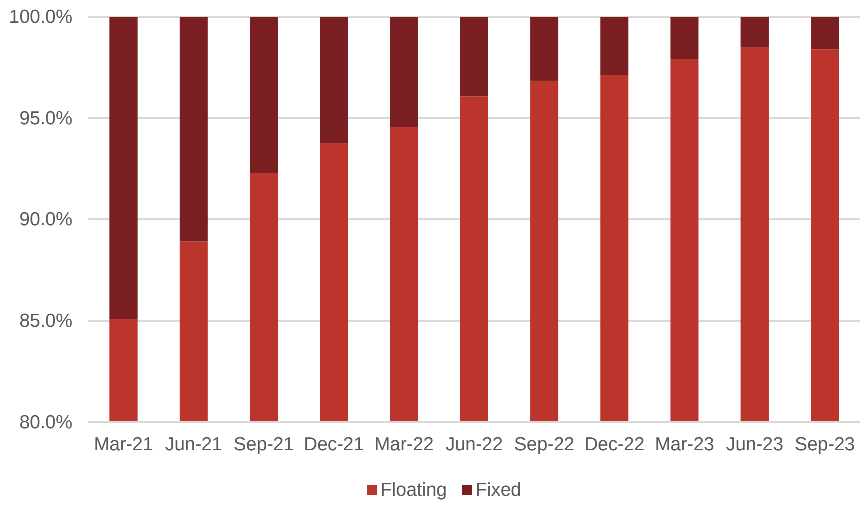
Figure 11. Portfolio Credit Rating Mix*



*Source: BondAdviser, Metrics. As at 30 September 2023. * Including cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Interest rate risk continues to be a negligible risk in the Fund's underlying portfolio as floating rate investments are significantly less impacted. However, in a rising interest rate environment, investors must be alert of increased risk of default due to borrowers having to meet higher interest payment commitments. This is pertinent with 98.3% of the underlying portfolio being floating rate.

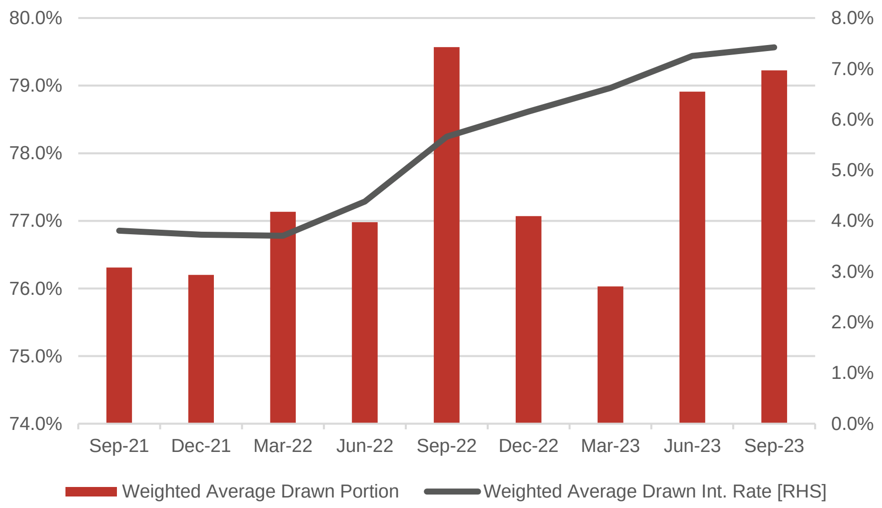
Figure 12. Portfolio Loan Interest Payment Mix*



*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

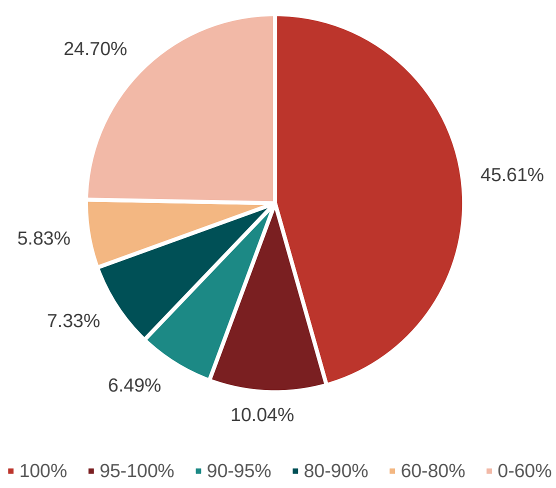
An interesting point to note on MXT's portfolio is the drawn portion of the portfolio. In a typical worsening economy, businesses would be expected to need more cash to continue operating. In MXT's portfolio case, the softening economic conditions have not had material impacts on the Fund's portfolio, which is supported by the 20.9% in undrawn funds on a committed basis. It is also worth noting that only 45.6% of loans on a committed basis are fully drawn as at 30 September 2023. A year prior, 48.8% of the portfolio was fully drawn with 20.3% of the total portfolio undrawn. The lack of change year on year indicates there has been de minimus change in borrowing counterparty cash needs. It is worth noting that a significant portion of the undrawn loans are construction/project facilities. The average drawn rate for construction loans is 58.6% and these facilities make up 24.7% of the underlying portfolio.

Figure 13. Portfolio Weighted Average Drawn Portion and Interest Rate*



*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

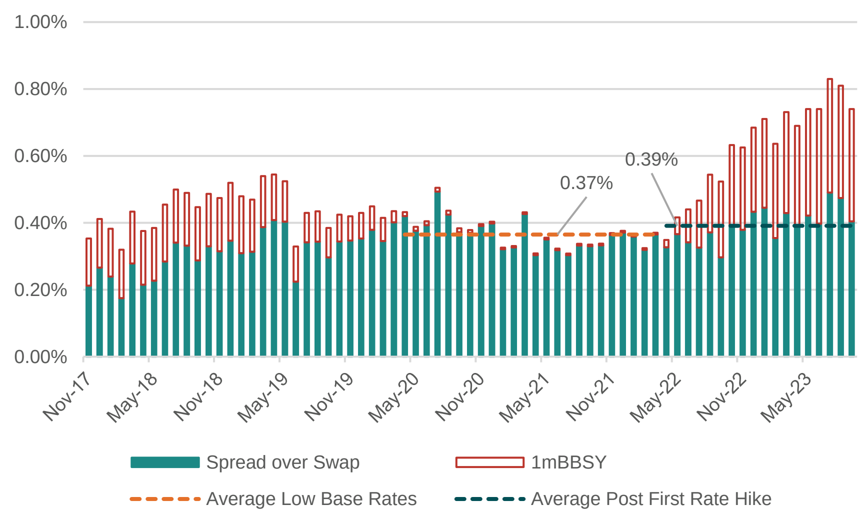
Figure 14. Portfolio Weighted Drawn Portion*



*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

For the two years between April 2020 and April 2022, the RBA cash rate was near zero at either 0.25% or 0.10%. Over this time, MXT returned 4.56% per annum net of fees. As loans are typically referenced to a benchmark of the 1-month swap rate (1mBBSY), we analyse the Fund's outperformance of a loan's benchmark additional to its RBA +1.50% target. During the two-year period of a low cash rate, MXT outperformed the 1mBBSY by an average of 37 basis points each month. During the hiking cycle (since April 2022) MXT has provided monthly returns 39bps above the 1mBBSY. This indicates that the return above the "risk-free" rate has increased in the rising rate environment. There has been a drastic increase in diversification and a higher weighting to senior secured holdings during this period, however the portfolio has tilted toward lower credit ratings, explaining the increase in risky returns. This is largely due to MXT's 60% exposure to DASLF, which has increased its exposure to commercial real estate, as is referenced in Figure 7.

Figure 15. Breakdown of MXT Monthly Net Returns

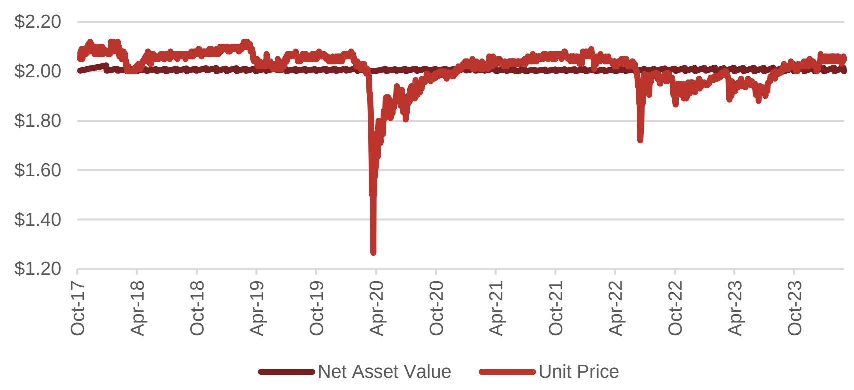


Source: BondAdviser, Metrics. As at 30 September 2023.

Fund Governance

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

Figure 16. Net Asset Value Against Unit Price



Source: BondAdviser, Metrics, Bloomberg. As at 1 March 2024.

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 unit price to NAV discount reached a point as high as 14.2% during June 2022, which had decreased to under 1% by February 2023. However, March 2023 renewed market turbulence following the failure of three US banks (Silicon Valley Bank, Silvergate Bank, and Signature Bank) and the collapse of Credit Suisse saw The Funds unit price to NAV discount widen to over 6% despite daily updates confirming that the NAV remained stable. MXT units traded at a 2.5% premium to NAV as at 29 February 2024, which is a positive shift following the market shock.

MXT announced on 1 December 2023 that the Fund had completed a wholesale placement for 98.2 million units at a price of $2.00 per new unit, raising a total of $196 million. Since this announcement, the Fund's Unit Price continuously traded at or above both the offer price of $2.00 as at 5 January 2024. Additional to this was the Unit Purchase Plan which closed on 30 January 2024, raising a further $76 million.

Quantitative Analysis

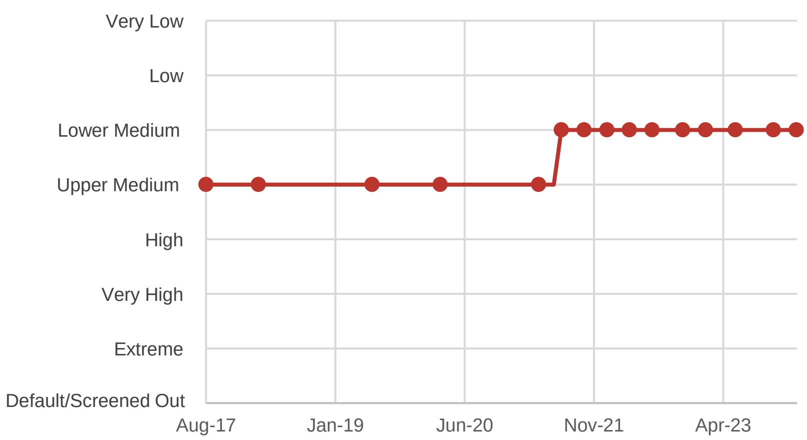
The underlying MXT portfolio has shown slight deteriorations versus the previous simulations as at 30 June 2023 in both the benign and the stressed scenario. Although that is the case, the portfolio still highlights the ability to protect investor capital against downside environments whilst delivering strong returns within a blue-sky backdrop. An important factor within credit portfolios is concentration, specifically exposure to individual counterparties. As diversification is an essential pillar to preserving capital, MXT's continued improvements to diversification has resulted in uplifts to its modelled outcomes in our *Quantitative Analysis*. The Fund has slightly increased its counterparty diversity from 292 in September 2022, to 303 as at September 2023. These positive diversification benefits have been entirely offset by the tilt towards lower credit rated borrowers. As such, the modelled performance has not seen much change within adverse conditions. The median capital returns in our stressed scenario are -1.05%, which is a slight deterioration from three months ago at -0.96%.

Over the past three months, investment-grade loan weights have decreased by 3 percentage points. Credit quality plays an integral role when structuring a credit portfolio, for which the shift towards lower rated investments represents a negative influence on capital protection. The high level of diversity on an individual investment basis counters this, driving positive defensive properties in the modelled outcomes. The 99% VaR in stressed conditions simulated a capital return of -2.98%, indicating only 1% of simulations in a GFC-like environment resulted in a capital loss worse than -2.98%.

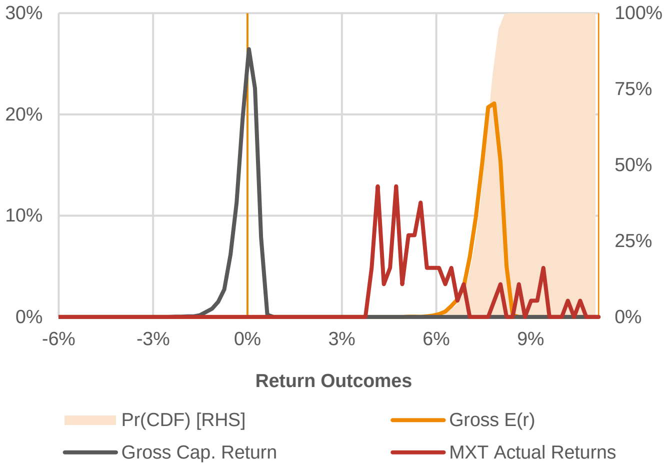
In our benign scenario, the portfolio saw far stronger simulations versus the previous experience. The mean gross expected returns increased 0.57 percentage points to 7.51% over the past three months as a result of increased sub-investment grade loans. The 99% VaR has increased 0.44 percentage points in the same time frame.

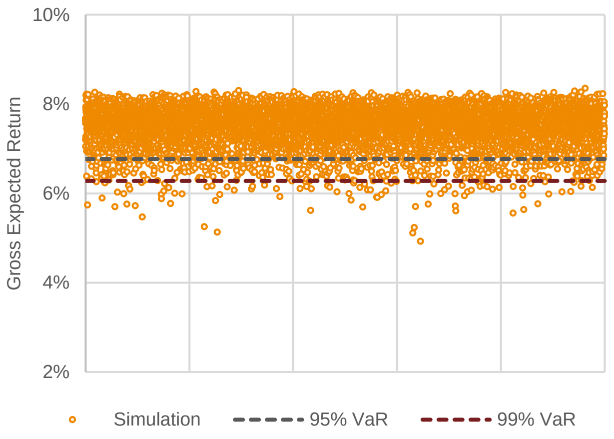
The strategic changes within MXT's portfolio relative to credit risk are a double-edged sword. While the slight shift in credit quality benefits the outcomes within the benign simulations, the defensive properties of the book are slightly lessened. The maintained high level of counterparty diversification bolstered by the robust outcomes in our portfolio simulation underscores our risk score of **Lower Medium** or "A", a credit rating notch above the weighted average credit profile.

Figure 17. Risk Score



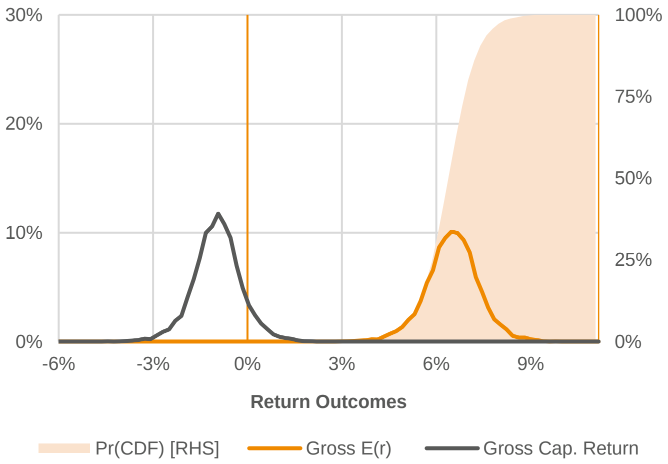
Scenario 1. Baseline Asset Assessment

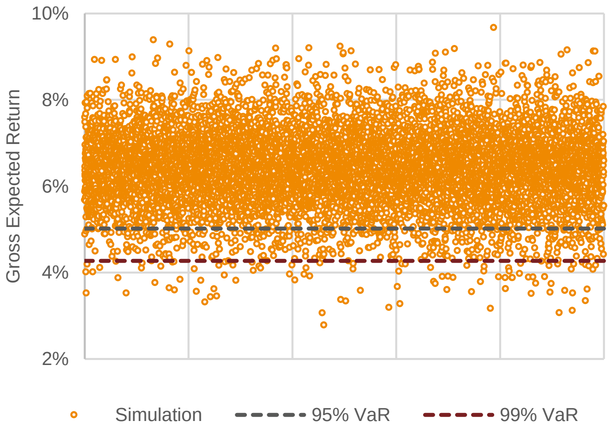




Source: BondAdviser Estimates as of 30 September 2023 portfolio. Excludes impact of management and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is not simulated. For a more detailed explanation of the methodology, please contact BondAdviser.

Scenario 2. Stressed Asset Assessment





Source: BondAdviser Estimates as of 30 September 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

Alternative Investment Fund Research Methodology

Click here to view

Important Information

BondAdviser has acted on information provided to it and our research is subject to change based on legal offering documents. This research is for informational purposes only. This information discusses general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice.

The content of this report is not intended to provide financial product advice and must not be relied upon or construed as such. The statements and/or recommendations contained in this report are our opinions only. We do not express any opinion on the future or expected value of any Security and do not explicitly or implicitly recommend or suggest an investment strategy of any kind.

BondAdviser will receive a licensing fee from the Manager in relation to this research report. BondAdviser Asset Management or associate investment vehicles which it controls may also choose to hold units of the Fund as necessary.

This report has been prepared based on available data to which we have access. Neither the accuracy of that data nor the research methodology used to produce the report can be guaranteed or warranted. Some of the research used to create the content is based on past performance. Past performance is not an indicator of future performance. We have taken all reasonable steps to ensure that any opinion or recommendation contained in the report is based on reasonable grounds. The data generated by the research is based on methodology that has limitations; and some of the information in the reports is based on information from third parties.

We do not therefore guarantee the currency of the report. If you would like to assess the currency, you should compare the report with more recent characteristics and performance of the assets mentioned within it. You acknowledge that investment can give rise to substantial risk and a product mentioned in the reports may not be suitable to you.

You should obtain independent advice specific to your particular circumstances, make your own enquiries and satisfy yourself before you make any investment decisions or use the report for any purpose. This report provides general information only. There has been no regard whatsoever to your own personal or business needs, your individual circumstances, your own financial position or investment objectives in preparing the information.

We do not accept responsibility for any loss or damage, howsoever caused (including through negligence), which you may directly or indirectly suffer in connection with your use of this report, nor do we accept any responsibility for any such loss arising out of your use of, or reliance on, information contained in or accessed through this report.

Report created on 4 March 2024.