Fund Research

Metrics Master Income Trust (ASX: MXT)

Overview

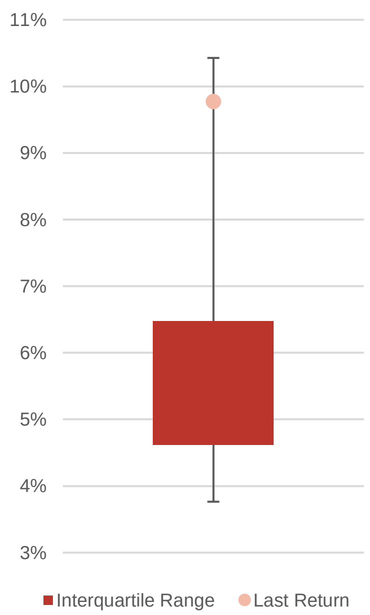
The Metrics Master Income Trust (the "Trust"; "MXT"; or the "Fund") is a listed investment trust designed to provide retail investors with ready access to the Australian corporate loan market. As at 31 December 2023, the market capitalisation of the Fund was $2.01 billion.

Private credit is an important part of the Australia corporate debt market which was previously restricted to major banks and institutional investors. MXT offers retail investors the opportunity to gain exposure to such sub-asset class that is not freely available to them.

The Trust's investment objective is to provide capital stability 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 Metrics Credit Partners (MCP, Metrics) Wholesale Investment Trust (WIT) whereby WIT 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



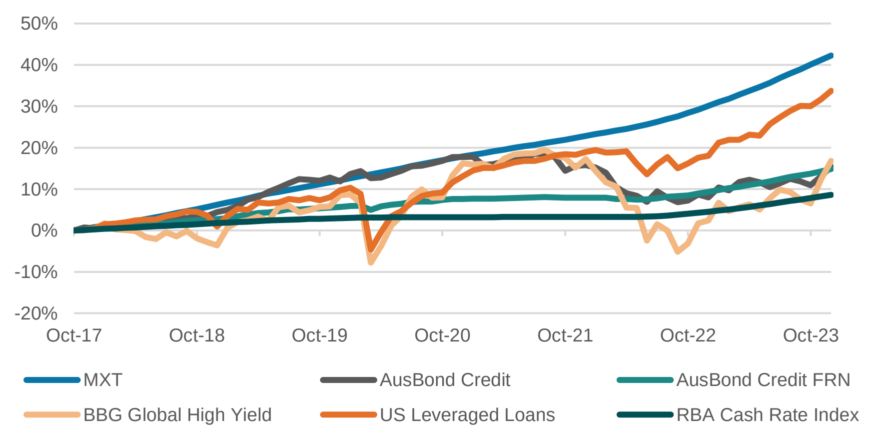
Source: BondAdviser, Metrics. Annualised monthly returns, after fees since inception. As at 31 December 2023.

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	0.82	0.76	0.78	**8.99**
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 December 2023.
** Return is monthly net total return based on NTA plus dividends.*

Figure 3. Relative Cumulative Performance



Source: BondAdviser, Metrics, Bloomberg. As at 31 December 2023. Calculated from cumulative net monthly returns of the Underlying Fund. Returns on NAV, not traded unit price, see Figure 17 for unit price variance.

Product Assessment

Highly Recommended

The Fund remains highly diversified and predominantly allocated to the safest part of the capital stack of borrowers on the crossover of investment grade.

Investors are able to gain exposure to three Metrics wholesale unlisted funds via the Metrics Master Income Trust (ASX: MXT), providing a diverse underlying portfolio 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).

The Fund has continuously outperformed its net return target over the past 12 months, 24 months, and since inception. On a rolling 24-month basis to December 2023, MXT delivered a net annualised return of 7.52% (assuming reinvestment of distributions), surpassing the target by 160 basis points per annum, up 5bps from three months ago. Since its inception in October 2017, the annualised net return is 5.89%, 115bps above the target return.

MXT's returns profile exhibits extremely low correlations with traditional asset classes and remains well above its target at all timeframes.

MXT is an excellent option for investors that seek an actively managed portfolio which has delivered a consistent and attractive monthly income stream, that also has low long-term correlation with traditional asset classes. Since its IPO in June 2017, the Fund has exhibited correlation of 7% to the AusBond Composite Index and 19% to the ASX 200. This is a function of the Fund's exposure to a diversified collection of private loans, primarily focused on the real estate sector. This characteristic allows MXT to bring diversification benefits to investment portfolios that are typically weighted towards domestic equities and bonds.

Stability in MXT's Net Asset Value (NAV) has long been a stalwart of the Fund, providing comfort to investors, especially during share market downturns. Investors must understand that unlike Metric's unlisted funds, MXT is susceptible to market volatility as it is an ASX-listed Fund and despite daily announcements confirming a steady NAV, has been previously adversely impacted by market-wide routs. Such a scenario can lead to the unit price trading at a discount to the NAV in periods of increased volatility. This provides a discounted buying opportunity for investors who maintain confidence in the strength of the Fund's underlying investment portfolio. While the Fund may experience higher unit price volatility, liquidity is greater as it is traded on the ASX. This susceptibility can be viewed both positively and negatively and we stress that investors weigh up such risks prior to investment. If potential unit price volatility is not a risk you would like exposure to, we suggest reading our reports on the Metrics Direct Income Fund as it is an unlisted fund which invests in the same underlying portfolio.

While many expect for the RBA cash rate to be maintained at an elevated level for the near term, it is worth noting for long-term investors that the underlying portfolio consists almost entirely of floating rate investments, and changes to interest rates, whether they are increasing or decreasing, will flow through to the portfolio's returns. As it is suspected that the economy is reaching the peak of the rate tightening cycle, returns may be hampered. At currently high base rates, and due to the floating nature of the portfolio's loans, the rate rises have largely been passed onto the borrower in the form of higher repayments. This reduces the ability for borrowers to meet their repayments and snowballs into heightened credit risk. Of the underlying portfolio, ~37% was originated in 2021 or earlier, meaning these borrowers have absorbed the full cash rate hiking cycle (+425bps since Mar-22). Although Metrics has never experienced a loss impacting investor returns, we do caution investors that over a third of the Fund's book are paying far greater interest than they would have expected if they believed the RBA's proclamation (no rate hikes until 2024). We do note that a lot of older loans would have been repriced or extended since their initial origination date.

Another risk is the heavy allocation to the real estate sector, which comprises 51% of the underlying portfolio. The weighting in real estate investments has remained over 50% for the past two years. This high weighting does reduce some of the downside protection given the high degree of correlation of companies in the same industry. We note that in a portfolio of 452 individual tranches, **all but four** of the real estate loans are of senior secured nature, giving such investments a high level of protection against possible defaults or losses.

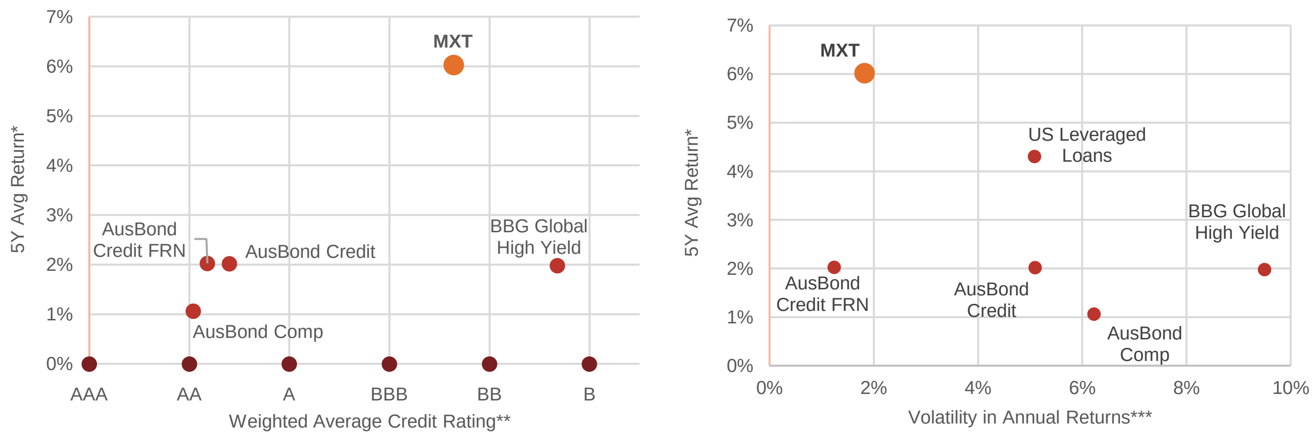
Both weakening economic conditions and changes resulting in greater regulatory capital requirements for banks are pushing them out of the commercial loans space. Banks retreating provides the Manager with access to an increased pipeline of opportunities. Stricter borrowing guidelines for borrowers who were previously eligible for bank financing has pushed such borrowers into Metrics' and other private credit fund managers' opportunity set. This in turn, has allowed Metrics the ability for more favourable risk-adjusted return opportunities and further lessens the risk of recycling short-term investment maturities.

Metrics' track record of zero losses impacting investor returns is impressive given the range of counterparties within its portfolios. We view this as a reflection of incredibly stringent screening protocols which are designed to establish confidence in full repayment before any assignment of funds to a prospective borrower takes place.

Our confidence in Metrics' ability to continue maintaining effective systems and procedures in minimising credit risk remains strong. Counterparty risk in the Fund is reduced via to the high level of diversification, with 301 unique counterparties within the portfolio. The Fund displays a substantial emphasis on seniority, with 90.8% of the portfolio being senior secured on a drawn basis excluding cash. This in turn, reiterates the safety of the individual investments. These risk reduction factors work hand in hand to help minimise the impact of potential losses to the portfolio in an event of a counterparty defaulting.

MXT continues to outperform its returns target and has demonstrated best-in-class process whilst maintaining high levels of diversification. We continue to view MXT as favourable from a risk-return perspective and maintain our product assessment at the highest attainable level 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 31 December 2023.*

Construction and Investment Process

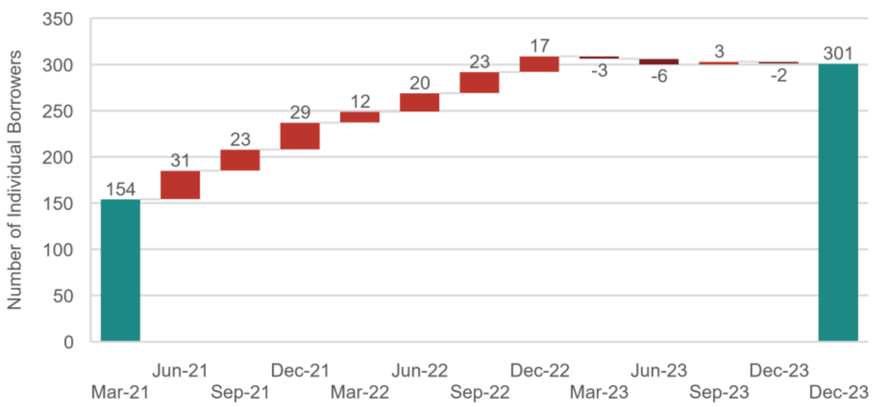
There have been **no material changes** to MXT's construction and investment process.

Portfolio Risk Management

Broken down to its most foundational level, a private credit portfolio's risk is determined by the expected losses which are driven by defaults and recovery rates given defaults. It is our view that credit portfolio risk has three primary factors that can be controlled by a portfolio manager: concentration, credit quality, and seniority. All of which can be steered to set the risk of a portfolio.

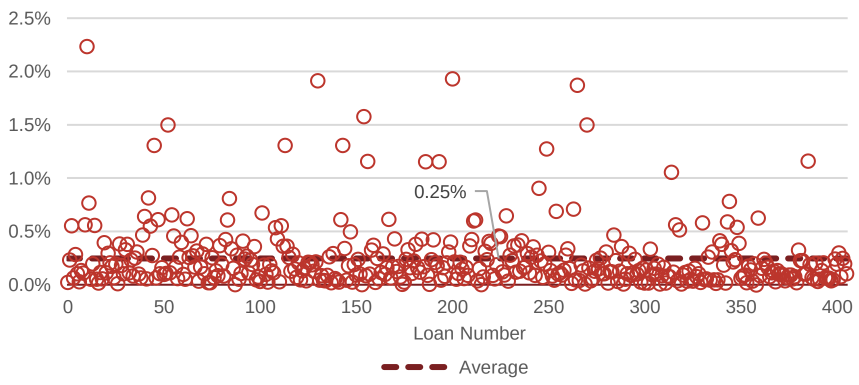
Diversification is an integral part of managing the risk within a portfolio at both a counterparty and individual investment level. When a portfolio becomes more diverse, the less it will be impacted by a single default. Notably, over the past twelve months, there has been a slight reduction in diversification as the underlying portfolio's number of unique counterparties has moved from 309 to 301 as at 31 December 2023. However, over the long term, the underlying portfolio has seen significant improvements, gaining 64 unique counterparties over the 24 months to 31 December 2023. Average exposure of individual investments has increased from 0.21% to 0.25% within the same one-year period as a function of there being fewer individual investments held within the portfolio. Despite the counterparty consolidation after a period of rapid growth, diversification remains a strong point of the Fund.

Figure 5. Unique Borrower Exposure Over Time



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

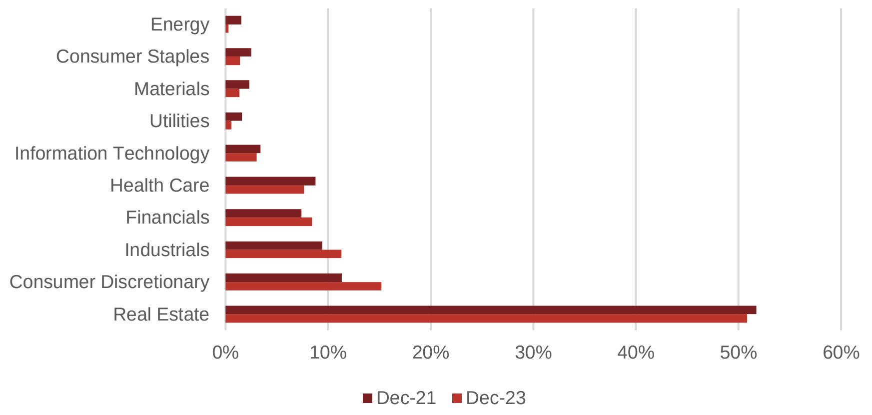
Figure 6. Individual Loan Exposure*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

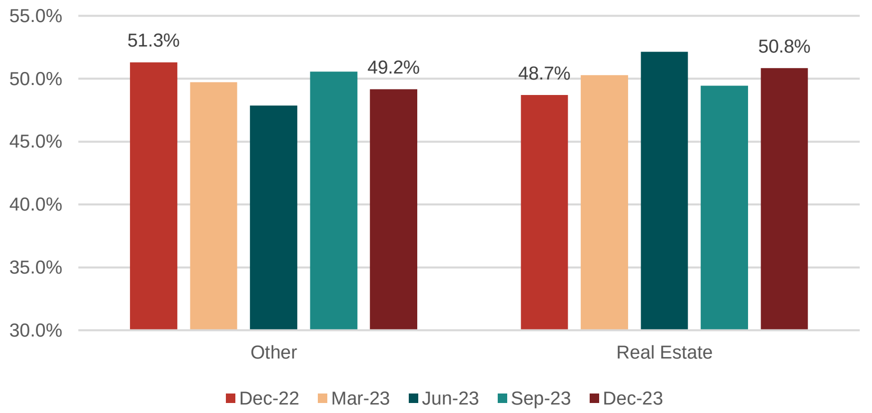
There has been little change over the past two years regarding sectoral exposures. Real estate continues to command just over half of deployed capital. We reiterate to the reader that this is an exposure worth questioning comfort with given the typically high level of intra-industry correlation. In other words, if the real estate market faced broad and exceptional weakness, around 51% of the Fund's loans could potentially face materially higher stress.

Figure 7. Portfolio Exposure by S&P Sector*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Figure 8. Real Estate Portfolio Holdings Over Time*

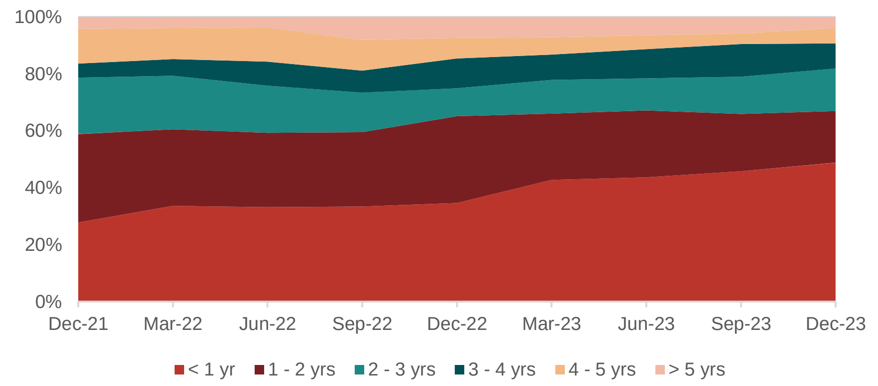


*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

The rising trend of investments with a maturity of less than one year continues to be apparent at 48.8% of the drawn portfolio excluding cash as at 31-Dec-23. We view this as an increasing concern as it is an 3.0 percentage point increase over the past three months. Additionally, the Fund's cash balance has moved from 0.06% six months ago and has doubled over the past three months to 0.42%. While not yet of concern, this trend coupled with half of the book maturing in the next 12 months raises concern whereby a failure of reinvesting maturing loans may result in a large cash increase and could hinder investment returns.

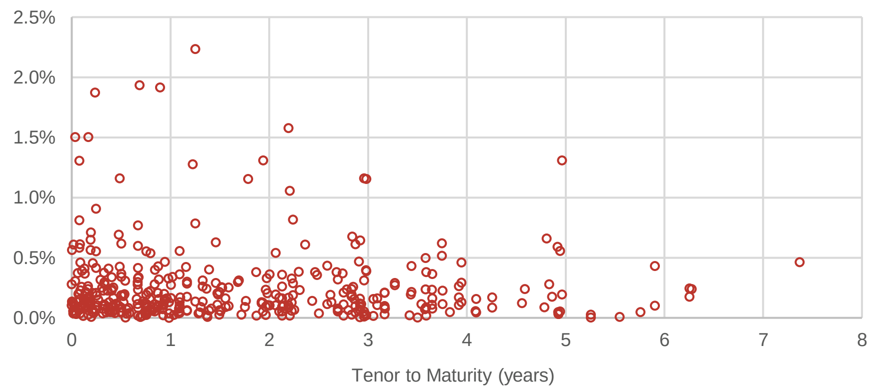
We note that the Manager views this as part of its strategy given greater portfolio churn results in more fees for investors and shorter tenors reduces the credit risk. Both factors drive higher risk adjusted returns. Given its track record and growing pipeline, we anticipate that Metrics should continue to be able to rollover these maturing investments.

Figure 9. Portfolio Loan Tenor Mix*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

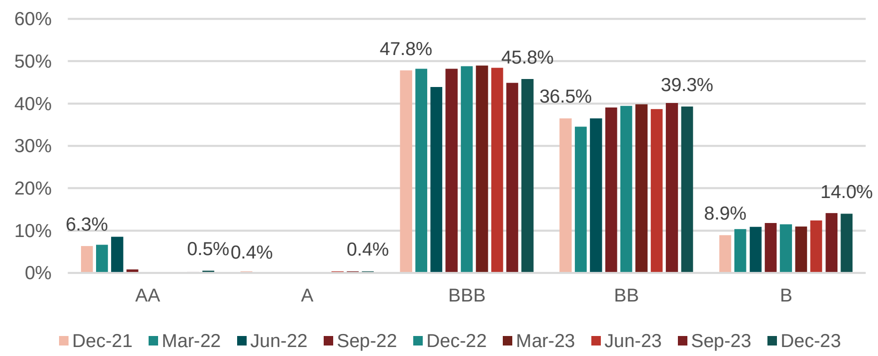
Figure 10. Individual Loan Exposure by Tenor to Maturity*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

The credit rating mix has remained largely the same over the three months to 31 December 2023, with the most significant change being the increase in AA rated investments as a function of cash increasing. Over the long term, the underlying portfolio has seen a shift into sub-investment grade assets. In the 24 months to December 2023, such investments have increased by 7.8 percentage points.

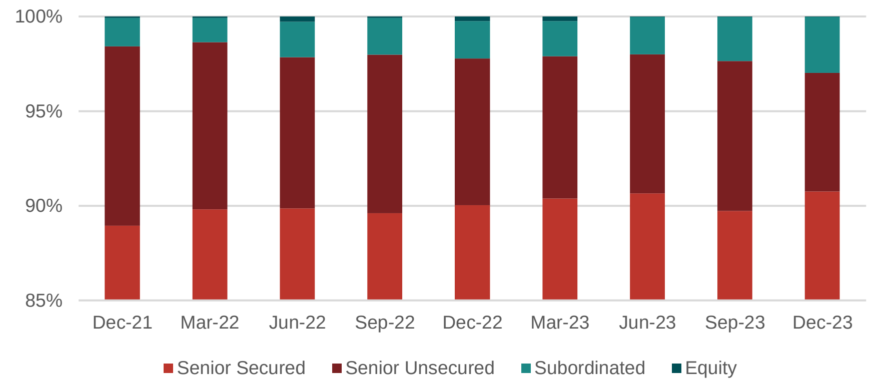
Figure 11. Portfolio Credit Rating Mix*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and including cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

The seniority of the underlying portfolio has remained largely unchanged over the past twelve months from a senior secured standpoint, improving by 72 basis points over the year to 90.75% on a drawn basis excluding cash. Interestingly, there has been an increasing trend in subordinated investments, especially over the past three months, whereby allocations have increased from 2.34% to 2.96% within this time frame. The predominantly senior secured nature of the portfolio provides comfort to investors as in the event of default, the Fund's investment would be repaid as a priority and would have a claim over the defaulting company's assets.

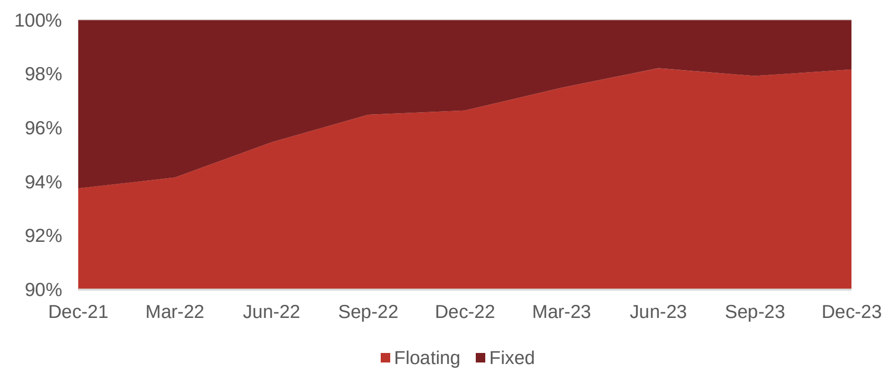
Figure 12. Portfolio Seniority Mix*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

The interest rate risk within the Fund's underlying portfolio has remained steady over the past six months at 98.2% floating rate. This feature of the Fund minimises duration (interest rate risk) for investors, however the borrowers paying the loans are subject to changing repayments as interest rates move. Of its outstanding loans by drawn value, 36.9% of the drawn portfolio excluding cash were originated prior to 2022. While Metrics has not experienced a default, this is cause for concern given over a third of the book would be paying significantly higher payments than were originally expected when the loan agreement was entered into. Then-Governor Phillip Lowe stated that there would be no rate hikes until 2024 and these borrowers have since absorbed seventeen 25 basis point hikes. This drastically elevates the risk of default as higher interest payments are met. Positively for these borrowers and therefore the credit risk in the Fund, markets are pricing in RBA Cash Rate cuts in the second half of 2024.

Figure 13. Portfolio Loan Interest Payment Mix*

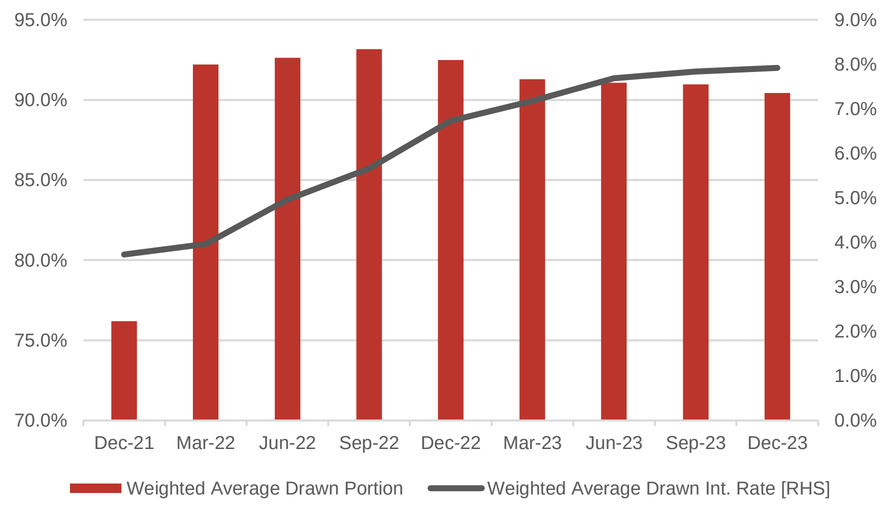


*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Based on the drawn value of commitments and excluding cash, 52.3% of the underlying portfolio was fully drawn as at 31 December 2023. Three months ago, 57.7% of the portfolio was fully drawn. In scenarios of heightened economic stress, businesses typically hold more cash to offset operating uncertainty. The fully drawn portion of the portfolio has decreased by 5.6 percentage points and the weighted average drawn portion has seen a slight decrease by 0.6 percentage points.

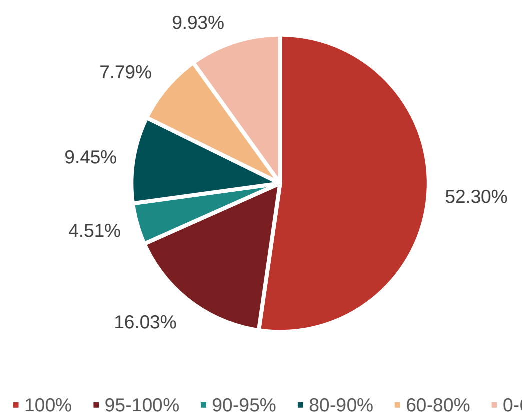
Interestingly, over the past five quarters, the weighted average drawn portion of the portfolio has been lower than the prior period. That said, there was a significant spike following the December 2021 quarter. The sustained higher drawn portion is an indication that businesses have leant on "dry powder" as the economic outlook has deteriorated. The impetus here is that we expect the economy to continue weakening and for more of MXT's portfolio companies to draw down on available cash. The concern then becomes, if the cash available to these companies is enough to see out the difficult operating times.

Figure 14. Portfolio Weighted Average Drawn Portion and Interest Rate*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

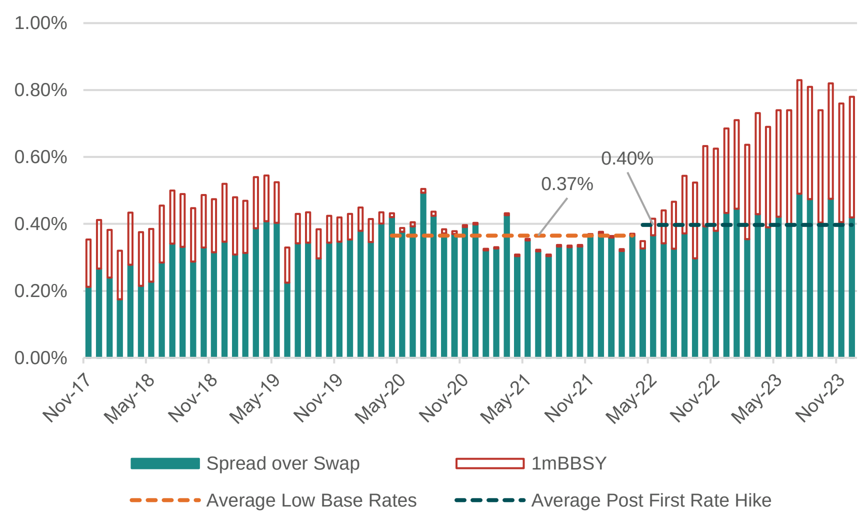
Figure 15. Portfolio Weighted Drawn Portion*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.*

Between April 2020 and April 2022, the RBA cash rate was near zero, at either 0.25% or 0.10%. During this period, the Fund returned 4.56% per annum net of fees. As loans in this portfolio are typically floating rate and referenced to a benchmark of the 1-month swap rate (1mBBSY), we analyse MXT's outperformance of a loan's benchmark additional to its RBA +3.25% target. During the two-year period of a near zero cash rate, MXT outperformed the 1mBBSY by an average of 37 basis points each month, which is 4.47% annualised. Since April 2022, MXT has provided monthly returns 40bps above the 1mBBSY (4.87% annualised). This indicates that the Fund's performance above the "risk-free" rate has improved in the rising rate environment. This comes as a function of slightly lower credit rating mix in the portfolio while still maintaining strong seniority and improving diversification.

Figure 16. Breakdown of MXT Monthly Net Returns

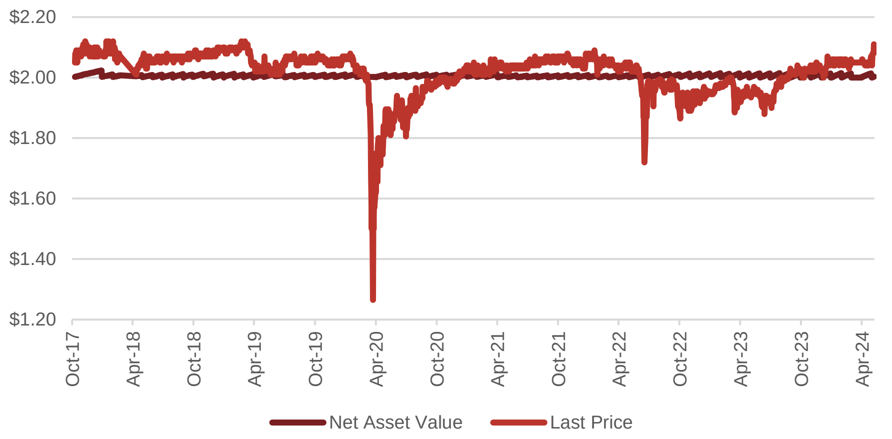


Source: BondAdviser, Metrics. As at 31 December 2023.

Fund Governance

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

Figure 17. Net Asset Value Against Unit Price



Source: BondAdviser, Metrics, Bloomberg. As at 8 May 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).

During June 2022, the unit price to NAV discount reached 14.2%. The discount gap closed after approximately 14 months on 28 August 2023, and MXT has continuously traded at premium to the NAV since (4.8% premium as at 8 May 2024). 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. Additional to this was the Unit Purchase Plan (UPP) which closed on 30 January 2024, raising a further $76 million. There have also recently been Wholesale Placements raising $31.0 million and $47.5 million. It is typical equity market behaviour for equity raises to result in share price drops and this has previously been a feature for the unit price of LITs after new units are issued. This has not been the case for MXT or Metrics' other LIT in the Metrics Income Opportunities Trust (ASX: MOT) which announced a UPP in February 2023.

Quantitative Analysis

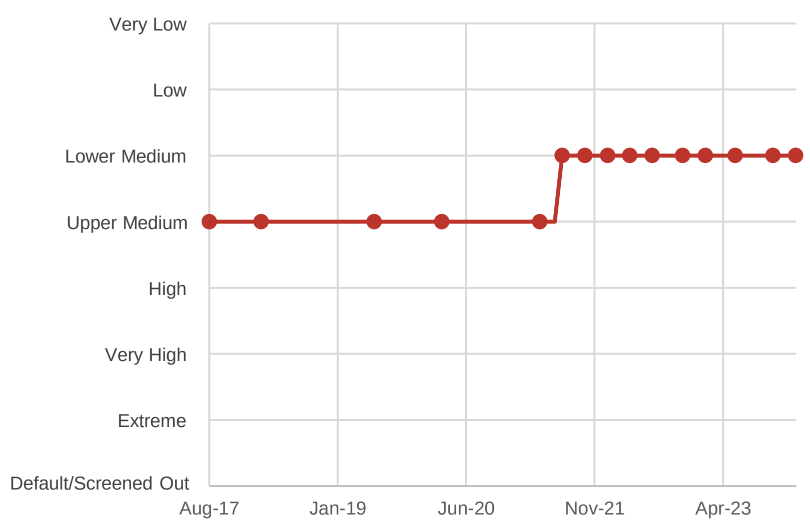
There has been little change quarter-on-quarter to MXT's underlying portfolio, with slight advancements to defensive aspects and income generation improving modelled results marginally versus the most recent simulation of the 30 September 2023 portfolio. Against three months prior, the portfolio provides slightly improved downside protection within our stressed environment modelling whilst delivering strong returns in a benign environment. This comes as a result of the slight increase in weighting to investment grade loans and to cash. As diversification is a key pillar in modelling a credit portfolio, it is no surprise that the stagnation in number of counterparties has resulted in a slowdown of improvements to modelled outcomes relative to quarter-on-quarter changes during the Fund's expansionary period around 2022, with changes recently having been driven by credit quality and seniority.

Over the past three months, Metrics has not undergone any significant changes within its underlying portfolio. In our stressed environment scenario, median capital returns improved by 21 basis points to -0.84% and the 99% VaR is -2.74%. The improvement is reflected largely by the 6 basis point increase in Investment Grade assets and the slightly higher cash balance. A greater cash balance adds a safeguard in a GFC-like environment as cash held will not face a capital loss whereas a loan might. On the other hand, in our benign scenario, a high cash balance would drag modelled returns lower as the uninvested capital does not earn income.

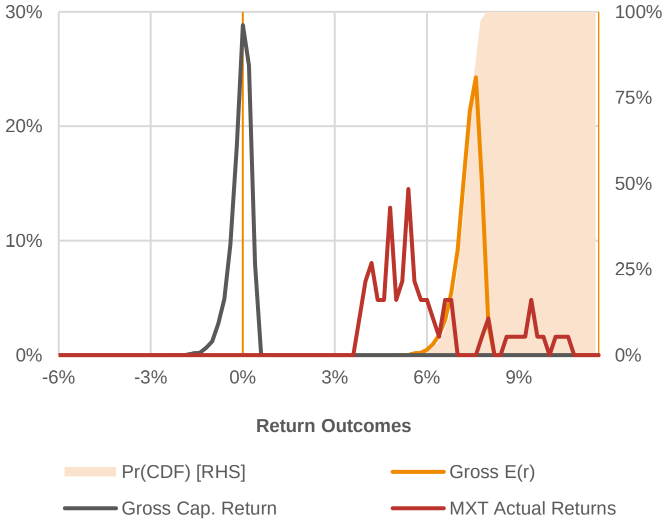
Median returns in our benign scenario were 7.33% while the 99% VaR was 6.04%, illustrating the stability and lack of expected variance in returns due to the portfolio's exceptional level of diversity with 452 underlying holdings.

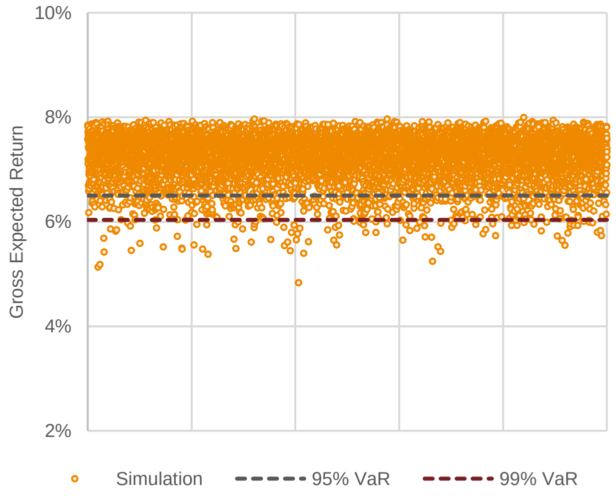
The defensiveness of the portfolio has improved slightly from very minor risk reduction tweaks. The high level of counterparty diversification along with the improved weighted average credit rating helped retain strong outcomes which underline our risk score of **Lower Medium** or "A".

Figure 18. Risk Score



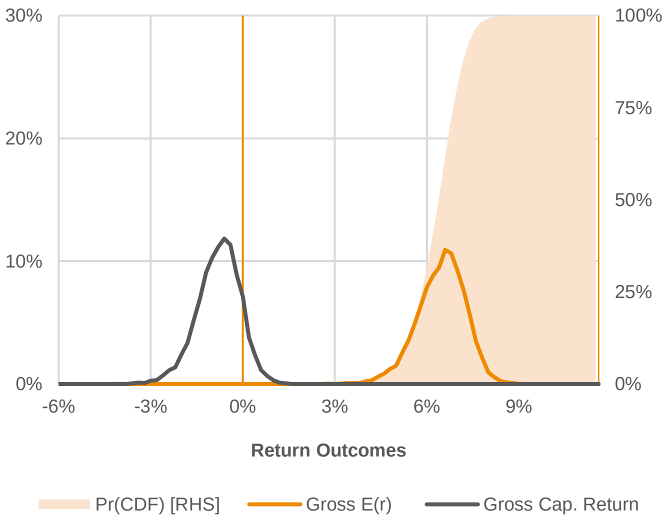
Scenario 1. Baseline Asset Assessment

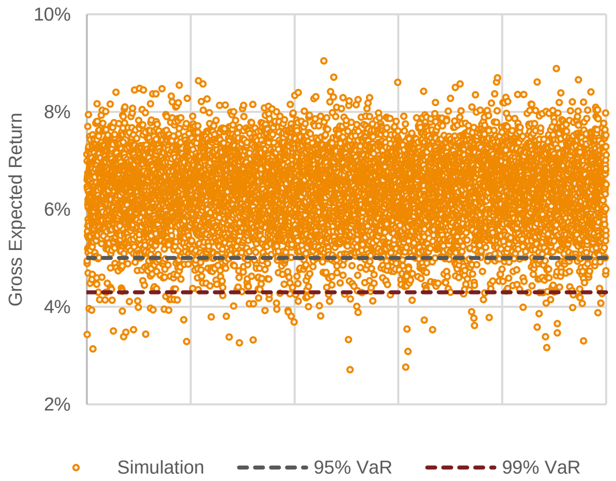




Source: BondAdviser Estimates as of 31 December 2023 portfolio. Excludes impact of management and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is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

Scenario 2. Stressed Asset Assessment





Source: BondAdviser Estimates as of 31 December 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 – 4 March 2024
- MXT Update Report – 3 January 2024
- MXT Update Report – 23 October 2023
- 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 9 May 2024.