Product Assessment

Report as at 16 Oct 2024

RECOMMENDED

La Trobe US Private Credit Trust

Rating issued on 10 Oct 2024 | APIR: LTC8436AU

Investment objective

To deliver income of 8.50% p.a. (net of fees and expenses), before any adjustments for foreign exchange rate fluctuations.

Manager	MS Capital Partners
Distributor	La Trobe Financial Services Pty Limited
Sector	International Fixed Interest \ High Income
Investment Style	Active
RI Classification	Aware
Absolute Risk	High
Relative Risk	Opportunistic Credit
Investment Timeframe	5-6 Years
Benchmark	Bloomberg AusBond Bank Bill Index
Min Investment Amount	$10,000
Redemption Frequency	Quarterly
Income Distribution	Monthly
Fund Size	Not Disclosed
Management Cost	0.75% p.a. Incl. GST
Performance Fee	N/A
Buy / Sell Spread	0.00% / 0.00%
Inception Date	01 Dec 2023

Fund facts

- Conservatively managed portfolio of primarily senior secured first-lien loans, focusing on middle market borrowers in the US
- High calibre investment team with significant lending experience, supported by a well-resourced lending platform
- Offered with quarterly liquidity, subject to a 5% cap

Viewpoint

The Fund, managed by New York-based Morgan Stanley Capital Partners (Morgan Stanley) and distributed by La Trobe Financial (La Trobe), provides investors with a leveraged exposure to a diversified portfolio of US direct senior secured loans, that aims to deliver attractive floating rate returns above cash. In Zenith's opinion, Morgan Stanley's origination capabilities and ability to leverage its network of corporate and private equity (PE) sponsor relationships, provides access to high-quality deal flow. With a focus on lending to companies with defensive earnings and positive free cashflow, we believe the Fund is a sound option for those investors seeking material returns above cash, albeit with limited access to capital.

Morgan Stanley's direct credit team is primarily based in New York comprising 67 professionals, while the underlying portfolio is managed by a Private Credit Investment Committee (IC). The IC is led by Jeffrey Levin, Head of Direct Lending, and comprises 10 senior investment professionals.

The Morgan Stanley direct lending platform has a long history of originating performing loans to a diverse range of corporate borrowers and PE sponsors. Further, its ability to tailor lending packages that generate competitive returns and at the same time, protect investor interests through seniority in the capital structure and robust covenant packages, is considered a point of differentiation.

The direct lending process is focused on originating senior secured loans, to US middle market borrowers that operate in defensive sectors such as healthcare, information technology, and industrial. A typical borrower will be generating earnings before interest, tax, depreciation and amortisation (EBITDA) of more than $US 50 million p.a., with positive free cashflow and exhibit a leverage profile of approximately six times (defined as total debt/EBITDA). In our opinion, Morgan Stanley’s direct lending approach is conservative, yet comprehensive in its application, effectively addressing key financial considerations throughout the underwriting process.

The portfolio is constructed to achieve diversification across a range of borrowers, industries, and sponsors. Despite the recent launch of the underlying portfolio, Morgan Stanley has achieved a sound level of diversification, with more than 50 borrowers currently held in the Fund, with position sizes typically in the range of 2% to 3%. As funds under management (FUM) increases, Zenith expects the level of individual borrower risk will decrease, with loan sizes expected to be held in the range of 0.50% to 1.50% of net asset value (NAV).

A key tenet of the investment strategy is the use of leverage, where the underlying investment exposure is increased by approximately 1x to 1.25x (e.g. for each $1 of investment, $2.25 of loans are held). The lending facility is provided by an external party and effectively allows Morgan Stanley to capture the difference between its lending spreads and the cost of financing.

Zenith highlights that the amount of leverage will change over time, in line with prevailing spreads, base rates, and the need to enhance returns to meet the income objective. In our opinion, while the amount of leverage is high and increases the risk profile of the strategy, Morgan Stanley's track record of minimising the incidences of defaults and its focus on defensive sectors should result in more attractive outcomes for investors.

Zenith highlights that the Fund's cost structure is high, with a look-through investment management fee of 2.70% p.a. and a performance fee of 12.5% above a 5% preferred return. While originating direct loans is a resource-intensive process and the asset class is inherently expensive to access, we firmly believe that there is scope to improve the structure, including lowering the base management fee and enhancing the performance fee hurdle structure.

Fund analysis

Fund characteristics

Constraint	Value
Single industry exposure	Max: 20%
Single borrower exposure	Max: 5%
Non-US borrower exposure	Max: 10%
Broadly syndicated loan exposure	0% to 10%
Leverage	1x to 1.25x

Investment objective and philosophy

The Fund is managed to deliver income of 8.50% p.a. (net of fees and expenses), before any adjustments for foreign exchange rate fluctuations, with distributions payable on a monthly basis, by investing in senior secured loans to US middle market borrowers.

The investment philosophy is premised on the belief that lending to defensive, US middle market corporates that generate strong, stable free cash flow and are backed by best-in-class PE sponsors with significant industry experience, represent an attractive opportunity set.

Investment process

The lending process starts with identifying a pipeline of potential lending opportunities, extending across a variety of different channels, including PE sponsors, financial advisors, and similar intermediaries. Zenith notes that most of the Fund's loans are backed by top-tier PE sponsors. The loans are 'club style' deals, where a group of lenders collectively provide a lending facility with agreed loan terms and covenants. Morgan Stanley is usually the lead manager on the loans its originates.

In Zenith's opinion, the origination process is enhanced by the scale of Morgan Stanley's broader business, which spans equity and debt capital markets, investment banking, and wealth management. Through these channels, the direct lending team is able to work directly with leading PE sponsors and corporates, in what is a relationship-led market.

Portfolio applications

Direct lending typically involves the provision of capital to borrowers to fund a range of business activities, including mergers and acquisitions, capital expenditure, and general working capital. These assets have a priority claim over equity in a company’s capital structure and are also secured by the assets of the firm.

The Fund may be appropriate for investors seeking material returns above cash, albeit with the potential for drawdowns and capital losses. Further, given the application of leverage (1x to 1.25x), drawdowns may be higher in more negative credit environments. From a portfolio perspective, the Fund is suitable as a component of a well-diversified portfolio and is considered most appropriate as a satellite exposure to fixed income.

Notwithstanding the more conservative nature of Morgan Stanley’s lending process, there is potential for moderate levels of volatility, with the potential for capital losses. As such, Zenith recommends taking a medium to long-term investment timeframe.

The Fund is offered with quarterly liquidity (subject to a cap of 5% of NAV). Therefore, we caution against the Fund being used by investors with short-term liquidity needs.

The Fund is an Australian unit trust, registered as a managed investment scheme under the Corporations Act, that invests via the onshore feeder fund into the underlying fund domiciled in the US. The underlying fund was established by Morgan Stanley specifically for the Fund managed by La Trobe. Zenith recommends investors seek independent tax advice regarding the tax implications of a feeder fund structure.

Fund responsible investment attributes

Key Information	Description
Zenith RI classification*	Aware
Has Responsible Investment Policy	Yes
PRI Status	
PRI Signatory	Yes

*Zenith RI Classification scale:

- Traditional
- Aware
- Integrated
- Thematic
- Impact

Absolute performance

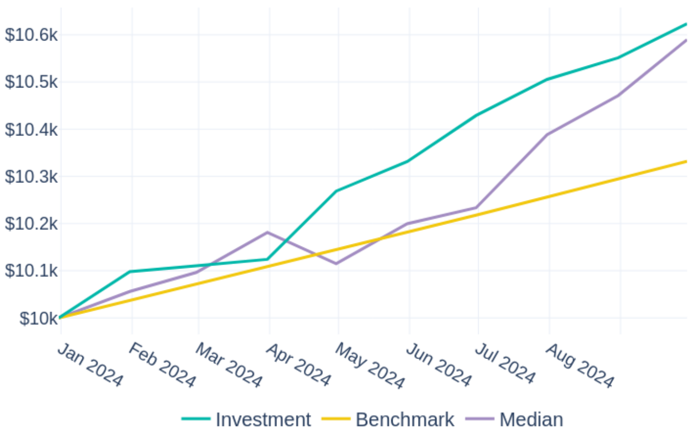
Performance as at 30 Sep 2024

Monthly performance history (%, net of fees)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	BM YTD*
2024	0.98%	0.12%	0.13%	1.43%	0.61%	0.95%	0.73%	0.44%	0.68%				6.23%	3.32%

**Bloomberg AusBond Bank Bill Index*

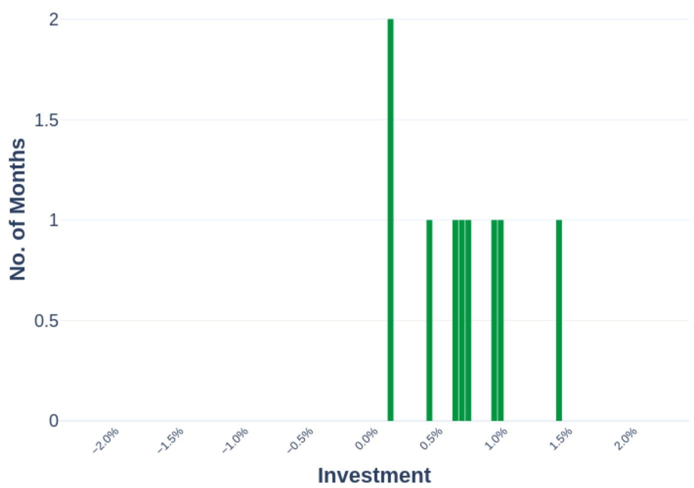
Growth of $10,000



Risk / return

Insufficient data for this chart

Monthly histogram



Minimum and maximum returns (% p.a.)

Absolute performance analysis

Instrument	1 Mth	3 Mths	6 Mths	Inception
Investment	**0.68%**	**1.86%**	**4.93%**	**6.23%**
Income	0.72%	2.22%	5.32%	6.11%
Growth	-0.04%	-0.36%	-0.39%	0.12%
Benchmark	**0.36%**	**1.12%**	**2.21%**	**3.32%**
Median	**1.13%**	**3.48%**	**4.01%**	**5.90%**
Cash	**0.36%**	**1.12%**	**2.21%**	**3.32%**

Ranking within sector (p.a.)

Ranking within Sector	Inception
Fund Ranking	12 / 30
Quartile	2nd

Absolute risk

Instrument
Standard Deviation (% p.a.)
Investment
Benchmark
Median
Downside Deviation (% p.a.)
Investment
Benchmark
Median

Absolute risk/return ratios

Instrument
Sharpe Ratio (p.a.)
Investment
Benchmark
Median
Sortino Ratio (p.a.)
Investment
Benchmark
Median

Zenith benchmarks funds in the 'International Fixed Interest - High Income' peer group against the Bloomberg AusBond Bank Bill Index. While this benchmark may not be consistent with the one adhered to by all rated participants, it has been adopted to provide investors with a common reference point against which similarly structured strategies may be assessed.

The Fund aims to deliver income of 8.50% p.a. (net of fees and expenses), excluding any adjustments for foreign exchange rate fluctuations.

The following commentary is current as at 30 September 2024.

Given the Fund’s recent inception date (July 2024), there is insufficient history to draw any meaningful conclusions on its absolute performance.

Notwithstanding this, Zenith highlights that Morgan Stanley has a proven track record of managing direct loans and generating returns in line with stated investment objectives, along with low incidences of default.

Relative performance

Excess returns

Statistic	1 Mth	3 Mths	6 Mths	Inception
Excess Return	0.32%	0.75%	2.72%	2.91%
Monthly Excess (All Mkts)	100.00%	100.00%	100.00%	77.78%
Monthly Excess (Up Mkts)	100.00%	100.00%	100.00%	77.78%
Monthly Excess (Down Mkts)	0.00%	0.00%	0.00%	0.00%

Capture ratios (% p.a.)

Statistic	1 Mth	3 Mths	6 Mths	Inception
Downside Capture	0.00%	0.00%	0.00%	0.00%
Upside Capture	189.93%	166.59%	220.76%	185.49%

Tracking error (% p.a.)

Instrument
Investment
Median

Information ratio

Instrument
Investment
Median

Beta statistics

Statistic
Beta
R-Squared
Correlation

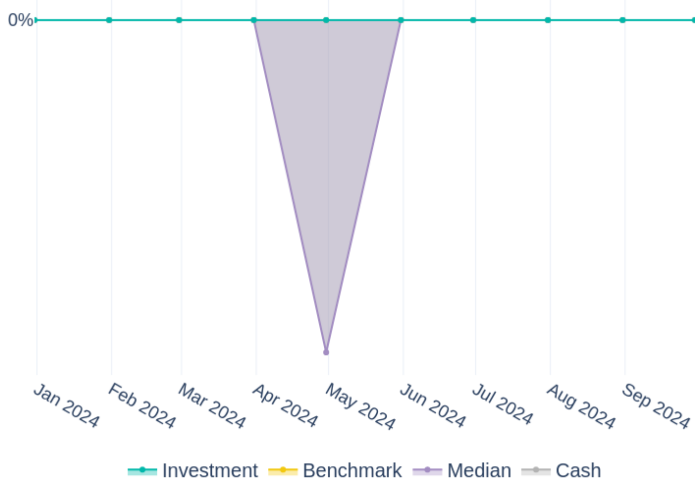
The following commentary is current as at 30 September 2024.

Zenith seeks to identify funds that can outperform their benchmark in greater than 50% of months in all market conditions as we believe this represents a persistence of manager skill.

Given the Fund's recent inception date (July 2024), there is insufficient history to draw any meaningful conclusions on its relative performance.

Drawdown analysis (since inception)

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.



The following commentary is current as at 30 September 2024.

Given the Fund's recent inception date (July 2024), there is insufficient history to draw any meaningful conclusions on its drawdown profile.

Fund commentary

Fund risks

Zenith has identified the following risks of the Fund. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

Key person risk: Given the collegiate nature of the IC, Zenith considers key person risk to be relatively low. Despite this, if Levin were to depart, it would warrant a reassessment of our rating.

Leverage risk: The underlying investment exposure is amplified through leverage of 1x to 1.25x (e.g. for each $1 of investment, $2.25 of loans are held). While the application of leverage may magnify potential gains, it may also result in greater drawdowns during challenging credit conditions.

Valuation risk: Given the idiosyncratic nature of loans, coupled with a limited secondary market, valuation risk is considered high for the Fund. While Morgan Stanley has a robust and clearly defined valuation policy, there is a risk that the realisable value of securities may not align with the mark-to-market value carried by Morgan Stanley.

Limited redemption risk: Investors are subject to a quarterly cap on redemptions of 5% of the Fund's NAV, processed on a pro-rata basis. As such, there is no guarantee that investor redemption requests will be satisfied in a timely manner.

Liquidity risk: As an over-the-counter private market, liquidity can vary through different market conditions. Investors should be aware that while the underlying Fund offers quarterly liquidity, in certain market conditions La Trobe may be unable to meet redemption requests and retains the flexibility to suspend redemptions.

Asset class risk: Although the Fund offers diversity in terms of industries, issuers, and maturities, the portfolio is primarily exposed to the direct loan market. Further, most participants are considered as sub-investment borrowers. As such, a deterioration in the economic and credit environment could lead to higher defaults and increased potential losses for investors.

Structuring risk: The Fund is structured as a master-feeder. The use of interposed entities introduces additional structuring, and complexity, while also reducing the proximity between the responsible entity and the underlying investment portfolio. Zenith recommends investors seek personal tax advice regarding the suitability of the Fund's investment structure.

Security/asset selection

Morgan Stanley's security selection process encompasses a traditional bottom-up due diligence review, which is summarised in an investment memo and forms part of the IC approval process.

The investment memo incorporates both traditional financial statement analysis and qualitative research, with a focus on a borrower's operating environment. The financial statement analysis includes a detailed review of a prospective borrower's financials, distilled into key metrics that are used to generate cashflow forecasts and conduct sensitivity analysis. Additionally, the memo includes a review of the PE sponsor's business plan, considering potential acquisitions and possible add-backs from operating synergies.

The qualitative assessment of a borrower includes a review of the industry structure, management strategy, and capital structure of the firm (e.g. the level of subordination and equity support). In addition, Morgan Stanley scores all loans based on a range of environmental, social, and governance (ESG) factors.

Once due diligence has been completed, the IC is presented with a formal recommendation for approval. Following approval, the team finalises the structure and terms of the loan document to provide the best opportunities for superior risk-adjusted returns. Zenith notes that once a loan is funded, the same investment professionals who originated and underwrote the loan remain involved in managing the investment throughout its duration.

In our opinion, Morgan Stanley's direct lending approach is conservative, yet comprehensive in its application, effectively addressing key financial considerations throughout the underwriting process.

Responsible investment approach

Morgan Stanley has been a signatory to the United Nations Principles for Responsible Investment since 2013. Additionally, Morgan Stanley has an established Responsible Investment Policy that was last updated in October 2023.

Morgan Stanley is committed to incorporating ESG considerations, believing that such factors can be a material contributor towards both risk mitigation and long-term investment returns. As such, the IC reviews ESG considerations as part of its due diligence process.

At this stage, the IC evaluates each potential borrower using a standard ESG questionnaire, factoring in both positive and negative considerations, to determine an ESG score for each potential borrower. While the identification of a material ESG risk will not automatically screen out a borrower, borrowers who fail to meet a pre-defined threshold require additional discussion and consideration by the IC. In addition, material ESG issues are reported and discussed quarterly by the IC as part of the portfolio management process.

In Zenith's opinion, while ESG is considered as part of the due diligence process, the approach is less invasive relative to the broader peer group.

Portfolio construction

The portfolio construction process is implemented by the IC, which oversees all decisions, including loan selection, position sizing, blending maturities, and managing unfunded commitments (e.g. loans with delayed draw and/or acquisition facilities).

The direct lending process is focused on originating senior secured loans, to US middle market borrowers that operate in defensive sectors such as healthcare, information technology, and industrial. A typical borrower will be generating EBITDA of more than $US 50 million p.a., with positive free cashflow and exhibit a leverage profile of approximately six times (defined as total debt/EBITDA).

In terms of loan diversification, no individual position is expected to exceed 5% of NAV, with position sizing determined by factors such as the size of the loan, the duration profile of the existing portfolio, and the overall risk tolerance of the team.

Despite the recent launch of the underlying portfolio, Morgan Stanley has achieved a sound level of diversification, with more than 50 borrowers currently held in the Fund, with position sizes typically in the range of 2% to 3%. As FUM increases, Zenith expects the level of individual borrower risk will decrease, with loan sizes expected to be held in the range of 0.50% to 1.50% of NAV.

The primary source of liquidity within the underlying fund is a function of the self-amortising nature of private loans, which are typically held for three years (despite the loan term being longer) with capital repaid to the Fund. Moreover, the combination of the liquidity sleeve and approximately one third of loans being repaid on an annual basis, results in approximately 40% of the portfolio being available for reinvestment and/or to meet redemption requests.

In Zenith's opinion, the liquidity framework is well-managed by Morgan Stanley and La Trobe, highlighting the inherent liquidity of the asset class combined with the PDS restrictions (i.e. 5% quarterly limit), which should provide a significant liquidity buffer.

A key tenet of the investment strategy is the use of leverage, where the underlying investment exposure is increased by approximately 1x to 1.25x (e.g. for each $1 of investment, $2.25 of loans are held). The lending facility is provided by an external party and effectively allows Morgan Stanley to capture the difference between its lending spreads and the cost of financing.

Zenith highlights that the amount of leverage will change over time, in line with prevailing spreads, base rates, and the opportunity to enhance returns to meet the income objective. In our opinion, while the amount of leverage is high and increases the risk profile of the strategy, Morgan Stanley's track record of minimising the incidences of defaults and its focus on defensive sectors, should result in more attractive outcomes for investors.

In terms of currency exposure, the portfolio is hedged to Australian dollars on a best endeavors basis. Responsibility for the Fund's hedging framework resides with La Trobe, who utilise foreign exchange forwards, rolled monthly, to reduce the impact of currency volatility on returns.

Overall, Zenith considers the portfolio construction approach to be well-structured, achieving a sound level of diversification across borrowers, sectors, and sponsors.

Risk management

Morgan Stanley's risk management approach is closely linked to the quality and depth of its underwriting process, where deal teams are responsible for identifying potential investment, operational, and governance risks. The identification and mitigation of these risks are included in the investment proposal and are discussed at the IC.

Further, risk oversight is provided by Morgan Stanley Investment Management (MSIM) Risk and Morgan Stanley's Firm Market Risk groups, which are independent of the Morgan Stanley Private Credit business, providing independent perspectives on investment/valuation, governance, and operational risks.

Toby Norris, Head of Risk Management for the Morgan Stanley Private Credit business, and member of the IC, is ultimately responsible for managing the Fund's investment risk, ensuring that each loan fits within the firm's overall risk policy. To assist with this, an internal credit rating classification system is applied, which groups loans into four categories (i.e. category 1 to category 4).

The investment team reviews each performing loan every quarter as part of its standard portfolio review process, with the team focused on the performance of the company relative to its business plan, earnings profile, and compliance with financial maintenance covenants. Any loan that is rated as a category three or four loan is added to a watch list and is reviewed on a more frequent basis. From a portfolio construction perspective, however, risk is managed by the IC and ultimately by Levin in his capacity as lead portfolio manager.

In Zenith's opinion, one of the most significant risks pertains to valuation risk, or more specifically the determination of fair value of each underlying investment. We note that this can be a subjective process in practice, particularly where a company is trading behind its business plan. Every quarter, a third-party valuation firm reviews and provides positive assurance on a portion of the performing investments, ensuring that each investment is assessed at least once within a rolling 12-month period. For any non-performing loans, a third-party valuation firm conducts a review at the end of each quarter.

Zenith highlights that the valuation approach is well-documented, with the input from an external provider adding another layer of independence to Morgan Stanley's risk management framework.

Overall, Zenith believes Morgan Stanley's risk management framework is sound and aligned with best practices. We highlight Morgan Stanley's track record of capital preservation and low incidences of defaulting borrowers, which we attribute to factors including its deep due diligence and robust credit monitoring.

Investment fees

	Fund	Sector Average
Total Fees and Costs (RG 97)	Not disclosed	0.88% p.a.
Management Fees and Costs	Not disclosed	0.79% p.a.
Transaction Costs	Not disclosed	0.09% p.a.
Performance fees	N/A	0.04%
Performance fees description	N/A	
Management Cost	0.75% p.a.	0.80% p.a.
Buy / Sell spread	0.00% / 0.00%	0.18% / 0.19%

All fees and costs are inclusive of GST unless indicated otherwise. The Performance Fee shown is the performance fee disclosed in the PDS. It is calculated by taking the average performance fees charged over the last five financial years (or less if the investment or performance fee mechanism has not been in place for five financial years).

The sector average is based on the average management fee of all funds within the 'International Fixed Interest – High Income' sector as surveyed by Zenith.

Zenith highlights that the Fund's cost structure is high, with a look-through investment management fee of 2.70% p.a. and a performance fee of 12.5% above a 5% preferred return. While originating direct loans is a resource-intensive process and the asset class is inherently expensive to access, we firmly believe that there is scope to improve the structure, including lowering the base management fee and enhancing the performance fee hurdle structure.

Zenith notes that Morgan Stanley passes the Original Issuer Discount (OID) through to the Fund's investors. We are supportive of the approach, noting that the treatment of OIDs differs across the peer group, with some lenders opting to retain a portion of the fee.

(The fees mentioned above are reflective of the flagship version only, fees may differ when the product is accessed through an alternate investment vehicle such as a platform).

About the fund manager

Organisation

Originally founded in 1935, Morgan Stanley (NYSE: MS) is a large investment bank and financial services firm that operates in 51 countries across the globe. Morgan Stanley Investment Management (MSIM) is the asset management arm of the broader group.

As at 30 September 2024, MSIM supervised approximately $US 1.6 trillion in funds under management (FUM) and employed over 1,350 investment professionals across equities, fixed income, and alternative asset classes.

Founded in 1952, La Trobe is an independent credit specialist and alternative asset manager, with operations in Melbourne and Sydney, spanning over 550 staff. La Trobe is owned by global alternative asset manager, Brookfield. La Trobe has approximately $A 20 billion in FUM as at 30 June 2024.

Investment management, hedging, and distribution functions are undertaken by La Trobe Financial Services Pty Ltd (LFS), whilst La Trobe Financial Asset Management Ltd (LFAM) is the responsible entity for the Fund.

Zenith holds a positive view of the arrangement between MSIM and La Trobe, combining a global direct lending specialist with La Trobe's strong track record in managing, marketing, and distributing alternative credit strategies in the Australian market.

As at 30 September 2024, Morgan Stanley managed $US 17 billion in the underlying Fund, with $A 5 million in the Fund.

Investment personnel

Name	Title	Industry Experience (yrs)	Tenure (yrs)	Location
Jeffrey Levin	Managing Director and Head of Direct Lending	22	15	New York, USA
Jeffrey Day	Head of Direct Lending Capital Markets & Business Development	24	5	Chicago, USA
David Kulakofsky	Head of Direct Lending Underwriting	23	4	Chicago, USA
Sean Sullivan	Head of Direct Lending Origination	22	4	New York, USA
Kunal Soni	Head of the Western Region and Technology Lending	25	4	Los Angeles, USA

Morgan Stanley's direct credit team is primarily based in New York comprising 67 professionals, while the underlying portfolio is managed by a Private Credit Investment Committee (IC). The IC is led by Jeffrey Levin, Head of Direct Lending, and comprises 10 senior investment professionals.

Levin chairs the IC and is ultimately responsible for the Fund. With over 21 years of experience in direct lending, Levin rejoined Morgan Stanley in 2019 after previously serving as Partner and Managing Director at The Caryle Group. Zenith considers Levin to be a highly experienced private credit investor, with an extensive history of managing loan assets across different credit cycles.

In addition to Levin, the IC includes Jeffrey Day, Head of Direct Lending Capital Markets, David Kulakofsky, Head of Direct Lending Underwriting, Sean Sullivan, Head of Direct Lending Origination, and Kunal Soni, Head of the Western Region and Technology Lending.

Day and Soni joined Morgan Stanley Private Credit in 2019. Prior to joining the firm, Day served as a Managing Director at Madison Capital Funding, where he focused on sponsor coverage, capital markets, and fundraising. As Head of Direct Lending Capital Markets, Day oversees liability management for direct lending, and also focuses on capital raising. Soni joined the firm from the Carlye Group, where he leads the investment team's activities in the Western region of the US, and drives origination and investment activities in the technology sector.

Kulakofsky and Sullivan joined Morgan Stanley Private Credit in 2020, having previously held senior management positions at Madison Capital and Antares Capital, respectively. As Head of Direct Lending Underwriting, Kulakofsky oversees the diligence, structuring, and execution of direct lending investment opportunities. Sullivan, however, primarily focuses on the origination of investment opportunities in his role as Head of Direct Lending Origination.

Zenith highlights the stability and longstanding nature of the IC, noting that Levin and Ashwin Krishnan, Managing Director and Co-Head of North America Private Credit, have had a working relationship since 2004, including the establishment of Morgan Stanley's Private Credit platform in 2009.

In Zenith's opinion, the IC is well-structured, comprising high-quality investment professionals with complementary backgrounds and experience, and is strongly supported by the broader Morgan Stanley business and its private credit platform.

MSIM compensates its employees based on principles of pay-for-performance, market competitiveness, and risk management, resulting in a compensation structure that includes both fixed and variable components. The fixed component includes a competitive base salary, with the variable incentive comprising a mix of a cash bonus and a deferred incentive award. Eligibility for, and the amount of any, discretion compensation changes over time, in line with each employee's overall contribution to business performance, where the portion of incentive compensation subject to deferral increases as an employee's compensation increases.

Zenith believes the approach embeds a strong co-alignment of interest with investors, ensuring investment performance and remuneration are closely linked.

In our opinion, Morgan Stanley's direct lending platform is impressive, with a long history of originating performing loans to a diverse range of corporate borrowers and PE sponsors. Further, its ability to tailor lending packages that generate competitive returns and at the same time, protect investor interests through seniority in the capital structure and robust covenant packages, is considered a point of differentiation.

About the sector

Sector characteristics

The Zenith 'International Fixed Interest – High Income' sub-sector consists of all funds that invest predominantly in the higher-yielding sectors of the global fixed interest market. These sectors typically include high yield, securitised loans and emerging market debt. The category includes funds that invest in specific underlying markets or a combination of each. Given the idiosyncratic nature of the sectors, managers commonly add value through security selection and/or sector rotation.

Zenith benchmarks all funds in this space against the Bloomberg AusBond Bank Bill Index. However, Zenith only uses this benchmark as a common reference point and it may not be reflective of the underlying benchmark used by many managers in this category.

It should be noted that the Bloomberg AusBond Bank Bill Index is typically used as a benchmark to measure the investment performance of a passively managed short-term cash portfolio. The Index has an average term to maturity of approximately 45 days. It comprises 13 domestic bank bills of equal face value, each with a maturity seven days apart.

Given the funds in the 'International Fixed Interest – High Income' sector invest in longer dated, higher default risk securities, they will potentially display higher downside volatility relative to the Zenith assigned index (i.e. while the index is used as a performance benchmark, it should not be used as an indication of the risk involved in investing in the sector).

Sector risks

Funds within the 'International Fixed Interest – High Income' sub-sector are exposed to the following broad risks:

Market risk: Changes in economic, technological, environmental or political conditions and market sentiment may lead to a decline in general security prices and overall market volatility. During a general downturn in the securities markets, multiple asset classes may decline in value simultaneously.

Interest rate risk: Fixed Interest securities are generally sensitive to changes in interest rates. An increase in interest rates may result in a fall in the value of these securities, while a decrease in interest rates can result in an increase in value.

Credit spread risk: In addition to being sensitive to general interest rate changes, non-government securities are also sensitive to changes in credit spreads (commonly the difference in yield between a Government Bond and a Corporate Bond). A widening of spreads results in a fall in the value of these securities.

Default risk: Given Fixed Interest securities represent loans to borrowers (including governments, banks and companies) there is a risk that these borrowers may default on interest or principal repayments. Default risk is often reflected in credit ratings assigned by various credit agencies, which are subject to change.

Currency risk: In addition to being exposed to general market risk, investments in international markets are exposed to changes in the value of the Australian Dollar relative to other foreign currencies. This may lead to increased volatility, independent of market moves. While Fixed Interest funds typically hedge their foreign investments back into Australian Dollars, there can be no guarantee that the funds will be hedged at all times or that a manager will be successful in employing the hedge.

Liquidity risk: Fixed Interest markets can experience periods of illiquidity, which can result in difficulties in buying or selling securities without adversely impacting the price.

Derivative risk: Derivatives are commonly employed by Fixed Interest managers to hedge Currency and other risks and/or as an alternative to direct purchases or sales of underlying assets. There are multiple risks associated with the use of derivatives; for example, the value of the derivative may not move in line with the underlying asset, counterparties to the derivative may not be able to meet payment obligations or a particular derivative may be difficult or costly to trade.

Leverage risk: Many derivatives have a leverage component. While leverage offers the opportunity to magnify gains, it may additionally magnify losses. An associated risk with leverage and magnification of gains/losses is that the portfolio's volatility may increase as a result. Investors need to be cognisant that the Fund may exhibit more volatility than one that is unlevered.

Administration and operations

Responsible Entity	La Trobe Financial Asset Management Limited

Zenith rating

Report certification

Date of issue: 10 Oct 2024

Role	Analyst	Title
Analyst	Jack Carroll	Associate Investment Analyst
Sector Lead	Rodney Sebire	Head of Alternatives & Global Fixed Interest

Association & relationship

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Rating history

As At	Rating
10 Oct 2024	Recommended
18 Sep 2024	Not Rated - Screened Out

Last 5 years only displayed. Longer histories available on request.

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